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Church and Governmental Plans

by

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This Portfolio revises and supersedes 372-4th T.M., *Church and Governmental Plans*. Portfolio 372-4th T.M. should be discarded.

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Church and Governmental Plans

PORTFOLIO DESCRIPTION

Tax Management Portfolio, *Church and Governmental Plans*, No. 372-5th, discusses issues concerning pension and welfare plans of churches and state and local governments under §414(d) and §414(e) of the Internal Revenue Code and the parallel provisions of ERISA.

Chapter I of this Portfolio provides an historical perspective of the regulation of these plans, and includes a description of some of the current issues in state law for governmental plans. Chapter II presents a detailed discussion of the definitions of "church plan" and "governmental plan" for purposes of the Code and ERISA. Chapter III sets out a detailed analysis of tax qualification rules that may apply to governmental and church plans under §401(a), §403(b) (including church retirement income account rules under §403(b)(9)), §457(b), and special rules for other types of deferred compensation. Chapter IV describes special rules for governmental and church welfare benefit plans. Chapter V addresses the relationship between these plans and Social Security benefits. Chapter VI deals with the reporting and disclosure requirements applicable to these plans. Chapter VII discusses sex and age discrimination issues.

The Worksheets of this Portfolio include former IRS Publication 778, which describes the rules applicable to §401(a) plans as in effect immediately prior to the enactment of ERISA, some of the legislative history to ERISA and the MEPPA, and charts summarizing the Code provisions applicable to §401(a) governmental and nonelecting church plans.

This Portfolio may be cited as Levine, 372-5th T.M., *Church and Governmental Plans*.

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TABLE OF CONTENTS

ISBN 978-1-63359-446-3

ISBN 978-1-63359-446-3

ISBN 978-1-63359-446-3

DETAILED ANALYSIS

I. Introduction

A. *In General*

This Portfolio discusses the many special rules and issues applicable to church and government-sponsored plans intended to meet the qualification requirements of §401(a) of the Internal Revenue Code of 1986,[1] §403(b) plans (including church retirement income account plans under §403(b)(9)), §457 arrangements, other forms of deferred compensation and various welfare and fringe benefit plans. Emphasis is placed on the extent to which these rules vary from the applicable laws that regulate private sector plans. When the rules for a church or governmental plan are the same as for private sector plans, this Portfolio will refer to the appropriate other Portfolio.[2]

B. *Regulation of Governmental Plans*

Federal regulation of state and local governmental retirement plans has historically been minimal for several reasons. One reason is the concept of federalism: the widely held belief that the federal government should not interfere in the relationship between state and local governments and their employees.[3] A second reason is that, unlike private employers that receive significant tax benefits if their plans meet the requirements of §401(a), government employers have no real incentive for maintaining a qualified plan because governmental employers are exempt from income tax.[4] It is the participants who benefit from the fact that contributions made to a qualified plan on their behalf are not taxable to them until actually distributed, and that such distributions may be entitled to tax-free rollover treatment. Thus, the sole consequence of any action taken by the IRS against a governmental plan for failure to meet qualification requirements would be to tax plan participants currently on their vested retirement benefits, which might cause many governments to switch to nonqualified unfunded plans.[5] A third reason is that governmental plans have tended to respond, with some success, to congressional efforts to change problematic provisions of the Code applicable to governmental plans.[6]

1. *Background*

When the Employee Retirement Income Security Act of 1974 (ERISA)[7] was initially considered, there was an unsuccessful attempt to make it fully applicable to governmental plans. Instead, ERISA §3031(a) authorized a congressional study of governmental retirement plans to analyze the necessity for federal legislation and standards with respect to such plans.

Pursuant to this directive, the House Pension Task Force of the Labor Standards Subcommittee conducted a comprehensive survey of governmental plans. The results of this survey were issued in March 1978,[8] and afterwards legislation was introduced that would have resulted in increased federal regulation of state and local government pension plans. Among such legislation was the Public Employee Retirement Income Security Act (PERISA)[9] and the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA).[10] Numerous objections were raised and neither piece of legislation passed.[11]

Under PEPPRA, all government employee pension plans would have been required to provide both summary plan descriptions and annual benefit statements to participants and beneficiaries.[12] They would also have been required to file annual reports containing financial and actuarial statements with the Department of Labor (DOL).[13] Plans would have been exempt from these requirements only if the governor of the state certified that state law imposed substantially similar requirements, that the state could adequately administer the law and that it would collect the annual reports required under its law.[14]

PEPPRA would also have required written plan documents that designated a named fiduciary and contained a state-

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[1] All section references herein are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, unless otherwise stated.

[2] For a detailed discussion of the general rules for these plans, see the following Portfolios: 351 T.M., *Plan Qualification — Pension and Profit-Sharing Plans*; 352 T.M., *Specialized Qualified Plans — Cash Balance, Target, Age-Weighted and Hybrids*; 358 T.M., *Section 401(k) Cash or Deferred Arrangements*; 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification*; 373 T.M., *Employee Benefits for Tax-Exempt Organizations*; 385 T.M., *Deferred Compensation Arrangements*; 388 T.M., *Section 403(b) Arrangements*.

[3] *See, e.g.*, H.R. Rep. No. 533, 93d Cong., 1st Sess. (1973).

[4] *See* §115.

[5] Public Employee Pension Benefit Plans: Joint Hearing Before the Subcommittee on Oversight of the Committee on Ways and Means and Subcommittee on Labor-Management Relations of the Committee on Education and Labor, House of Representatives, 98th Cong., 1st Sess. 163–65 (1983) (testimony of S. Allen Winbourne, Assistant Commissioner—Employee Plans and Exempt Organizations IRS).

[6] *See, e.g.*, the repeal of nondiscrimination rules, enactment of §415(n) (permitting the purchase of past service credit by governmental plans), and the exemption under the Worker, Retiree, and Employer Recovery Act of 2008 for public plans from the market rate of return rule for hybrid plans (Pub. L. No. 110-458, §123).

[7] Pub. L. No. 93-406.

[8] Committee on Education and Labor, House of Representatives, "Pension Task Force Report on Public Employee Retirement Systems," 95th Cong, 2d Sess., 2–5 (1978) (1978 Task Force Report).

[9] H.R. 4928 and H.R. 4929, 97th Cong. (1st Sess. 1981).

[10] H.R. 5144, 98th Cong. (2d Sess. 1984).

[11] There was considerable lobbying against increased federal regulation of public plans by various groups. The following are some of the arguments raised against federal regulation: (1) State legislatures have taken significant action in addressing the shortcoming of public plans cited in the 1978 Task Force Report. Most public plans are well administered and funded. (2) State and local government pensions are part of the basic personnel and compensation functions of state and local government. State governments have the ultimate responsibility for the pension obligations of their public plans within their jurisdiction and are the most appropriate level of government for regulating such plans. Each state has diverse and unique conditions that call for flexibility and control at the state level. (3) A major impetus for ERISA legislation, private sector bankruptcies and defaults, does not exist in the public sector. (4) Federal legislation would create a new bureaucracy and would result in increased costs and complexity.

[12] PEPPRA §103 and §111.

[13] PEPPRA §112.

[14] PEPPRA §102.

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ment of funding policy, if any, as well as the method of carrying out such policy.[15] Plan assets would have been required to be held in trust. Most significantly, plan fiduciaries would have been held to a "prudent man standard" and would have been required to act solely in the interest of participants and beneficiaries.[16] Diversification of plan investments would generally have been required and there would have been a limit on the total aggregate fair market value of all employer securities, property or obligations that could be acquired by the plan.[17]

2. State Regulation

The operation of governmental plans is significantly controlled by state and local constitutional and contractual law. Benefit formulas, forms of benefits, age, service, vesting, and contribution requirements are often set out by statute, elaborated upon in promulgated rules, regulations, policies and procedures and greatly vary from jurisdiction to jurisdiction. For that reason, state regulation generally is beyond the scope of this Portfolio, but it is important for those who deal with plans of state and local governments to recognize and understand the local laws that surround them.

C. Regulation of Church Plans

Congress has generally taken a light hand in regulating church plans, in deference to the First Amendment mandate that Congress make no law prohibiting the free exercise of religion.[18] However, Congress has shown an increased willingness to subject employee benefit plans maintained by church-controlled organizations to the rules applicable to private plans when the function of the organization is not primarily religious in nature. For example, although Congress has exempted church-sponsored §403(b) tax-sheltered annuity plans from applicable nondiscrimination tests and also exempted church-sponsored pension plans from the restrictions on nonqualified deferred compensation plans of governmental and tax-exempt organizations,[19] it chose not to provide a similar exemption to plans maintained by church-controlled organizations that received substantial support from governmental sources or from sales of goods, services, or facilities to the general public.[20] Thus, plans maintained by church-controlled hospitals or universities, though considered church plans for ERISA purposes,[21] generally are subject to greater regulation under the Code. In addition, although some special rules apply, church plans are not exempted from complying with various health care laws. Further, church plans are not exempt from the §409A or §457A rules for nonqualified deferred compensation, nor are there any special §409A or §457A rules that apply to church plans.

The following sections of this Portfolio address issues concerning pension and welfare plans maintained by churches or by state and local governments. These plans may be considered maintained by a single employer or they may be multiple-employer plans; in some cases that status may not be clear. They also may be the product of collective bargaining.

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[15] PEPPRA §202.

[16] PEPPRA §204.

[17] PEPPRA §204 and §207. Note that many similar provisions are contained in the Uniform Management of Public Employee Retirement System Act developed by the National Conference of Commissioners in State Law. See discussion at III.F.10., below.

[18] *See, e.g.,* S. Rep. No. 383, 93d Cong., 2d Sess.; 124 Cong. Rec. 12,108 (1978); 125 Cong. Rec. 10,052 (1979). Church plans generally are subject to the rules governing pension plans that were in effect prior to ERISA, which were principally found in the I.R.C. These rules will be discussed throughout this Portfolio.

[19] *See* §457(e)(13).

[20] Compare §403(b)(12)(B) and §457(e)(13), both of which define "church" by reference to the definition set out in §3121(w)(3). For these purposes, a church includes a convention or association of churches, or an elementary or secondary school that is controlled, operated or principally supported by a church or by a convention or association of churches. §3121(w)(3)(A). A "qualified church-controlled organization" is defined as a church-controlled tax-exempt organization described in §501(c)(3), other than one which: (1) offers goods, services or facilities for sale, except on an incidental basis, to the general public, unless such sale is at a nominal charge substantially less than costs; and (2) normally receives more than 25% of its support from either governmental sources and/or from receipts from admissions or sales of goods, services or facilities. *See* §3121(w)(3)(B). Thus, church-controlled organizations that would not qualify under the definition in §3121(w)(3)(B) generally would include most separately incorporated church hospitals, colleges, universities, and nursing homes, but may also include other charities that sell goods or services and have substantial governmental funding. For discussion of the employer aggregation rules that apply to church-controlled organizations for purposes of satisfying the nondiscrimination rules, see III.F.13., below.

[21] For a discussion of what is a church plan, see II.B., below.

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II. Definitions

A. Governmental Plan

The term "governmental plan" is defined in Titles I and IV of ERISA and in the I.R.C. In Title I, ERISA §3(32) defines a governmental plan as "… a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." Section 414(d) of the I.R.C. contains a substantially identical definition, except that it refers to a plan "established *and* maintained" rather than "established *or* maintained." In Title IV of ERISA, which deals with public insurance of defined benefits, ERISA §4021(b)(2) also contains a substantially identical definition of governmental plan, using the "established *and* maintained" language. This difference in one word of the definition has created some confusion, as discussed below.

1. Established and/or Maintained

a. Meaning of "Established and/or Maintained"

The DOL has consistently taken the position that a plan is "established or maintained" by an employer that makes contributions to it or that is involved to a significant degree in its administration. Generally, if a government employer makes contributions to a plan, the plan will be considered a governmental plan, even if the employer is not otherwise involved in plan administration.[22] Thus, the DOL has ruled that a plan was not a governmental plan where the government employer did not participate in setting up the plan, had no power to amend or terminate it and provided no contributions, funds or personnel for its operation.[23] However, while contributions by the government employer is the most important factor in governmental plan status, the fact that the government employer may remit monies to a plan through payroll reductions does not in and of itself mean that the plan is a governmental plan.[24] Similarly, the IRS has ruled that a plan covering employees of a volunteer fire company that provided fire protection services to villages on a contract basis was not a governmental plan because the plan was established and maintained by the fire company and not the government entity.[25] Although the villages jointly contributed to the fire company's funding through the contract and exercised some review authority over the fire company's budget, this affiliation was not, according to the IRS, significant enough for the firemen to be considered village employees or for the company to be an "alter ego" of the villages.[26]

Note: The IRS released a draft of anticipated proposed regulations to define the term "governmental plan" that would retain the "established *and* maintained" standard for governmental plans under §414(d) (but not necessarily for ERISA), though other changes in the draft proposed regulation would largely moot the difference.[27] Under draft Prop. Reg. §1.414(d)-1(k)(1), a plan would be established and maintained for the employees of a governmental entity if: (1) the plan is established and maintained for employees by an employer, within the meaning of Reg. §1.401-1(a)(2); (2) the employer is a governmental entity; and (3) the only participants covered by the plan are employees of that governmental entity.

b. Plan Established by Private Employer but Maintained by Government Entity

In some instances, a plan that was established by a private employer is subsequently maintained by a government entity after the government entity's acquisition of the private employer's assets or operations. This poses no problem under ERISA §3(32), because that section defines a governmental plan as one "established *or* maintained" by a government entity, and a plan that is simply maintained by a government employer would clearly fall within that definition.[28] However, the question arises

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[22] *See, e.g.*, DOL Adv. Op. 86-23A (plan providing health and welfare benefits to county firefighters pursuant to collective bargaining was governmental plan, even though county employer did not appoint any plan trustees or otherwise participate in day-to-day operations and its involvement was limited to making contributions in accordance with terms of collective bargaining agreement and right to review, upon request, any records relating to plan); DOL Adv. Op. 79-83A (plan providing benefits to city school teachers was governmental plan where school district was sole contributor, even though district appointed only one of seven trustees, each having one vote, and action required majority vote). *See also* DOL Adv. Op. 2000-11A, DOL Adv. Op. 2000-07A, DOL Adv. Op. 95-25A, and DOL Adv. Op. 89-16A. *But see* DOL Adv. Op. 83-36A (plan maintained by teachers association is not governmental plan even though some school districts made contributions on behalf of employees pursuant to collective bargaining agreements, where school districts did not appoint trustees or in any other way control benefit arrangement).

[23] *See* DOL Adv. Op. 97-05A (§403(b) plan of a nonprofit organization controlled by elected sheriffs acting voluntarily, which provided social services pursuant to government contract was not governmental plan); DOL Adv. Op. 80-16A (death benefit plan established by city police benevolent association was not governmental plan, notwithstanding that 10 of 13 trustees were required to be city employees, police chief served as association president if association member, and association business was conducted on city property).

[24] *See* DOL Adv. Op. 83-36A and DOL Adv. Op. 83-13A.

[25] PLR 8045106.

[26] See the discussion of union-related plans at II.A.1.c., below.

[27] REG-157714-06, 76 Fed. Reg. 69,172 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011). *See* Announcement 2011-78. The regulations would not be applicable earlier than for plan years beginning after the date they are published as final regulations.

[28] *See, e.g.*, DOL Adv. Op. 95-20A (plan established by private employer and later assumed by governmental employer was governmental plan); DOL Adv. Op. 81-14A (plan established by private employer but maintained by government entity that had purchased assets was governmental plan); DOL Adv. Op. 80-50A, DOL Adv. Op. 80-36A. See *Rose v. Long Island R.R. Pension Plan*, 828 F.2d 910, 8 EBC 2443 (2d Cir. 1987), in which the court rejected the argument that a plan must be both established and maintained by a government entity in order to be a governmental plan under ERISA §3(32). The court noted that restricting the governmental plan exemption to those plans that were both established and maintained by a government entity would subject a private plan that was subsequently taken over by a governmental body to the requirements of ERISA, an outcome that would conflict with the federalism-based concerns that initially led Congress to exempt governmental plans from ERISA. The court added that "[a] broad reading of the term 'established' — whereby a new plan may be established under ERISA without the preexisting one having been formally 'terminated' — is more consistent with the legislative intent behind the governmental plan exemption." Similarly, in *Skornick v. Principal Fin. Grp.*, 383 F. Supp. 3d 176 (S.D.N.Y. 2019), the court relied upon the principles of *Rose* to determine that an employee of the Brooklyn Public Library was not a participant in a "governmental plan" exempt from ERISA. See also *Roy v. Teachers Ins. and Annuity Ass'n*, 878 F.2d 47, 11 EBC 1477 (2d Cir. 1989), in which the court held that a retirement program under which the employee owned the annuity contracts purchased on his behalf was a governmental plan where the government employer established the program, set eligibility and vesting requirements and approved the form of annuity contracts. The court specifically noted that because the government employer "established" the program, it was unnecessary to determine whether it "maintained" it in order to confer governmental plan status.

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whether such a plan would fall within the definitions of a governmental plan in I.R.C. §414(d) and, if the plan is a qualified defined benefit plan, ERISA §4021(b)(2), in light of the reference in those sections to plans that are both "established *and* maintained" by a government entity.

The Pension Benefit Guaranty Corporation (PBGC) first addressed this issue soon after the enactment of ERISA and ruled that pension plans maintained by a public agency or political subdivision that have been taken over from a private business are governmental plans and are excluded from the provisions of Title IV of ERISA.[29] Relying on legislative history, the PBGC's rationale was that Congress exempted governmental plans from the general provisions of Title IV of ERISA because it believed that government entities could fulfill their pension obligations to their employees through their taxing powers in lieu of federal termination insurance, and strict construction of the word "established" would, therefore, frustrate congressional intent. The PBGC concluded that the legislative intent behind ERISA §4021(b)(2) was to exclude a plan taken over by a government entity from the requirements of Title IV.[30]

The IRS also ruled that a plan established by a private employer that was subsequently taken over by a government entity was a governmental plan within the meaning of §414(d).[31] However, that ruling contained no discussion of the "established and maintained" language of that section.

The IRS may address in anticipated proposed regulations whether and how a change in status from private to governmental or governmental due to an acquisition or asset transfer would affect a plan's exemption as a governmental plan. Under draft Prop. Reg. §1.414(d)-1(k)(2)(i),[32] if the government takes over a private employer (e.g., through a stock acquisition) or becomes the employer under a plan established by a private entity (e.g., in connection with an asset transfer), the plan and all of its assets and liabilities attributable to service before and after the date of the change would be treated as being established by a governmental entity. If a private entity takes over for a government employer under a plan, under draft Prop. Reg. §1.414(d)-1(k)(2)(ii), the plan generally would be treated as being established by the nongovernmental employer on the date of the change. However, the plan would continue to be a governmental plan if the benefits held under the plan are frozen and a governmental entity assumes responsibility for the plan. If the assets and liabilities of a governmental plan are transferred to a private plan, the private employer would be responsible under draft Prop. Reg. §1.414(d)-1(k)(2)(ii)(C) for satisfying the minimum funding standards of §412 for benefits attributable to services performed, even if performed before the date of the change, but the former governmental plan or employer also would be responsible for the pre-change benefits.

Comment: The converse issue, i.e., whether a plan established by a government entity and subsequently taken over by a private employer would be a governmental plan, has not been addressed by the DOL. It could be argued, however, that such a plan should no longer be considered a governmental plan because it has ceased to be backed by the security of the government's taxing power and its treatment as a governmental plan would be inconsistent with Congress's goal in enacting ERISA of "remedy[ing] certain defects in the private retirement system."[33] This approach also would be consistent with IRS guidance on the tax effects when the plan sponsor of a §457(b) plan ceases to be a governmental entity and becomes a private tax-exempt employer or vice versa.[34]

c. Plan Established Through Collective Bargaining

According to the DOL, the term "governmental plan," as defined in ERISA §3(32), is not limited to plans established by the unilateral action of governmental employers.[35] The term could include collectively bargained plans and plans jointly administered by trustees appointed by government entities and by labor unions if these plans were funded by the employer and only covered employees of government entities. In taking this position, the DOL made the following observations about the term "governmental plan:"

> In our view, the term "governmental plan," as defined in §3(32) of ERISA, is not so narrow as to include only plans established by the unilateral action of employers which are governmental entities and plans which are ultimately within the exclusive control of governmental entities. Neither the language of §3(32), nor the legislative history relevant to the section indicate that the definition of "governmental plan" set forth in that section was intended to embrace only such plans… .[36]

Although in the factual situation giving rise to this opinion letter the government entity had the same number of plan trustees as the union, this does not seem to be a prerequisite for governmental plan status. The DOL has ruled, for example, that a plan that only covered county firefighters was a governmental plan where the county was the exclusive source of funding,

[29] PBGC Op. Ltr. 75-44.

[30] PBGC Op. Ltr. 75-44.

[31] PLR 7935040.

[32] REG-157714-06, 76 Fed. Reg. 69,172 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011). *See* Announcement 2011-78.

[33] H.R. Rep. No. 533, 93d Cong., 1st Sess. (1973); ERISA §2. This issue was briefly discussed in *Rose*.

[34] *See* Reg. §1.457-10.

[35] DOL Adv. Op. 79-36A. This opinion letter was in response to a request for an opinion on whether plans established through collective bargaining between municipal or school district employers and a union representing government employees were governmental plans. In all cases employer contributions provided the exclusive source of funding, each plan was jointly administered by trustees appointed by the union and the employer in equal numbers, and deadlocked issues were to be resolved through arbitration. Although the request for the opinion letter was subsequently withdrawn when the matter became the subject of litigation, the DOL nevertheless used it as an opportunity to state its position.

[36] DOL Adv. Op. 79-36A. This interpretation of the legislative history of the governmental plan exemption was echoed by the district court in *Feinstein v. Lewis*, 477 F. Supp. 1256, 1 EBC 1927 (S.D.N.Y. 1979), aff'd without op., 622 F.2d 573 (2d Cir. 1980), which resulted when the trustees of the plans that were the subject of DOL Adv. Op. 79-36A, after waiting over four years for the DOL to respond to its request for an opinion letter, filed suit seeking a ruling that the plans were subject to ERISA and that state insurance laws were thus preempted. Such a ruling could be made only if the plans were found not to be governmental plans. The *Feinstein* court first held that even though the plans were the result of collective bargaining, they were established and maintained by a government employer. It then reviewed the legislative history of ERISA and the governmental plan exemption and concluded that Congress, in exempting governmental plans, was concerned more with the governmental nature of public employees and employers than with the details of how a plan was established or maintained.

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except for dependent coverage, even though the county did not appoint the trustees or otherwise participate in the day-to-day operations of the plan.[37]

The IRS came to a similar conclusion under §414(d) regarding the §457(b) plan considered in Rev. Rul. 2004-57.[38] The plan was offered and administered by a union, and only made available to members of the collective bargaining units represented by the union who are employed by governmental employers (political subdivisions of a state or their agencies or instrumentalities). The plan was in addition to a §457(b) plan offered by the state. The plan stated that it is established and maintained by the governmental employer and participants were informed of this. Only investments approved by the union were offered under the plan and amounts deferred by employees of governmental employers that adopted the plan, plus any amounts directly transferred from any other eligible governmental §457(b) plan, provided the plan's exclusive source of funding. Union members employed by governmental employers that did not adopt the plan were not eligible to participate in the plan, and no contributions could be made on their behalf regardless of whether their governmental employer was part of any collective bargaining agreement with the union and regardless of whether the employees were union members. Employees of the union were not eligible to participate in the plan. The plan treated all deferrals under all eligible plans in which an individual participated by virtue of his or her relationship with a single employer as a single plan for purposes of determining whether deferrals in excess of the §457(b) limitations had been made. Under these facts, the IRS concluded that the plan did not fail to be an eligible governmental plan under §457(b) solely because the plan was offered and administered by the union.

Simultaneously with Rev. Rul. 2004-57, the IRS issued transition advice for plans that were offered and administered by unions that did not meet the facts of the ruling. In Announcement 2004-52, the IRS provided that in the case of a plan established before June 14, 2004, that did not satisfy the requirements of the revenue ruling solely as a result of being established and maintained by a union instead of being established and maintained by an eligible governmental employer may nonetheless be treated as a governmental plan if:

> (1) contributions to the plan ceased with respect to payroll periods that began after December 31, 2004; and
>
> (2) either of the following corrective actions was completed by December 31, 2005:
>
> > (a) the eligible governmental employer adopted the plan, or
> >
> > (b) the accounts of the employees under the plan were transferred (not rolled over) into an eligible governmental plan maintained by the eligible employer as defined under §457(e)(1)(A) in accordance with the requirements of Reg. §1.457-10(b)(4). For this limited purpose, the transferor plan was treated as an eligible governmental plan of the same employer.

The plan also had to satisfy all of the other requirements for governmental §457(b) plans. If the corrective actions were not completed by December 31, 2005, the plan was treated as an ineligible deferred compensation arrangement, subject to §457(f) so that benefits were currently includible in income. Likewise, if the plan was liquidated before December 31, 2005, without corrective action, distributions from the plan were to be taxed in accordance with §457(f).

The draft version of anticipated proposed Treasury regulations[39] does not add any special rules for plans established through collective bargaining or reference Rev. Rul. 2004-57. The draft would provide only a limited rule in draft Prop. Reg. §1.414(d)-1(k)(3), under which employees of a labor union whose members are covered by the collectively bargained plan would be treated as employees of the governmental entity that is the plan sponsor for purposes of determining whether the participants covered by the plan are employees of the governmental entity.

d. Plan Maintained by Private Employer but Mandated by Government Entity

The PBGC has ruled that a plan maintained by a private employer pursuant to a contract between that employer and a government entity was a governmental plan, if the government entity was required to pay benefits that would be insured under Title IV of ERISA in the event of plan termination.[40] In that instance, all funding was an "allowable expense" under the contract and was solely provided by the federal government which, as noted above, was required to pay any benefit entitlements under the plan, including termination benefits that would be insured under Title IV. In contrast, the PBGC has ruled that a plan was not a governmental plan, even though the contractor was reimbursed by the government for its contributions to the plan, because the government agency was not required to make direct payments of benefits to the employees and did not guarantee payment of pension benefits in the event of plan termination.[41]

However, in at least one opinion, the PBGC in a similar situation did not look to whether the plan guaranteed termination benefits, but instead simply focused on whether the par-

[37] DOL Adv. Op. 86-24A. *See* DOL Adv. Op. 95-25A. In DOL Adv. Op. 2004-01A, the DOL determined that certain health and legal funds maintained by a governmental entity that were part of the bargaining agreements between the entity and union were governmental funds within the meaning of ERISA §3(32). In determining whether a plan is established or maintained by a governmental entity, the DOL looks at the extent to which the plan is funded by the entity and the extent to which the entity is involved in the discretionary administration of the plans. Although the legal fund was created without direct involvement of the governmental entity, the governmental entity authorized the establishment of the fund and continued to ratify its ongoing maintenance. Further, the governmental entity provided most of the funding for all the funds and all fund participants were employees of the governmental entity except for a de minimis number of participants.

[38] *See also Daniels-Hall v. NEA*, No. C 07-5339RBL, 2008 BL 313983, 43 EBC 2715 (W.D. Wash. 2008), aff'd, 629 F.3d 992, 50 EBC 1481 (9th Cir. 2010) (403(b) plan held to be established and maintained by a governmental school district), *and Silvera v. Mut. Life Ins. Co.*, 884 F.2d 423, 11 EBC 2053 (9th Cir. 1989) (certain insurance policies insured by MONY held to be under governmental plans); *but compare Hanson v. United Life Ins. Co.*, No. CV 01-1504ABC(BQRX), 2001 BL 19301 (C.D. Cal. Oct. 30, 2001) (welfare benefit plan administered by a public employee organization not a governmental plan).

[39] REG-157714-06, 76 Fed. Reg. 69,172 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011). *See* Announcement 2011-78.

[40] PBGC Op. Ltr. 77-126.

[41] PBGC Op. Ltr. 98-2, PBGC Op. Ltr. 83-16.

ISBN 978-1-63359-446-3

ticipants were government employees. It ruled that because the participants were employees of the private employer and not the government entity, the plan could not be a governmental plan.[42]

Comment: Although this approach may be justified based on the language of the statute, the analysis taken by the PBGC in its other rulings, i.e., whether the government entity is responsible for payment of benefits otherwise insured under Title IV of ERISA in the event of plan termination, may be more sound in light of the legislative history of the governmental plan exemption. If the government entity is responsible for benefits that would otherwise be insured under Title IV, there is no reason for the payment of Title IV premiums, and, thus, no reason for the plan not to be deemed governmental under ERISA §4021(b)(2).

Comment: The IRS, DOL and PBGC have been working jointly on further guidance on the definition of governmental plan which, among other things, addresses the meaning of "established and/or maintained." In November 2011, the IRS and Treasury issued advance notices of proposed rulemaking containing a draft of general guidance being considered for determining whether a retirement plan is a governmental plan within the meaning of §414(d) and a draft of guidance for plans of an Indian tribal government.[43] Although the proposed regulations apply only to I.R.C. §414(d), the DOL and the PBGC were consulted in developing the proposal and will have access to copies of the comments received. It is anticipated that the three agencies will apply the resulting definition uniformly across the agencies.

2. *Plan Considered Established and/or Maintained for Its Employees*

As previously discussed, in order for a plan to qualify as a governmental plan, it must be established and/or maintained by the government entity for its employees. Thus, a plan that includes both government employers and more than a de minimis number of nongovernmental employees cannot be a governmental plan. For example, the PBGC has ruled that a plan was not a governmental plan where both government employers and private employers subject to Title IV of ERISA participated, all contributions were commingled and all amounts payable were a general charge upon plan assets. It concluded that Title IV applied to all employers and premiums were due for all participants, including those participants employed by government employers.[44]

Although the DOL has not made such a similar determination, it has recognized the issue. For example, in reviewing the trust agreement of a plan it determined to be a governmental plan, the DOL stated that provisions in the agreement that could permit employees or former employees of a nongovernmental entity to participate in the plan, or that permitted the trust fund to be merged with a trust fund of a nongovernmental plan, could jeopardize governmental plan status if the plan acted pursuant to those provisions.[45]

This does not mean that under certain circumstances a governmental plan cannot provide benefits to a small number of individuals who are not government employees. In DOL Adv. Op. 80-50A, the DOL ruled that a plan was a governmental plan even though it provided benefits to a limited number of individuals who might never be employees of the government entity.[46] In that situation, the government entity had acquired the assets of a number of privately held bus companies, some of which had maintained retirement plans. The assets of most of the plans were merged into the plan maintained by the government entity and most of the employees of the affected companies became government employees. The DOL noted that the few nongovernmental employees who would be receiving benefits from the plan had nevertheless been employees of businesses that the government entity was currently operating and that the government entity had assumed financial responsibility for the pension obligations of those businesses.[47] In other rulings, the DOL has permitted collectively bargained governmental plans to cover a small number of employees of the union.[48]

Similarly, in a situation involving the unwinding of a joint venture between the University of California (UC) and Stanford University, the DOL ruled that governmental plan status under ERISA §3(32) was not adversely affected when certain former private sector employees of the joint venture were reemployed by UC, a governmental entity, resumed participation in the UC defined benefit pension plan and §403(b) plan, and were given service credits and allowed to transfer account balances from the joint venture plans.[49] According to the DOL, those actions pertain to how a governmental employer decides to provide benefits to its employees and do not undermine the governmental plan status of its benefit programs under Title I of ERISA.

The IRS has not ruled under §414(d) on whether a de minimis number of nongovernmental employees may participate in a governmental plan.[50] In an advance notice of proposed rulemaking, the IRS declined to propose a de minimis rule.[51] However, under draft Prop. Reg. §1.414(d)-1(k)(3), employees of a labor union whose members are covered by the collectively bargained plan or employees of the plan would be treated as employees of the governmental plan sponsor. Otherwise, draft

[42] PBGC Op. Ltr. 81-13.

[43] REG-157714-06, 76 Fed. Reg. 69,172, 69,178 (Nov. 8, 2011); as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011); *see* Announcement 2011-78; REG-133223-08, 76 Fed. Reg. 69,188 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011); *see* Announcement 2011-79.

[44] PBGC Op. Ltr. 77-169.

[45] DOL Adv. Op. 86-23A and DOL Adv. Op. 86-24A.

[46] *See* DOL Adv. Op. 99-10A (inclusion of 28 nongovernmental employees of educational accrediting agency did not cause CalPERS to fail to be governmental plan).

[47] DOL Adv. Op. 80-50A.

[48] DOL Adv. Op. 2005-21A (2 out of 1,150 participants continued to participate while on leave of absence as full-time elected officials of union representing plan employees); DOL Adv. Op. 2005-17A (5 out of 33,600 participants were employees of plan itself); DOL Adv. Op. 2000-04A (3 out of 838 participants were nongovernmental employees); DOL Adv. Op. 2000-01A (11 participants out of 1488 were nongovernmental employees); DOL Adv. Op. 95-14A (253 out of 183,000 participants were nongovernmental employees); DOL Adv. Op. 95-15A (236 out of 10,987 participants were nongovernmental employees).

[49] DOL Adv. Op. 2002-10A.

[50] The IRS will not rule on whether a plan is a governmental plan under §414(d). Rev. Proc. 2025-3, §3.01(67).

[51] REG-157714-06, 76 Fed. Reg. 69,172, 69,178 (Nov. 8, 2011).

ISBN 978-1-63359-446-3

Prop. Reg. §1.414(d)-1(k)(1) would require that the only participants covered by the plan are employees of that governmental entity.

3. *Meanings of Political Subdivision and Agency or Instrumentality*

a. *Political Subdivision*

The term "political subdivision" is not defined in ERISA. As a result, reliance has been placed on criteria used for determining status as a political subdivision under other federal statutes. The most important indicators of political subdivision status have been deemed to be: (1) creation directly by the state, such that the entity constitutes a department or administrative arm of the government; or (2) administration by individuals who are responsible to public officials or to the general electorate.[52]

A few private letter rulings, but no court decisions, have considered what constitutes a political subdivision under §414(d). However, factors to be considered indicia of political subdivision status have been suggested in several court cases and revenue rulings interpreting other I.R.C. sections that refer to the term "political subdivision," such as §103, which exempts interest paid on bonds of states or political subdivisions, and §170,[53] which permits a charitable deduction for contributions to a political subdivision of any state. The most important of these indicia are: (1) performance of traditionally public functions; and (2) state delegation to the entity of one or more powers generally exercised by the state, such as the power of eminent domain, police power or taxing power.[54] It is not necessary for the entity to possess all powers, but the powers it has must be substantial.[55] Other factors mentioned, usually in addition to those cited above, include existence as a public corporation under state law and exemption from state and local taxation.[56]

The PBGC has found entities to be political subdivisions under ERISA §4021(b)(2) where they: (1) were created pursuant to state statute; (2) were considered to be a political subdivision by the state; (3) had taxing authority that was usable to pay any deficient funding in the plan, including benefit obligations upon plan termination; and (4) were considered political subdivisions by the IRS.[57]

b. *Agency or Instrumentality*

The terms "agency" or "instrumentality" have much broader application than the term "political subdivision."[58] However, frequently, the distinction between these terms and "political subdivision" is blurred.[59]

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[52] *See, e.g.*, *Rose v. Long Island R.R. Pension Plan*, 828 F.2d 910, 8 EBC 2443 (2d Cir. 1987), one of the few cases that has interpreted the term "political subdivision" within the context of ERISA §3(32). In *Rose*, the Second Circuit applied the criteria used by the U.S. Supreme Court in *NLRB v. Natural Gas Utility Dist. of Hawkins Cnty., Tenn.*, 402 U.S. 600, 604–05 (1971), a case involving the determination of status as a political subdivision under the National Labor Relations Act. The court held that the Metropolitan Transportation Authority, which held all the stock of the railroad, was a political subdivision of New York State because: (1) it was created directly by the state; (2) it was administered by members appointed and removable by the governor; (3) it performed the governmental function of improving the transportation system; (4) it had eminent domain power; (5) it was exempt from state and local taxes; and (6) it had the power to establish rules for public conduct that preempted local ordinances. *See also Koval v. Wash. Cnty. Redevelopment Auth.*, 574 F.3d 238, 47 EBC 1886 (3d Cir. 2009) (county authority is political subdivision of state under ERISA §3(32) using *NLRB* test); *Brown v. Reliance Standard Life Ins. Co.*, 52 F. Supp. 3d 1209 (N.D. Ala. 2014) (ERISA covers life insurance policy issued under employee benefits plan of medical center operated by public corporation that is health care authority; medical center is not political subdivision under ERISA); *Shore v. The Charlotte-Mecklenburg Hosp. Auth.*, 412 F. Supp. 3d 568 (M.D.N.C. 2019) (applying the *Hawkins County* standard, the court held that a hospital authority created by city resolution is a political subdivision under ERISA §3(32) because: (1) it was created by the state through a delegation of authority to a local government body pursuant to state statute; (2) it was administered by the board of commissioners who are appointed and removed by the county chairman who is an elected official; (3) it had the power of eminent domain; (4) it had broad grant of authority under state statute and could receive appropriations from the state's general fund; (5) it was subject to public record laws; and (6) its commissioners were not compensated); *Milby v. Liberty Life Assurance Co. of Bos.*, 102 F. Supp. 3d 922 (W.D. Ky. 2015) (entity created to operate a hospital closely related to a state university is not a "political subdivision" or "agency or instrumentality" of the state under ERISA §3(32); applying *Hawkins County* standard, court concluded that entity: (1) was not created directly or indirectly by state because no action of state legislature was required for it to be created and neither state nor state university was involved in its formation; (2) was not administered by individuals who are responsible to public officials or general electorate because only a minority of members of entity's board of directors were appointed by, and could be removed by, an individual who was responsible to a public official; (3) was not an agency or instrumentality of the state based on Rev. Rul. 89-49 factors (discussed below); and (4) did not, in its employment relationships, function like a government agency because it retained its own employees who were not considered to be state university employees, were not on the state university's payroll and, most importantly according to the court, were not covered under any of the state university's employee benefit plans, including the long-term disability plan at issue).

[53] *See* PLR 9402028 (contributions to organization, which was corporate and political body under state law, were deductible under §170(c)(1) as gifts to or for use of instrumentality of political subdivisions of state).

[54] *See, e.g.*, *Commissioner v. Estate of Shamberg*, 144 F.2d 998 (2d Cir. 1944), which involved determination of the political subdivision status of the Port Authority of New York under the predecessor to §103, and Rev. Rul. 58-473, in which the IRS ruled that an authority running a sewer and water system for a township was a political subdivision such that contributions to it were deductible under §170. *See also* PLR 9346007 (hospital authority's merger and asset transfer to reorganize health care system did not alter or affect hospital authority's status as political subdivision under §103(a) where hospital authority's grant of power of eminent domain and appointment and control of its board of directors by county continued after reorganization), PLR 9126053 and PLR 8906057.

[55] *See Phila. Nat'l Bank v. United States*, 666 F.2d 834 (3d Cir. 1981), involving the definition of the term "political subdivision" under §103, in which the court held that there had been no delegation of essential governmental power. Similarly, in Rev. Rul. 77-165, the IRS ruled that a state university that received state appropriations, maintained a campus police force and had been delegated eminent domain power for specific purposes was not a political subdivision because, even though certain sovereign powers had been delegated to the university, the extent to which the university could exercise these powers was insubstantial. *See also* TAM 201334038 (community development district that was organized and operated to ensure private control and avoid responsibility to general public does not qualify as a state or political subdivision under §103(c)(1); mere delegation of sovereign power is not sufficient to create political subdivision); TAM 9347001 (temporary insurance underwriting association established by state was not political subdivision of state when it failed to offer any facts to show that it was municipal corporation or had been delegated any state sovereign powers).

[56] *See, e.g.*, *Estate of Shamberg*, 144 F.2d 998 (2d Cir. 1944).

[57] *See* PBGC Op. Ltr. 81-31 and PBGC Op. Ltr. 76-95.

[58] *See, e.g.*, *Green v. Balt. City Bd. of Sch. Comm'rs*, No. 1:14-cv-03132-WMN, 2015 BL 72114 (D. Md. Mar. 17, 2015) (health plan is a governmental plan because it is maintained by the Baltimore City Board of School Commissioners, a state agency or instrumentality).

[59] *See, e.g.*, PLR 8906057, PLR 8217128, in which the IRS ruled that an entity was both a political subdivision and an instrumentality.

ISBN 978-1-63359-446-3

(1) IRS Rulings

The IRS generally relies on Rev. Rul. 57-128[60] to determine whether an organization is an instrumentality of a state or political subdivision. In this ruling, the IRS examines the following factors:

- whether the entity is used for a governmental purpose and performs a governmental function;
- whether performance of the entity's function is on behalf of one or more state or political subdivisions;
- whether there are many private interests involved, or whether the state or political subdivisions involved have the powers and interests of an owner;
- whether control and supervision of the organization is vested in public authority;
- whether expressed or implied statutory or other authority is necessary or exists for the creation and use of the organization; and
- the degree of financial autonomy in the source of the entity's operating fund.

Applying these criteria, the IRS has ruled that the following are governmental plans:

- A plan maintained by an entity established by state law for the purpose of providing public transportation, where all property owned by the entity was state property exempt from creditors, members of the governing board were members of the executive branch or appointed by the governor, and the entity had the power of eminent domain and could set fares, hold hearings and issue regulations.[61]
- A plan maintained by an entity established under a specific section of the state code to assist blind people with services, training and employment, where such entity was financed with federal, state and local funds, was operated by a board appointed by the governor with senate consent, and was required to submit its budget to the state for approval.[62]
- A plan maintained by an entity created as a public trust under state law for the purpose of establishing and maintaining hospitals and other health care facilities, where the government hospital board and trustees were the same people, no private interest existed and the entity took the place of a comparable administrative unit which would otherwise have been maintained by the state.[63] However, an essentially private organization will not qualify as an agency or instrumentality of a state or local government merely because it has some quasi-governmental power or receives some governmental funding. For example, a plan established and maintained by a volunteer fire company created before the incorporation of the villages it served, was not a governmental plan where the only control the villages had over the fire company was the funding it paid to it pursuant to a mutually negotiated contract.[64] Similarly, a plan maintained for employees of certain private nonprofit charitable, cultural or educational institutions, including certain child care centers that received partial financial support from the city, was held not to be a governmental plan even though the city also appointed two of the nine members of its administrative committee.[65] In addition, absent the requisite governmental connection, the characterization of the organization as an "instrumentality" is not controlling.[66]
- A supplemental, nonqualified, unfunded defined benefit plan maintained by two §501(c)(1) corporations (Y and Z) created by an act of Congress to perform governmental functions. The President, with the advice and consent of the Senate, appoints Y's members, and Y must regularly report to and consult with the full Congress, which has delegated to Y broad powers that inherently are governmental in nature, including the power to promulgate and enforce certain federal industry regulations and assess civil penalties that are payable to the United States. Y and Z are an integral part of X, which is required to submit reports to Congress, including an annual report of its operations and weekly reports indicating the condition of Z. The financial accounts of Y are subject to audit by the Government Accountability Office. Although Y is not funded through congressionally appropriated funds, it is funded through profits of Z, which, after payment of statutory dividends to members of Z, are otherwise earmarked for the U.S. Treasury. Z performs governmental functions such as performing industry services for the federal government and conducting examinations and inspections of certain industry institutions. Z is subject to the oversight of Y, which appoints one-third of the directors of Z and approves the

[60] This ruling addressed what constituted employment with an agency or instrumentality for purposes of FICA. A second revenue ruling dealing with status as an agency or instrumentality for purposes of FICA, Rev. Rul. 65-26, also is frequently cited, although it adds little to the prior ruling.

[61] PLR 8217128 (IRS concluded that entity was used for governmental purpose, performed its function on state's behalf, was controlled and supervised by state, was created and authorized by statutes, possessed financial autonomy, and state was part of its operating fund source).

[62] PLR 7914066.

[63] PLR 7811044. See PLR 7902043, in which the IRS ruled that a plan was a governmental plan where it was maintained by an organization created pursuant to joint resolutions of government entities, financed with federal, state and local funds and operated by a board appointed by elected officials. Any rules or regulations promulgated by the board were subject to approval by the government entities. *See also* PLR 9404022 (joint venture formed to further governmental purposes of assisting states in the efficient administration of state tax laws held wholly owned instrumentality of state for purposes of §3121(b)(7) and §3306(c)(7)); PLR 9320043 (association of public housing authorities of four states, formed under state statutes permitting public agencies to enter intergovernmental cooperation agreements, and whose operating expense funding comes from the member public housing authorities, classified as political subdivision of those states).

[64] PLR 8045106. *See* IRS Info. Letter 2013-0033 (a wholly privately owned company cannot be a political subdivision or an instrumentality of a state or political subdivision under Rev. Rul. 57-128, even if its employees participate in a retirement system maintained by the state or local government).

[65] DOL Adv. Op. 85-07A.

[66] *See, e.g.*, *Krupp v. Lincoln Univ.*, 663 F. Supp. 289 (E.D. Pa. 1987) (characterization of private university as "instrumentality" of state and as "state-related institution" as part of bill designed to enable state to provide greater financial support did not make university government entity). *Compare* DOL Adv. Op. 80-15A (certain plans covering persons employed by project funded by legal service corporation were not governmental plans because statute that created corporation specifically provided that corporation was not considered a department, agency or instrumentality of federal government).

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compensation of all directors, officers and employees of Z. The IRS ruled that the plan, which was maintained for the benefit of selected officers of Y and Z, qualified as an exempt governmental deferred compensation plan for purposes of §3121(v)(3).[67]

In Rev. Rul. 89-49, the IRS ruled that a retirement plan established for the employees of a municipal volunteer fire company was not a governmental plan under §414(d), primarily because the municipalities to which the company provided contract services exerted a minimal degree of control over the fire company's everyday operations. The IRS also noted that: (1) the fire company was not affiliated with the state under specific legislation; (2) community donations paid for part of the company's expenses; (3) the firefighters elected the company's managing board of directors; and (4) the state has not treated the company's employees as state or municipal employees.

The IRS relied on Rev. Rul. 89-49 in PLR 9009059 when it ruled that a plan maintained by an agency established by state statute to provide electricity, water, and sanitary sewer utilities to a city was a governmental plan. The IRS determined that the agency was supposed to generate revenue for the city by selling those utility services on the city's behalf and that it used this revenue to pay for bond issues and to make annual contributions to the city's budget. In addition, the IRS noted that employees of the agency were also considered city employees and that the city was responsible for all of the agency's liabilities.[68]

In PLR 9040065, the IRS applied Rev. Rul. 89-49 by placing particular emphasis on the degree of control exercised by state government over the organization's everyday operations. The IRS concluded that because the plan was created by state statute as an integral part of the state government, it is necessarily controlled by that government, and, thus, is a governmental plan under §414(d). The IRS followed similar reasoning in PLR 9516049 and concluded that because a charter school's charter had to be reviewed and approved by the school district, the state maintained control over the school's operation. Thus, the IRS ruled that the school, whose charter was revoked for financial mismanagement and failure to meet academic goals, was an agency or instrumentality of the state government before revocation of its charter and that the accrual of benefits under a defined benefit plan covering the school's employees during the period its charter was in effect will not adversely affect the plan's status as a governmental plan under §414(d).[69] For a discussion of rules that the IRS anticipates proposing to permit governmental plans maintained by state and local governments to include employees of public charter schools, see II.A.3.b.(2), below. In PLR 200402031, the IRS ruled that the police department of a federally recognized Indian tribe qualified as a state agency or instrumentality, and thus, the department's contributions to a state governmental plan were deemed contributions by a state agency or instrumentality for purposes of §414(d). The IRS concluded that the police department was distinguishable from the entity described in Rev. Rul. 89-49 because of the degree of control that the state and the county ultimately exercised over the department's daily operations.

In contrast, in TAM 9413003, the IRS National Office advised that a private, voluntary, nonprofit, unincorporated association formed to promote, regulate and direct the interscholastic athletic activities of state high schools was not a wholly owned instrumentality of a state for federal employment tax purposes. The National Office explained that merely because an organization's operations may result in a benefit to the public, or the state encourages the formation and activities of such organization and may exercise some supervision and control over its activities, that does not make such organization a wholly owned instrumentality for federal employment or income tax purposes. The National Office also concluded that the firm apparently could not incur debt, liability or obligations that would impose any obligation on the state or its agencies.[70]

In PLR 200244021, the IRS ruled that a corporation that essentially was a joint venture between the public and private sectors, was not a government agency or instrumentality and, thus, was eligible to sponsor a §401(k) plan. The IRS relied on Rev. Rul. 89-49 and noted that the rationale used in Rev. Rul. 89-49 for determining whether an organization is a government agency or instrumentality is equally applicable for §401(k)(4)(B) as well as §414(d). The corporation, which was exempt from tax under §501(c)(6) as a business league, was established in order to develop and operate an information network and database that covers each U.S. state, territory and insular possession. Here, the IRS concluded that the private sector had substantial control over the corporation; the board of directors was selected by both the private sector and the government; the corporation's long-term funding came from user fees and sale proceeds rather than government sources; its officers included both government officials and individuals from the private sector; the organization's activities and funds were not regulated; and its employees were not treated as governmental employees.

In *Smith v. Regional Transit Authority*,[71] the Fifth Circuit court followed the six-factor test set forth in Rev. Rul. 57-128, as modified by Rev. Rul. 89-49, to conclude that an entity that provided day-to-day operations for New Orleans's transit system was an agency or instrumentality of Louisiana's regional transit authority, a political subdivision of Louisiana. In reaching its conclusion, the Fifth Circuit emphasized that the entity's status as a private company alone, and its treatment of its employees as private employees, did not necessitate a finding that it was not an agency or instrumentality where overall evidence weighed heavily in favor that the organization was an agency or instrumentality. In concluding that the organization was an agency or instrumentality of the regional transit authority, the

[67] PLR 200247040.

[68] *See* PLR 9420039 (plan maintained by subsidiary of corporation hired by city's mass transit agency to operate transit system qualifies as governmental plan).

[69] Similar rulings regarding charter school employees include PLR 200017053 and PLR 9813019. See PLR 9541040, in which a nonprofit public service corporation, created by a city to operate its mass transit system, had a substantial degree of financial and operational control over the everyday operations of the system satisfying the requirements of Rev. Rul. 89-49 and, thus, met the definition of a governmental plan. See also PLR 199928030, in which a special purpose district was found to have sufficient control over a private waste management facility that governmental employees transferred to the private company would remain eligible to participate in the state pension system.

[70] *See* PLR 9749014 (because degree of control exercised by state over state bar association was minimal, bar association escaped classification as agency or instrumentality of state, and was, therefore, permitted to include §401(k) cash or deferred arrangement as part of profit-sharing plan).

[71] 827 F.3d 412 (5th Cir. 2016).

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Fifth Circuit noted that its purpose was to manage the public transit system, it performed its functions on behalf of the regional transit authority, the regional transit authority had control over the organization due to its authority to remove its general manager, and the organization was funded exclusively by the regional transit authority.

(2) Draft Treasury Proposed Regulations

In November 2011, the IRS and Treasury issued an advance notice of proposed rulemaking[72] containing a draft of general guidance on whether a retirement plan is a governmental plan under I.R.C. §414(d). A facts and circumstances test would apply under draft Prop. Reg. §1.414(d)-1(c) or §1.414(d)-1(f) in making the determination of whether an entity is an agency or instrumentality of a state (or of its political subdivision) or of the United States. Both "main factors" and "other factors" would be considered in deciding whether an entity is an agency or instrumentality of a state. The main factors considered under draft Prop. Reg. §1.414(d)-1(f)(2)(i) in support of status as an agency or instrumentality of a state (or political subdivision) would be:

- the entity's governing board or body is controlled, without material restriction, by a state;
- the members of the governing board or body are publicly nominated and elected;
- the state has fiscal responsibility for the entity's general debts and other liabilities, including funding benefits under the entity's employee benefit plans;
- the entity's employees are treated in the same manner as state employees (e.g., they are granted civil service protection) other than for providing employee benefits; and
- if the entity is not a political subdivision, it is delegated the authority to exercise sovereign powers of the state pursuant to a state statute.

Factors proposed to be "minor" factors under draft Prop. Reg. §1.414(d)-1(f)(2)(ii) would include:

- whether the entity's operations are controlled by the state;
- whether the entity is directly funded through tax revenues or other public sources (not merely payments under a contract to provide a governmental service or funding through state or federal government grants);
- whether a specific enabling statute prescribes the purposes, powers, and manners in which the entity is to be established and operated (i.e., excluding a nonprofit corporation that is incorporated under general corporation laws);
- whether the entity is treated as a governmental entity for federal employment tax or income tax purposes;
- whether the entity is an agency or instrumentality of a state for state law purposes;
- whether a state or federal court has determined the entity to be an agency or instrumentality of a state;
- whether a state has the ownership interest in the entity and no private interests are involved; and
- whether the entity serves a governmental purpose.

The criteria suggested under draft Prop. Reg. §1.414(d)-1(c)(2) for status as an agency or instrumentality of the United States would be:

- performance or assistance in the performance of a governmental function;
- whether the U.S. government has all of the powers and interests of an owner, or no private interests are involved (and corporate stock held by an entity is not considered a private interest if it is not acquired for investment purposes or for purposes of control);
- whether the U.S. government is vested with the entity's supervision and control (with control being more than extensive regulation of an industry);
- whether an Act of Congress exempts the entity from federal, state, and local tax;
- whether the U.S. government created the entity pursuant to a specific enabling statute that prescribes the purposes, powers, and manner in which the entity is to be established and operated;
- whether the U.S. government provides the entity with financial assistance (not merely payments under a contract to provide a governmental service);
- whether a federal court has determined the entity to be an agency or instrumentality of the United States;
- whether other governmental entities recognize and rely on the entity as an arm of the U.S. government; and
- whether the entity's employees are treated in the same manner as federal employees other than for providing employee benefits.

In early 2015, the IRS and Treasury indicated that they are considering proposing regulations under I.R.C. §414(d) that would specify that a state or local retirement system that covers employees of a public charter school still could be considered a governmental plan within the meaning of I.R.C. §414(d) and permit those employees to participate in the system. The proposal would require that the following requirements be met by the school:

- it is a nonsectarian independent public school that serves a governmental purpose by providing tuition-free elementary or secondary education, or both;
- it is established and operated in accordance with a specific state statute authorizing the granting of charters to create independent public schools or authorizing the establishment of independent public schools;
- its employees' participation in the state or local retirement system is expressly required or permitted under applicable law;
- either —

[72] REG-157714-06, 76 Fed. Reg. 69,172 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011). *See* Announcement 2011-78.

ISBN 978-1-63359-446-3

(1) its governing board or body is controlled by a state, political subdivision of a state, or agency or instrumentality of a state or a political subdivision; or

(2) its primary source of funding is from a state, political subdivision, or agency or instrumentality of a state or political subdivision; its employees' rights to their accrued benefits under the state or local retirement system are not dependent on whether the entity continues to participate in the system and, if the entity ceases participation, a governmental entity has responsibility for the employees' accrued benefits, including the continued funding of the accrued benefits, to no lesser extent than it would have for the employees of any other participating employer in the system; and it is or is part of a local educational agency, as defined in 20 U.S.C. §7801(26), and is subject to the significant regulatory control and oversight by a state, political subdivision, or agency or instrumentality of a state or political subdivision — i.e., it is held accountable by an authorized public chartering agency with power over its charter and it must comply with health and safety and academic and financial accountability standards that are similar to those that are generally applicable to other public schools in the state; and

• all financial interests of ownership in the entity are held by a state, political subdivision, or agency or instrumentality of a state or political subdivision — i.e., the entity's governing documents require that, upon dissolution or final liquidation of the entity, the entity's net assets must be distributed to another public school that meets these requirements or to a state, political subdivision, or agency or instrumentality of either.[73]

(3) DOL Advisory Opinions

With respect to ERISA, the DOL advised that the Federal Reserve System is an agency or instrumentality of the U.S. government for purposes of ERISA §3(32), and that certain employee benefit plans that are established and maintained by the Federal Reserve and that only cover Federal Reserve employees are governmental plans under ERISA §3(32).[74]

The DOL has ruled that a defined benefit plan of a hospital authority created and operated pursuant to a state statute as a "public body corporate and politic" under state law was a governmental plan under ERISA §3(32), based on the hospital authority's relationship with the county and city that established it.[75] The powers and functions of hospital authorities are set forth in the state statute as "public and essential governmental functions," and the state supreme court has held that hospital authorities established under the statute are governmental entities and instrumentalities of political subdivisions of the state, the DOL noted. The retirement plan at issue covered the employees of a particular campus of the hospital authority, and state law permits this arrangement, even though all the facilities are not located within the county and/or the city that established the hospital authority, if the hospital authority operates these facilities pursuant to the request or with the approval of the city or county in which the facilities are located.

In DOL Adv. Op. 2005-01A, the DOL found that the status of Georgia's state health benefits plan as a governmental plan would not be adversely affected under ERISA §3(32) by extending coverage to the employees of Georgia's Agricultural Commodities Commissions (ACCs). The advisory opinion established a direct line from the ACCs to the Georgia Constitution, and then from the Georgia Constitution to the Georgia General Assembly, to confirm each ACC as a public corporation and instrumentality of the State of Georgia. Subsequently, in DOL Adv. Op. 2005-07A, the DOL reached the same conclusion regarding coverage by the same plan for employees of certain federally qualified health centers (FQHCs). Public and private not-for-profit health centers may qualify as FQHCs, which include diverse types of organizations and programs eligible to receive federal funding for serving certain medically underserved areas or populations. However, in this opinion, the DOL relied on its position that participation by a de minimis number of private sector employees does not adversely affect a plan's status as a governmental plan, citing DOL Adv. Op. 95-15A and DOL Adv. Op. 95-27A. Here, the participation of 880 FQHC employees in the plan, together with the approximately 1,500 other nongovernmental employees participating in the plan, represented less than 1% of the total participants in the plan, which the DOL considered within its de minimis standard. The DOL assumed, without examining or expressing an opinion on the issue, that none of the FQHCs would constitute an agency or instrumentality of state government within the meaning of ERISA §3(32). Public FQHCs in Georgia were defined as those owned or operated by a municipality, county, hospital authority, or a combination thereof, but the FQHCs addressed in DOL Adv. Op. 2005-07A were not so owned or operated and were not otherwise agencies or instrumentalities of the State of Georgia.

The DOL referred to its de minimis standard in DOL Adv. Op. 2005-07A in DOL Adv. Op. 2012-01A, in which it found that participation by private, nonprofit employers in Connecticut's state group health plan would adversely affect the plan's status as a governmental plan under ERISA §3(32). Connecticut estimated that 175,000 private employees would become eligible to enroll, and the estimated number of state employees and retirees currently enrolled was 100,000. Explaining that it has not established a specific number of employees or percentage threshold that would exceed a de minimis number for this purpose, DOL viewed the participation of private nonprofit employers in the Connecticut plan as more than de minimis. The DOL also advised that it would not treat the private nonprofit employers as governmental agencies or instrumentalities under ERISA §3(32) solely because they operate under a contract with a state agency for the purpose of providing direct health and human services to the public, or receive 50% or more of their gross annual revenue from federal, state or local grants or funding. The DOL noted previous opinions in which it concluded that private sector contractors, including nonprofit or tax-exempt organizations, are not governmental agencies or instrumentalities for purposes of ERISA §3(32) merely be-

[73] Notice 2015-7, §III.A. The IRS also expects to provide transition relief for governmental plans that cover such employees before the effective date of final regulations, which are expected to apply prospectively and to include a delayed effective date. Notice 2015-7, §IV.

[74] DOL Adv. Op. 2006-05A.

[75] DOL Adv. Op. 2003-18A.

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cause they perform public service functions under governmental direction and control pursuant to contracts with governmental entities, citing DOL Adv. Op. 97-05A and DOL Adv. Op. 95-27A.

c. Credit Unions

Generally, a state-chartered credit union would not be a political subdivision of a state or an agency or instrumentality of a state or political subdivision of a state, so that its plans would not be governmental plans. Currently, though, there is some uncertainty as to whether employee benefit plans of federal credit unions may be exempt from ERISA as governmental plans within the meaning of I.R.C. §414(d) and ERISA §3(32). The IRS has indicated that, with respect to any §457(b) plan of a federal credit union, such plans can be treated as nongovernmental plans if the plan was in effect on August 15, 2005, and the federal credit union had consistently treated the plan as a nongovernmental plan for purposes of the I.R.C. and ERISA, until further guidance is issued.[76] Previously, the IRS had ruled that federal credit unions were instrumentalities of the federal government and thus were not eligible to sponsor §457(b) plans.[77]

Draft proposed regulations generally would treat a federal credit union as a nongovernmental tax-exempt organization and therefore an eligible employer under §457(e)(1)(B).[78] Draft Prop. Reg. §1.414(d)-1(c)(3) contains an example of a federal credit union that is a tax-exempt entity, has members who are individuals who share a common bond and are current or former members of specified employers, is member-owned, and is controlled by a board of directors that is elected by its membership. Using the facts and circumstances test for determining status as a governmental entity that is an agency or instrumentality of the United States, the credit union would not qualify as a governmental entity because its directors are elected by its members and are not responsible to the United States, except as required by the Federal Credit Union Act and related regulations.

4. Indian Tribe Plans

The definition of a governmental plan includes a plan that is established and maintained by an Indian tribal government (ITG), a subdivision of an ITG, or an agency or instrumentality of either.[79] All of the participants of the plan must be employees of the entity and substantially all of their services must be in the performance of "essential governmental functions" and not in the performance of commercial activities. Pending further guidance, the definition of an essential governmental function under §7871(e) is a reasonable and good faith interpretation of what constitutes an essential government function under §414(d).[80]

Notice 2006-89, as modified by Notice 2007-67, provides transitional relief to ITGs and applies a reasonable and good faith standard for compliance. Under this guidance, ITG plans may not be treated as governmental plans if they continue to accrue benefits for employees who perform certain commercial activities, specifically, employees who are employed by a hotel, casino, service station, convenience store, or marina operated by the ITG from the first day of the first plan year beginning on or after August 17, 2006. This rule does not include teachers in tribal schools. If an ITG freezes benefits to the commercial employees and adopts a new plan for those employees, the new plan will be treated as a continuation of the relevant portion of the mixed ITG plan that covered the commercial ITG employees prior to the first day of the first plan year beginning on or after August 17, 2006. However, the ITG cannot reduce the benefit formula provided to participants in the continuing commercial plan for that first plan year. The plan covering governmental employees may retain benefits for commercial employees for service before the first day of the first plan year beginning on or after August 17, 2006. Reasonable and good faith compliance also may be achieved through a spinoff into a separate plan of the assets and liabilities related to commercial employees.[81]

ITG plans that provide benefits both to employees performing essential governmental functions and employees who perform commercial activities have until the date that is six months after final regulations are issued under §414(d) to take steps to provide separate plan coverage for governmental employees and commercial employees.[82] A draft version of proposed regulations was released in November 2011.[83]

The draft proposed rules provided by the IRS would use the broader concept of governmental activity instead of the concept of essential government functions used in Notice 2006-89 and Notice 2007-67. Draft Prop. Reg. §1.414(d)-1(g)(1) would provide that a plan of an ITG is a governmental plan under §414(d) as long as the employees covered under the plan provide substantially all of their services in the performance of governmental activities of an ITG (i.e., a governmental ITG employee). Some specific activities would be defined as commercial or governmental activities. For example, governmental activities would include activities that are related to the building and maintenance of public roads, sidewalks, and buildings; public sewage and drainage facilities; public work projects (such as schools and government buildings); and public utilities and the development of newer and emerging technologies; and criminal protection services.[84] Commercial activi-

[76] Notice 2005-58.

[77] PLR 200430013.

[78] REG-157714-06, 76 Fed. Reg. 69,172, 69,179–80 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011). *See* Announcement 2011-78.

[79] I.R.C. §414(d) and ERISA §3(32), as amended by the Pension Protection Act of 2006 (2006 PPA), Pub. L. No. 109-280, §906(a), effective for any year beginning on or after August 17, 2006; Notice 2006-89. *See* Draft Prop. Reg. §1.414(d)-1(a)(3), REG-157714-06, 76 Fed. Reg. 69,172 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011); Announcement 2011-78. *But see Dobbs v. Anthem Blue Cross and Blue Shield*, 600 F.3d 1275, 48 EBC 2473 (10th Cir. 2010) (applying definition of governmental plan retroactively; remanding to determine whether all employees of ITG perform substantially all services for essential governmental functions).

[80] Notice 2006-89, §III.D.

[81] Notice 2006-89, §III.A and B.

[82] Notice 2007-67, §III, *modifying* Notice 2006-89, §III.B. *See* REG-133223-08, 76 Fed. Reg. 69,188, 69,192 (Nov. 8, 2011) (preamble).

[83] REG-133223-08, 76 Fed. Reg. 69,188 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011); Announcement 2011-79. The proposed regulations would apply to plan years beginning six months after their publication as final regulations. Transition rules would treat the plan of an Indian tribal government as a governmental plan under §414(d) if the plan makes a reasonable, good faith effort to satisfy the statute and complies with Notice 2006-89 and Notice 2007-67 or the proposed rules.

[84] Draft Prop. Reg. §1.414(d)-1(g)(6)(i).

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ties would be activities relating to the operation of a hotel, casino, service station, convenience store, or marina.[85] A facts and circumstances test would apply to other activities.[86] Under Draft Prop. Reg. §1.414(d)-1(g)(8), the determination of whether an employee is a governmental ITG employee, or instead is an employee who renders a significant portion of his or her services in the performance of a commercial activity of an ITG (i.e., a commercial ITG employee), would be based on the employee's assigned duties and responsibilities. The determination would consider the location of the employee's services in relation to the activity and the payroll treatment of the services. Subject to these factors, the determination would be based on the employee's assigned duties and responsibilities under the facts and circumstances, and compliance would be deemed if the plan operates using a reasonable, good faith interpretation of the statute and rules. The reasonable, good faith standard would apply to the assignment of employees to governmental and commercial plans only if the benefit levels provided by the separate plans are uniform, however.

ITG plans are excluded from the PBGC termination insurance requirements.[87]

5. Moratorium on Rulings and Opinions

In November 2011, IRS and the Treasury Department, working in conjunction with the DOL and PBGC, released advance notices of proposed rulemaking on the definitions of "governmental plan" and "Indian tribal governmental plan."[88] Representatives of the IRS and DOL have informally indicated that, until the regulatory project on the definition of governmental plans is finalized, there is a moratorium on rulings and opinions on the governmental plan definition.[89]

B. Church Plan

A church plan is defined in I.R.C. §414(e) and ERISA §3(33) as: "a plan established and maintained … for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under [I.R.C. §501]."[90] The statute goes on to provide that "[a] plan established and maintained for its employees (or their beneficiaries) 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 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."[91] ERISA §4021(b)(3) refers to the I.R.C. definition for determining whether a plan is a church plan for purposes of plan termination insurance.[92] However, ERISA §4021(b)(3) further provides that the plan termination insurance provisions of Title IV of ERISA do not apply to any plan that is a church plan as defined in I.R.C. §414(e) unless the plan has both made an election under I.R.C. §410(d) and notified the PBGC that it wishes Title IV to apply.

Note that the definition of "church plan" is not as limited as the definition of "church" for purposes of FICA and certain other purposes, such as the application of nondiscrimination rules to §403(b) plans.[93] As a result, a plan may be a church plan under §414(e) and exempt from ERISA under ERISA §4(b), but different rules may apply to the church plan depending upon whether the participating employer in question is a "church" or a "qualified church-controlled organization."[94]

The issue of what constitutes a "church plan" for purposes of ERISA gained prominence through a string of circuit court cases discussing whether the ERISA church plan exemption applies to religiously affiliated hospitals providing plans, despite the fact that the plans were not established by churches. The principal issue has been one of statutory interpretation — whether the above quoted language that a plan "established and maintained" by a church "includes" a plan "maintained" by a church-related organization should be interpreted to mean that a church must still have established the plan, or whether a plan

[85] Draft Prop. Reg. §1.414(d)-1(g)(7)(i).

[86] Draft Prop. Reg. §1.414(d)-1(g)(6)(ii) (including absence of relevant factors for a commercial activity and whether activity provides public benefit to ITG members) and §1.414(d)-1(g)(7)(ii) (including whether activity is type that is operated to earn profit, typically performed by private businesses, and has customers substantially from outside of Indian tribal community).

[87] ERISA §4021(b)(2), as amended by Pub. L. No. 109-280, §906(a)(2)(B), and former ERISA §4021(b)(14), as added by Pub. L. No. 109-280, §906(b)(2)(C). Former ERISA §4021(b)(14) was struck when technical corrections were made to the Pension Protection Act of 2006, presumably because it duplicates the provision in ERISA §4021(b)(2). Pub. L. No. 110-458, §109(d)(2), effective as if included in Pub. L. No. 109-280 (i.e., applicable to any year beginning on or after August 17, 2006). Pub. L. No. 110-458, §112.

[88] REG-157714-06, 76 Fed. Reg. 69,172 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011). *See* Announcement 2011-78; REG-133223-08, 76 Fed. Reg. 69,188 (Nov. 8, 2011), as corrected at 76 Fed. Reg. 76,633 (Dec. 8, 2011); Announcement 2011-79.

[89] *See* Rev. Proc. 2025-3, §3.01(67) (IRS does not issue determination letter on whether plan is governmental plan under I.R.C. §414(d)).

[90] I.R.C. §414(e)(1); ERISA §3(33)(A).

[91] I.R.C. §414(e)(3)(A); ERISA §3(33)(C)(i). In PLR 202051003, the IRS ruled that retirement plans administered by a church-affiliated university that is a tax-exempt §501(c)(3) organization qualifies as a church plan under §414(e). The university is controlled by or associated with the church: the university is governed by the board of trustees that is at least two-thirds members of church leadership or church conference; any trustee can be removed at any time by the electing church body; the committee responsible for the oversight of compensation and benefits consists solely of the board of trustees members; eligible plan participants may not be considered employed in connection with one or more unrelated trades or businesses under §513; and all eligible participants are university employees and do not include employees of for-profit entities. In PLR 201442072, the IRS ruled that a retirement plan administered by a tax-exempt ministry established by a religious order that is directly under the jurisdiction of a church's highest levels of authority qualifies as church plan under §414(e). The ministry is associated with the church based on shared common religious bonds: the ministry's sole member is the religious order's leader; its board of directors are elected by and members of the religious order; its staff must conform to the church's standards of ethics; and it is listed in the church's directory. The pension committee administering the plan also is an organization associated with the church: it consists primarily of members of the religious order; its principal purpose and function is the administration of the plan; and its members are appointed by the board, which reports annually to the leader who has the power to remove its members.

[92] The PBGC generally defers to the IRS for determinations of status as a church plan. *See, e.g.*, PBGC Op. Ltr. 78-1 (plan sponsor seeking determination of applicability of church plan exemption under Title IV of ERISA instructed to obtain IRS ruling). *See also* GCM 39007 (Nov. 2, 1982) (IRS rules on church plan status after plan sponsor seeking to terminate plan was advised by PBGC to seek ruling from IRS on church plan status; IRS ruling to be determinative of whether plan required to file Notice of Intent to Terminate with PBGC). Similar deference would likely be afforded a determination by the DOL.

[93] §403(b)(12)(B).

[94] §3121(w)(3)(A), §3121(w)(3)(B); *see* §403(b)(12)(B) and §457(e)(13).

ISBN 978-1-63359-446-3

maintained by such a church-related organization was essentially deemed to be established and maintained by a church. The U.S. Supreme Court resolved the issue in *Advocate Health Care Network v. Stapleton*,[95] holding that the ERISA exemption for church plans does not require that the plan be originally established by a church. Thus, a plan maintained by an entity described in ERISA §3(33)(C)(i), which the Court called a "principal-purpose organization,"[96] may qualify as a church plan, regardless of who established it. Before *Advocate Health Care Network v. Stapleton*, some courts supported by prior longstanding IRS and DOL church plan guidance, held, based on the interplay between ERISA §3(33)(A) and §3(33)(C) and the 1980 amendments to ERISA §3(33)(C), that a plan established by a non-church nonprofit organization, instead of by a church, could qualify as a church plan if the organization is controlled by or associated with a church.[97] The Third,[98] Seventh,[99] and Ninth Circuits,[100] in contrast, had each held that ERISA §3(33) requires that a plan may be considered a church plan only if it is established by a church or a convention or association of churches, notwithstanding the decades of IRS private letter rulings that such plans may be church plans.[101]

Comment: The U.S. Supreme Court's decision in *Advocate Health Care Network v. Stapleton* generally saves hospital and other non-church organizations with religious affiliations that consider their plans to be church plans from having to satisfy the various I.R.C. and ERISA requirements from which church plans are exempt. The decision does not address which entities fall within the scope of a "principal-purpose organization," however, and employees challenging a church plan exemption might still seek to establish that an entity's ties to the church are insufficient for it to have "principal-purpose organization" status. In addition, the decision did not consider other issues, such as what is a "church" for this purpose, what it means to be "controlled by or associated with" a church or convention or association of churches, or the constitutionality of the church plan definition, all issues raised by plaintiffs in the lower courts, because these were not before the Supreme Court.

The Tenth Circuit considered the question of what qualifies as a principal-purpose organization in *Medina v. Catholic Health Initiatives*.[102] The court stated that ERISA imposes a three-step inquiry for entities seeking to use the church plan exemption for plans maintained by principal-purpose organizations: (1) is the entity a tax-exempt nonprofit organization associated with a church; (2) if so, is the entity's retirement plan maintained by a principal-purpose organization; and (3) if so, is that principal-purpose organization itself associated with a church? In order for a tax-exempt nonprofit organization to be associated with a church, the court reasoned, the organization only needs to share common religious bonds or convictions with that church. Because Catholic Health Initiatives' (CHI) Articles of Incorporation provided that CHI was organized and operated exclusively for the benefit of the Catholic Healthcare Federation and because CHI is listed in The Official Catholic Directory, the court determined CHI is associated with a church. Next, the court needed to decide if the plan was maintained by an organization whose principal purpose is administering or funding a retirement plan for entity employees. Appellant argued that the subcommittee responsible for the administration of the plan is part of a larger organization and not an organization itself. The court disagreed, finding that the organization need not be wholly independent from the church.

Also at issue in *Medina* was the definition of "maintain." Although appellant conceded that the subcommittee administered the plan, she argued that CHI maintained it, and consequently, because CHI's principal purpose is health care and not the administration and funding of the plan, CHI cannot qualify for the exemption. The court, however, ruled that "maintain" does not necessarily include the power to modify or terminate the plan, but merely to "keep in a state of validity."

Lastly, the court explained that, because CHI is associated with the Catholic Church, it naturally follows that the subcommittee charged with administering the plan, which is a subdivision of CHI, is associated with the Catholic Church.[103] Thus,

[95] 137 S. Ct. 1652 (2017).

[96] The Court did not address the issue of whether "a church-associated organization whose chief purpose or function is to fund or administer a benefits plan for the employees of either a church or a church-affiliated nonprofit" included the hospitals' internal benefits committees. *Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652 (2017).

[97] *E.g.*, *Medina v. Catholic Health Initiatives*, 147 F. Supp. 3d 1190 (D. Colo. 2015) (Catholic Health Initiatives retirement plan is a church plan because the sponsor is associated with a church: the sponsoring organization exhibited obvious affinities with the Catholic Church and the plan administrators' expenses were paid by an organization with such affinities), *aff'd*, 877 F.3d 1213 (10th Cir. 2017); *Overall v. Ascension*, 23 F. Supp. 3d 816 (E.D. Mich. 2014) (Catholic healthcare system's retirement plan constitutes a church plan).

[98] *Kaplan v. Saint Peter's Healthcare Sys.*, 810 F.3d 175 (3d Cir. 2015) (only a church can establish a plan that qualifies for exemption under ERISA §4(b)(2); retirement plan established by church agency is ineligible for church plan exemption), *rev'd sub nom. Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652 (2017).

[99] *Stapleton v. Advocate Health Care Network*, 817 F.3d 517 (7th Cir. 2016) (plan of religiously affiliated hospital not exempt church plan under ERISA; text of statute is not ambiguous; word "includes" in ERISA §3(33)(C)(i) expands upon who may maintain plan, but not who may establish one, and ERISA §3(33)(C)(ii)(II), which states that employees of a qualifying, church-affiliated organization may be considered employees of a church for purposes of exemption, does nothing to render inoperative ERISA §3(33)(A)'s gatekeeping requirement that plan first be established by a church), *rev'd*, 137 S. Ct. 1652 (2017).

[100] *Rollins v. Dignity Health*, 830 F.3d 900 (9th Cir. 2016) (plan of religiously affiliated hospital not exempt church plan under ERISA; neither the expansion of definition of eligible employees, nor the expansion of the definition of organizations permitted to maintain church plans made by the 1980 amendments to ERISA §3(33)(C), eliminate the requirement that a church plan must first be established by a church), *rev'd sub nom. Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652 (2017). *See Durham v. Prudential Ins. Co. of Am.*, 236 F. Supp. 3d 1140 (C.D. Cal. 2017) (applying *Rollins* rationale that church plan must be established by church to disability plan of church-affiliated university; stay in *Rollins* pending Supreme Court review does not affect persuasive authority).

[101] *See, e.g.*, PLR 201319036, PLR 200023057, PLR 9717039, PLR 9525061, and PLR 9409042, among hundreds of rulings. *See also* Robert Rachal, *Pension Plan Administration and Court Deference to the IRS — The 'Church Plan' Cases as a Case Study on the Significance of Agency Deference to Plan Administration*, 42 BNA Pens. & Ben. Rep. 705 (Apr. 14, 2015); Mary K. Samsa & Joseph K. Urwitz, *The Church Plan Struggle as Litigation Unfolds*, 41 BNA Pens. & Ben. Rep. 1320 (June 24, 2014).

[102] 877 F.3d 1213 (10th Cir. 2017).

[103] The court determined that it was not necessary to determine the precise scope of what it means for a principal-purpose organization to be associated with a church, because, as a matter of logic, a subdivision wholly encompassed by a larger entity shares that entity's affiliations.

ISBN 978-1-63359-446-3

the court determined that CHI did qualify for the church plan exemption.[104]

A faith-based organization may maintain a plan that does not qualify as a church plan, in which case the plan is subject to regulation like any other ERISA plan. In *Story v. Aetna Life Insurance Co.*,[105] a participant in an employer-sponsored welfare plan brought claims under state law challenging the termination of her long-term disability insurance benefits. The court held that the state law claims were preempted by ERISA, rejecting the participant's argument that ERISA did not apply because the plan constituted a church plan exempt from ERISA's requirements. The church plan exemption did not apply, the court reasoned, because the plan documents indicated that the employer's intent was to treat the plan as an ERISA plan, the employer filed a Form 5500 on behalf of the plan with the Department of Labor, and the plan sponsor did not require a certain percentage of its workforce to be of a particular faith or receive financial assistance from any church.

Comment: Church plans that are exempt from ERISA risk liability under state fiduciary standards, contract law and insurance rules. Some plan sponsors may find it advantageous to maintain an ERISA plan and comply with a single federal regulatory structure rather than various state laws. In one of the first cases challenging the traditional interpretation of the church plan definition, for example, former employees of a church-related publishing house, which had terminated an underfunded defined benefit plan and substantially reduced the pensions paid to participants, challenged the longstanding interpretation of these MEPPA provisions. While the district court in that case rejected the argument by the former employees that a church plan had to have been established by a church and could not be sponsored by an organization that is only controlled by or associated with the church, the court would not dismiss state law claims against the Lutheran denomination of which the publishing house was a part and which were generally based on alter ego liability theories.[106]

1. Bases for Establishing Church Plan Status

As noted above, there are two bases upon which a plan may be considered as a church plan. The first is if the plan is established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches that is tax-exempt under §501. Second, a plan that is not established and maintained by a church or a convention or association of churches also may be treated as a church plan if the plan covers persons who may be deemed employees of a church, or a convention or association of churches, and the plan is maintained by an organization that is controlled by or associated with a church or convention or association of churches and that has as its principal function the administration of retirement or welfare benefits to church employees.

These situations are discussed in more detail below.

a. Plan Established and Maintained by Church or by Convention or Association of Churches

The initial inquiry in establishing whether a plan satisfies the first basis for being a church plan is determining whether the entity that has established it is a church or a convention or association of churches.

(1) Church Defined

Although every church is a religious organization, not every religious organization is treated as a church under the I.R.C.[107] The term "church" is not defined in the I.R.C., ERISA or regulations. However, the IRS has developed criteria to be used in identifying organizations that qualify for church status for federal income tax purposes. These are as follows:

- a distinct legal existence;
- a recognized creed and form of worship;
- a definite and distinct ecclesiastical government;
- a formal code of doctrine or discipline;
- a distinct religious history;
- a membership not associated with any other church or denomination;
- a complete organization of ordained ministers serving their congregations and selected after completing prescribed courses of study;
- a literature of its own;
- established places of worship;
- regular congregations;
- regular religious services;
- schools for the religious instruction of the young; and
- schools for the preparation of its ministers.[108]

The IRS also will consider any other facts and circumstances that may bear upon the organization's claim to church status.[109]

These criteria have been adopted or cited by a number of courts.[110] No one factor is controlling, although the existence of

[104] The court also found no violation of the Establishment Clause.

[105] No. 4:13-cv-00149-A, 2013 BL 217694 (N.D. Tex. Aug. 8, 2013).

[106] *Thorkelson v. Publ'g House of the Evangelical Lutheran Church in Am.*, 764 F. Supp. 2d 1119, 50 EBC 2154 (D. Minn. 2011).

[107] *See, e.g., VIA v. Commissioner*, T.C. Memo 1994-349; *Chapman v. Commissioner*, 48 T.C. 358 (1967); *De La Salle Inst. v. United States*, 195 F. Supp. 891 (N.D. Cal. 1961). *See* 484 T.M., *Tax Issues of Religious Organizations* (Estates, Gifts, and Trusts Series).

[108] *See* IRS Pub. 1828, *Tax Guide for Churches and Religious Organizations*; GCM 37116 (May 9, 1977) (association not church or convention or association of churches under §6033(a)(1) because it has few characteristics looked to by IRS and courts in determining whether religious organizations are churches for I.R.C. purposes). See also Joint Committee on Taxation, "Overview of Tax Rules Applicable to Exempt Organizations Engaged in Television Ministries" (JCS-21-87) (Oct. 5, 1987), which contains a brief summary of what constitutes a "church."

[109] IRS Pub. 1828.

[110] *See, e.g., Lutheran Soc. Serv. of Minn. v. United States*, 758 F.2d 1283, 1286–87 (8th Cir. 1985); *Am. Guidance Found. v. United States*, 490 F. Supp. 304, 306 (D.D.C. 1980), aff'd without op. (D.C. Cir. 1982); *Church of the Visible Intelligence That Governs the Universe v. United States*, 4 Cl. Ct. 55 (1983). *But see Found. of Human Understanding v. Commissioner*, 88 T.C. 1341 (1987) (court found criteria "helpful" but does not adopt; found organization has sufficient "associational aspects" to be considered church).

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an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code have been held to be of central importance.[111] The existence of a membership not associated with any other church or denomination has been deemed to be particularly significant.[112]

In *Advocate Health Care Network v. Stapleton*,[113] the Supreme Court ruled that a "plan established and maintained … by a church" includes a plan maintained by a principal-purpose organization. The Supreme Court concluded that a plan maintained by a principal-purpose organization therefore qualifies as a "church plan," even if a church did not establish it.

Comment: This definition of "church" would tend to exclude evangelical religious ministries, sometimes referred to as "para-church" organizations, even though their principal purpose may be to hold religious services in order to convert others to their religion, because the members of such organizations tend to belong to other churches. Such ministries also tend to lack a number of other factors that appear in a traditional religious denomination, such as an established place of worship, an ecclesiastical government, regular congregations, and schools for instruction of the young.[114] However, there were relatively few such organizations at the time the IRS criteria for defining a church developed. The role of such organizations and their connections to traditional churches grew throughout the 1990s, and some practitioners question whether the definition of church should be interpreted more broadly so as to include such organizations. Some such organizations alternatively may attempt to qualify as religious orders, as described below.

(2) Religious Orders as Churches

For purposes of §414(e), the term "church" 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.[115] The IRS has stated that a religious order or organization will be considered to be engaged in carrying out the functions of a church if its duties include the ministration of sacerdotal functions and the conduct of religious worship. What constitutes the conduct of religious worship or the ministration of sacerdotal functions depends on the tenets and practices of a particular religious body constituting a church.[116]

Much of the early controversy concerning status as a church involved religious orders. Religious orders may have many attributes of a church and may qualify as a church. The general rule has been that a religious order is treated as a church for purposes of federal income taxation only if it is principally engaged in religious activities.[117] Although the IRS has not attempted to define what constitutes a "religious activity," it has taken the position that an organization's principal activity will not be considered religious if such activity would serve as a basis for exemption on other than religious grounds under §501(c)(3).[118] Thus, a religious order whose primary function was operating a hospital would not be considered a church because operating a hospital provides a nonreligious basis for exemption under §501(c)(3).[119] For reasons set out in II.B.1.b., below, however, this determination may not preclude a plan covering employees of the hospital from being a church plan, because the hospital will often otherwise be controlled by or associated with a church for purposes of §414(e).

(3) Convention or Association of Churches

The phrase "convention or association of churches" is not defined in the I.R.C. or regulations. Generally, the IRS has interpreted the phrase "convention of churches" to be a statewide, regional, or national group of churches of the same denomination that engages in cooperative efforts.[120] An "association of churches" has been described as a group of churches organized on less than a statewide level.[121] The IRS has ruled that an organization was qualified as an association of churches even

[111] *Am. Guidance Found.*, 490 F. Supp. 304.

[112] See, e.g., *Chapman v. Commissioner*, 48 T.C. 358, in which the court held that an evangelical organization performing dental work for missionaries, religious workers and natives was not a church where: (1) organization's individual members maintained their affiliation with various churches; (2) organization was inter-denominational and did not seek converts other than to principles of Christianity generally; and (3) organization did not ordain its own ministers. The court noted that the fact that members conducted religious services was not conclusive per se that the organization was a church.

[113] 137 S. Ct. 1652 (2017).

[114] *See, e.g., Young Life Campaign v. Patino*, 176 Cal. Rptr. 23 (Cal. App. 3 Dist. 1981) (applying *Chapman,* in holding Young Life to be church for state unemployment tax purposes); *but see Young Life v. Division of Emp't and Training*, 650 P.2d 515 (Colo. 1982) (Young Life held not to be church for state unemployment tax purposes); and *Campus Crusade for Christ v. Unemp't Appeals Comm'n*, 702 So.2d 572 (Fla. App. 5 Dist. 1997) (distinguishing *Patino*).

[115] Reg. §1.414(e)-1(e).

[116] Reg. §1.511-2(a)(3)(ii), which the IRS frequently refers to when citing Reg. §1.414(e)-1(e). *See, e.g.*, PLR 8849076.

[117] *See, e.g., De La Salle Inst. v. United States*, 195 F. Supp. 891 (N.D. Cal. 1961) (religious order whose main activities were operating schools and winery was not church for purposes of §511(a)(2)(A) which at that time exempted churches from tax on unrelated business income). See also GCM 37266 (Sept. 22, 1977) (revoked on other grounds), which specifically deals with the status of a religious order as a church for purposes of §414(e) and provides a good discussion concerning whether religious orders should be treated as churches. *But see Harclerode v. Sisters of Mercy*, No. 79-4022 (D. Kan. Nov. 2, 1981), an unpublished decision that involved a claim that a retirement plan maintained by the order violated the vesting requirements of ERISA. The order operated a hospital. The court granted summary judgment to the order on the ground that the plan was a church plan to which the vesting requirements were inapplicable, finding that as long as the hospital was tax exempt under §501 there was no requirement that it have a religious purpose. This position was expressly rejected by the IRS in GCM 39007 (Nov. 2, 1982), which termed the court's analysis "weak" and noted that *Harclerode* was a private action to which neither the DOL nor the Treasury were parties. In Rev. Proc. 91-20, the IRS set forth guidelines it applies in determining whether an organization qualifies as a religious order for employment tax purposes. *See* V.A.3., below.

[118] *See* GCM 37266 (Sept. 22, 1977). Section 501(c)(3) exempts the following from income tax: corporations, and any community chest, fund, or foundation, organized and exclusively operated for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment) or for the prevention of cruelty to children or animals.

[119] *See* GCM 37266 (Sept. 22, 1977) (concluding that retirement plan maintained by order for its lay employees was not church plan). This IRS Memorandum was one of the factors leading to the amendment of the church plan definition to include plans maintained by principal purpose organizations in the Multiemployer Pension Plan Amendment Act of 1980 (MPPAA), Pub. L. No. 96-364. Following that change in the law, the IRS changed its position in GCM 39007 (Nov. 2, 1982), which, while not conceding that a religious order was not a church, nevertheless held that a plan established and maintained by the order could be a church plan.

[120] *See* PLR 8309092 and PLR 201345041.

[121] *See* PLR 8309092 and PLR 201345041.

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though it was comprised of churches of different denominations.[122]

In one ruling, the IRS indicated that a group of churches will qualify as a convention or association of churches only if the group principally engages in religious activities.[123] Thus, a group of churches that sent ministers to nursing homes, hospitals, and other institutions not normally visited by clergymen, but which also provided social services such as marriage counseling, adoption services, and refugee placement, and which operated a fundraising program was not considered an association of churches for purposes of §6033 because its activities were not principally religious.[124] In contrast, an organization was considered to be an association of churches under §6033 where the activities of the organization included making grants and loans for construction of new churches, awarding scholarships and grants for the education of missionaries and their children, and the operation of chaplaincy programs in hospitals.[125] The IRS also seems to have taken a less restrictive view when groups of churches operate hospitals and nursing homes.[126]

Any organization that otherwise is a convention or association of churches may be comprised of individual members, including individuals with voting rights in the organization and churches.[127]

b. *Plan Maintained for Employees of Organization Controlled by or Associated with Church or Convention or Association of Churches*

As originally enacted by ERISA, the term "church plan" was limited to a plan established and maintained by a church, a convention or association of churches or, under certain limited circumstances, a plan established and maintained by a church and an agency of such church for the employees of both the church and the agency.[128] Thus, it was crucial that the entity maintaining the plan be a church.[129]

(1) *Organization Controlled by or Associated with Church*

As confirmed by the Supreme Court in 2017 in *Advocate*, the limitation on the scope of the term "church plan" as enacted by ERISA that the plan sponsor must be a church was removed by the Multi-Employer Pension Plan Amendment Act of 1980 (MEPPA).[130] Thus, §414(e)(3) provides that even if the organization maintaining the plan (for example, a church pension board or retirement committee) is not itself a church, a plan still may be treated as a church plan if the organization is controlled by or associated with a church, provided that the principal purpose of the organization is to fund or administer the plan or program and the plan is for the employees of a church or of a convention or association of churches.[131]

Multiple-employer plans are considered church plans only if each employer sponsoring the plan is a church that is exempt under §501(a).[132] In PLR 201323042, the IRS ruled that a benefit plan for employees of a church-affiliated organization does not qualify as a church plan because it was established as a multiple-employer plan, not all of whose participating employers were church plans. Although the plan was amended to provide that it is a collection of single-employer plans rather than a multiple-employer plan, the IRS determined that it cannot become a church plan because it was not originally established as such. In addition, the amended plan cannot be a church plan because it is merely a continuation of the original multiple-employer plan.

An organization is deemed to be associated with a church if it shares common religious bonds and convictions with the church or convention or association of churches.[133] Generally, such commonality of belief is demonstrated when members of the organization are appointed by, or are members of, the tax-exempt organization controlled by or associated with a church.[134] It has been suggested that the plan document should

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[122] Rev. Rul. 74-224 (membership comprised of Catholic and Protestant churches of various denominations; governing board consisted of two voting members from each church). *See* PLR 200235032.

[123] PLR 8309092.

[124] PLR 8309092. Section 6033(a)(3)(A)(i) exempts churches and conventions or associations of churches from certain filing requirements.

[125] PLR 8624126.

[126] *See* PLR 201345042 (hospital's successor is associated with a church or a convention or association of churches under §414(e)(3)(D) because the organization and church shared a common religious bond and the church indirectly controlled the organization through another organization; successor's employees met the definition of employee under §414(e)(3)(B), and were deemed to be employees of a church or a convention of churches); PLR 201309028 (senior housing provided by nonprofit corporation was controlled by association of churches where members of nonprofit corporation were church congregations that form religious association); PLR 199904041 (hospital controlled by two different churches was controlled by association of churches); PLR 9853053 (preschool and homes for aged controlled by two different churches were controlled by association of churches).

[127] §7701(n), added by Pub. L. No. 109-280, §1222, effective August 17, 2006, and redesignated by Pub. L. No. 110-245, §301(c)(2)(C), effective June 17, 2008.

[128] For plan years beginning before 1983, former I.R.C. §414(e)(3) permitted a plan in existence on January 1, 1974, to be treated as a church plan if it was established and maintained by a tax-exempt church and agency of the church.

[129] *See, e.g.*, TAM 8016035 (plan maintained by nonprofit hospital under church auspices not church plan); DOL Adv. Op. 75-28 (plan maintained by cemetery of diocese not church plan); DOL Adv. Op. 75-27 (plan maintained by home for disadvantaged under church auspices not church plan). *See also* DOL Adv. Op. 75-29 (plan maintained by Jewish educational institution not church plan); GCM 37266 (Sept. 22, 1977) (plan maintained by religious order that did not meet requirements for being church not church plan).

[130] Pub. L. No. 96-364.

[131] §414(e)(3)(A).

[132] Reg. §1.414(e)-1(c).

[133] §414(e)(3)(D). *See, e.g.*, PLR 200313019 (hospital organization associated with church). *But see* PLR 201420028 (qualified multiple-employer plan adopted by nonprofit with stated mission of enhancing life of Religion X community and other entities ruled not a church plan; applicant demonstrated that entities share same religion and serve same community as Religion X churches, but did not demonstrate that a church or association or convention of churches is associated with nonprofit, other entities, or committee administering the plan in such a way that employees of nonprofit and other entities could be deemed to be employed by a church, or association or convention of churches).

[134] *See, e.g.*, PLR 201538023 (entity that provides mental health, habilitation and educational services to children, adolescents and families in need for a church ministry that is controlled by church is deemed associated); PLR 201333024 (common bonds existed where committee administering retirement plan was controlled by president who was controlled by religious council); PLR 201230031 (committee administering plan was directly controlled by board that was associated with church through convention of churches); PLR 8734033 (committee administering plan appointed by board of religious order shares common religious bonds with order and, thus, with church); PLR 8326165 (common bonds existed where two of three members of retirement committee must be members of religious order). *See also* DOL Adv. Op. 86-19A and DOL Adv. Op. 86-4A (association with church assured because

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recite that the organization administering the plan shares common religious bonds and convictions with the church.[135]

It is not necessary for the individuals who administer the plan to do so on a full-time basis or for that role with the organization to be their principal activity or responsibility, provided that the organization itself has the administration of the plan as its principal purpose.[136] This is normally satisfied by having the plan administered by a special committee, made up of persons who are appointed by and may be removed by the organization.[137]

(2) Employee of Church or Convention or Association of Churches

Section 414(e)(3)(B)(ii) provides that the term "employee of a church or a convention or association of churches" includes "an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under §501 and which is controlled by or associated with a church or a convention or association of churches." Thus, it is not necessary for the actual employer to be a church, provided that the employing organization is exempt from tax under §501 and is "controlled by or associated with a church."[138]

(3) "Controlled by" or "Associated with" Church

An organization is deemed controlled by a church if a majority of the officers and directors are appointed by the church's governing board or by officials of a church.[139] An organization is deemed associated with a church if it is shown to share common religious convictions and bonds.[140] For organizations under the auspices of the Roman Catholic Church, common religious convictions and bonds may be demonstrated by showing that the organization is listed in *The Official Catholic Directory*.[141] Many religious denominations publish similar directories.

In PLR 9038057, the IRS ruled that a religious educational institution operated under the aegis of an unidentified conference of churches was not closely associated enough with a convention of churches under §414(e)(3)(D) for its retirement plan to qualify as a church plan. The IRS explained that such association requires a clearly identifiable relationship that is more than incidental and which may be demonstrated by: (1) the sharing of common religious bonds and convictions through the carrying out of functions of a church and having a mission parallel to those of churches; (2) the presence of church influence over the general direction of the associated organization; (3) significant appointments to the associated organization's governing board; (4) preferential treatment of church members with respect to hiring practices; (5) the involvement of a majority of church members on the organization's operations and activities; (6) the sponsoring of activities designed to support the religious mission of a particular church; and (7) the level of financial support an organization receives from a church. Among the most significant facts cited by the IRS in support of its conclusion were that under the school's charter, the conference only appointed five of the school's 33 trustees; less than 0.5% of the school's annual revenues came from the conference; and the school did not give an admissions preference or a faculty hiring preference to church members.

In GCM 39832, the Chief Counsel's Office noted that different religions grant different levels of autonomy to their constituent organizations. Therefore, although such an entity's listing in an annual directory of churches signifies a strong association, that listing alone, without further indicia of affiliation or association, does not support a conclusion that the entity is associated with the convention or association of churches. Rather, the statutory test for association is based on the facts and circumstances of each case.

PLR 201308033 involved the plan of a nonelecting §501(c)(3) corporate organization formed to establish and maintain a religion's educational institutions under the patronage of that religion's central body (Congregation G) and to prepare students to become clerics, religious teachers and communal service workers for that religion, and to grant educational degrees. The organization was the sole seminary that ordains seminarians for that religion, and many of its employees were ordained clerics. The IRS noted that the corporation is an organization sponsored by and affiliated with Congregation G, receives financial support and oversight from Congregation G, and is engaged in carrying out the functions of the church in furtherance of Congregation G's mission. Accordingly, the

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order appoints and removes committee members, who are required to be members of order which is part of church).

[135] *See* GCM 39007 (Nov. 2, 1982). The IRS noted that because the plan was being terminated, proof of association with the church could be shown by parol evidence. *See also* GCM 39793 (July 6, 1989) (plans specifically required members of administrative committee to share common religious bonds or to be member of church associated with convention or association of churches).

[136] *See* GCM 39007 (Nov. 2, 1982).

[137] *See, e.g.*, PLR 199951050.

[138] *See, e.g.*, GCM 39793 (July 6, 1989) (employees of tax-exempt private college controlled by association of churches deemed to be employees of such association); PLR 201803007 (hospital employees are deemed employees of the religious order, where the hospital is sponsored and controlled by the religious order, by virtue of being employees of a §501(c)(3) organization which is controlled by or associated with the order; thus, the hospital's §401(a) and §403(b) plans are §414(e) church plans); PLR 201425025 (employees of §501(c)(3) organizations participating in self-funded health benefit plan are deemed to be church employees, as each has a church involved in its governance, receives financial support from a church, or is otherwise sufficiently associated with a particular church; plan is sponsored and administered by §501(c)(3) organization formed primarily for that purpose for religious denomination and allowing in membership only churches and organizations associated with denomination and qualified to maintain a church plan, and ruled to be an organization described in §414(e)(3)(A)); PLR 201339004 (employees of school that has common religious bond to church, is included in the church directory and is indirectly controlled by the church are church employees); PLR 201322051 (employees of private non-profit college preparatory school are deemed to be employees of church by virtue of being employed by school controlled by religious society); PLR 201224042 (employees of nonprofit corporation formed to lobby on behalf of religious society are church employees); PLR 201222052 (employees of organization that assists church-sponsored schools are church employees); PLR 200305031 and PLR 200313019 (employees of church-affiliated hospitals are church employees).

[139] Reg. §1.414(e)-1(d)(2). *See, e.g.*, PLR 201739010 (entity whose board of directors elects committee as administrator and fiduciary of retirement plan, where entity is an affiliate of church, is sufficient to establish association; retirement plan determined to be qualifying church plan); PLR 201415015 (nonprofit corporations operating jointly as continuing care retirement community and maintaining welfare benefit plan are controlled by church; church conference founded them and selected all directors, and plan's administrative control is vested in committee that is controlled by church through conference's controlling power over board of directors and a majority of whose members must be directors).

[140] Reg. §1.414(e)-1(d)(2).

[141] Published annually by P.J. Kennedy & Sons, New Providence, NJ. *See, e.g.*, PLR 8919066, PLR 8734033, PLR 8606038, and PLR 8326165. *See also* GCM 39007 (Nov. 2, 1982); DOL Adv. Op. 86-19A and DOL Adv. Op. 86-4A.

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IRS concluded that the organization satisfied the requirements of §414(e)(3)(D) as an organization that is associated with a church or a convention or association of churches because it shares common religious bonds and convictions with and is controlled by Congregation G. Further, noting that the organization's employees, except for some non-U.S. residents, were eligible to be plan participants, and ordained clerics and ministers of the gospel who were faculty members were also designated as employees, the IRS concluded that, under §414(e)(3)(B) and §414(e)(3)(C), the organization's employees were deemed to be employees of Congregation G and that Congregation G was deemed to be the employer of those employees for purposes of the church plan rules. Finding that the plan's administrative committee qualified as an organization described in §414(e)(3)(A), the IRS ruled that the plan was a church plan as defined in §414(e).

In PLR 201222052, the IRS ruled that a separately incorporated §501(c)(3) organization that exists primarily to assist religious schools sponsored by a particular church is associated with a church under §414(e)(3)(D), and thus, the organization's retirement plan qualified as a church plan. The IRS noted that this organization is housed in the church's main offices rent-free, is considered an "allied organization" of the church and is listed in the church's annual directory. The executive director is required to be a priest, deacon, or lay communicant in good standing in the affiliated church, and the presiding bishop of the church sits as honorary chair of the organization's governing board. Similarly, in PLR 201224042, the IRS found that a nonprofit corporation that was formed to coordinate and enhance the efforts of a religious society to lobby government officials is associated with a church. The corporation was listed in a directory associated with the religious society, and most members of its governing committee were appointed by the religious society, the IRS reasoned. The IRS applied similar reasoning in PLR 201247023, ruling that an unincorporated religious §501(c)(3) organization that was included in a church's official directory of related organizations was associated with the church for purposes of §414(e)(3)(D).

In PLR 9645007, the IRS concluded that the associational nexus under §414(e)(3)(D) could be found in the institutional connections between the church and the organizations that maintain the church plans, and includes the existence of common religious beliefs, and that a proposed restructuring of these supporting organizations (done in connection with registration of the funds under the 1940 Investment Company Act) will not alter this associational nexus (and also will not subject the plan to §501(m), relating to the provision of commercial-type insurance).

A church or convention or association of churches is treated as the employer of an individual who is employed by a tax-exempt organization that is controlled by or associated with such church.[142] Thus, a church or other organization could maintain a plan covering employees of an organization that is controlled by or associated with it.

Example: Organization B, a religious order, wholly owns Organization C, a nonprofit corporation that is listed in *The Official Catholic Directory* and is exempt from tax under §501. Organization C controls various health care and educational institutions, each of which also is exempt from tax. Organization C establishes Plan X for its employees and the employees of various institutions it controls. Because Organization C is listed in *The Official Catholic Directory,* it is considered associated with the Roman Catholic Church. Its employees are thus considered employees of the church under §414(e)(3)(B)(ii). Because the employees of the various institutions work for tax-exempt organizations that are associated with a church, they may be treated as employees of Organization C pursuant to §414(e)(3)(C).[143] Therefore, Organization C's plans would be considered church plans. Note, however, that because Organization C is not itself a church, its plans must be administered by an organization whose principal purpose is to fund or administer the plans.[144]

Conversely, being a religious charity without being controlled by or associated with a church or convention or association of churches is not sufficient for the religious charity's plans to be church plans.[145]

c. Church Plan Status Rulings

Rev. Proc. 2011-44 modified the usual private letter ruling process prescribed in the annual revenue procedure for obtaining rulings and determination letters (other than from the Tax-Exempt/Government Entities Division)[146] to require that plan participants, beneficiaries and alternate payees receive a notice that a request for a ruling on church plan status has been requested from the IRS. The Revenue Procedure includes a model notice to be provided by the applicant for the ruling. A copy of the notice, together with a statement that the notice was provided, must be included with the ruling request. The statement must specify the date or dates the notice was provided, and the date must be within 30 days before the letter ruling request is submitted to the IRS. For ruling requests already pending on September 26, 2011, the applicant had until November 25, 2011, to submit a copy of the notice to interested persons (modified to specify that the letter ruling request has already been submitted to the IRS) to the IRS along with a statement in a cover letter referencing the pending ruling request and stating the date or dates on which such notice was provided. Prior to issuing Rev. Proc. 2011-44, representatives of the IRS and DOL informally indicated that there was a moratorium on rulings and opinions on church plan status except in the situation of plans sponsored by churches which have been church plans since adoption and always been treated as church plans.

[142] §414(e)(3)(C).

[143] *See* PLR 8606038. *See also* PLR 200236046 and PLR 200236048 (plans maintained by church-controlled §501(c)(3) charities listed in official church directories qualify as church plans); PLR 8734033 (organization establishing plan and all participating employers were listed in official directories, all employees should be treated as church employees).

[144] §414(e)(3)(A). *See, e.g.*, PLR 201803007 and PLR 199951050.

[145] *Chronister v. Baptist Health*, 442 F.3d 648, 37 EBC 1303 (8th Cir. 2006); *Lown v. Continental Casualty Co.* 238 F.3d 543, 25 EBC 1838 (4th Cir. 2001); *cf. Hall v. USAble Life*, 774 F. Supp. 2d 953, 51 EBC 1074 (E.D. Ark. 2011).

[146] *See* Rev. Proc. 2025-1, App. E.

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2. Exclusions from Church Plan Definition

The term "church plan" does not include: (1) a plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of a church who are employed in connection with one or more unrelated trades or businesses within the meaning of §513; or (2) a plan whose participants are not substantially comprised of employees defined in §414(e)(1) or §414(e)(3)(B).[147]

"Employees" generally includes: (1) ministers, regardless of the source of their compensation; (2) employees of a tax-exempt organization controlled by or associated with a church; or (3) employees who have separated from service and whose account balance or accrued benefit remains in the plan or on whose behalf contributions are made for a period of up to five years after separation.[148]

a. Plan Established or Maintained Primarily for Benefit of Employees Employed in Connection with Unrelated Trade or Business

(1) Employment in Connection with Unrelated Trade or Business

Section 513(a) defines the term "unrelated trade or business" with respect to a tax-exempt organization as, "any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501."[149]

A "trade or business" generally includes any activity carried on for the production of income from the sale of goods or performance of services.[150]

A church employee is employed in connection with an unrelated trade or business if a majority of such employee's duties and responsibilities are directly or indirectly related to the carrying on of such trade or business.[151] In making this determination, reference is made to the employee's total responsibilities. Thus, an employee may have insignificant responsibilities with respect to any one trade or business, but when all trades or businesses are considered together, these duties may represent the majority of such person's duties with respect to employment with the church.[152]

Reg. §1.414(e)-1(b)(2) sets out tests for determining whether a plan was established and maintained primarily for the benefit of employees who are not employed in connection with an unrelated trade or business.

(2) Establishment Test

(a) Plan Not in Existence on September 2, 1974

A plan that was not in existence on September 2, 1974, will be considered established primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses if, on the date the plan is established, less than half the employees of the church eligible to participate in the plan are employed in connection with an unrelated trade or business.[153]

For purposes of this test, an employee will be considered eligible to participate in a plan if the employee is a participant or could be a participant upon making mandatory employee contributions.[154]

(b) Plan in Existence on September 2, 1974

A plan in existence on September 2, 1974, will be considered established primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses only if the persons employed in connection with such unrelated trades or businesses comprised less than one-half of all persons participating in the plan at any time during the plan year, and, in the same year, such persons received less than one-half of the total compensation paid by the employer to participants during the plan year.[155] This second test only applies if the benefits or contributions are based on compensation.[156] The plan must have met these rules in either of its first two plan years ending after September 2, 1974.[157]

(3) Maintenance Test

To be treated as maintained for the benefit of employees who are not employed in connection with unrelated trades or businesses, for plan years ending after September 2, 1974, a plan must meet the requirements of the establishment test discussed above in four out of five of its most recent plan years.[158] The determination that a plan is not a church plan applies to the second year within a five-year period in which it fails to meet the requirements, and to all subsequent years.[159] If a plan has not completed five plan years, it will be considered a church plan unless it fails to meet the requirements in at least two plan years.[160]

(4) Facts and Circumstances Test

A plan that meets the establishment test but fails the maintenance test still may be considered a church plan under Reg. §1.414(e)-1(b)(2)(ii) and §1.414(e)-1(b)(2)(iii) if it can demon-

[147] §414(e)(2).

[148] §414(e)(3)(B), §414(e)(3)(E). *See* PLR 201323043 (employees of tax-exempt associations were considered employees of convention of churches because of common religious bonds and shared funding between associations and convention). This dovetails with the ability to make contributions to a §403(b) plan for five years after termination of employment. *See* §403(b)(3); Reg. §1.403(b)-4(d).

[149] The term does not include a trade or business: (1) in which substantially all the work is performed for the organization without compensation; (2) that consists of selling merchandise that has been received by the organization as gifts or contributions; or (3) that is carried on primarily for the convenience of members, students, officers or employees. §414(e)(3)(B), §414(e)(3)(E).

[150] Reg. §1.513-1(b).

[151] Reg. §1.414(e)-1(b)(3).

[152] Reg. §1.414(e)-1(b)(3).

[153] Reg. §1.414(e)-1(b)(2)(i)(A).

[154] Reg. §1.414(e)-1(b)(2)(iv).

[155] See Reg. §1.414(e)-1(b)(2)(i)(B), which refers to the requirements set out in Reg. §1.414(e)-1(b)(2)(ii)(A) and §1.414(e)-1(b)(2)(ii)(B).

[156] Reg. §1.414(e)-1(b)(2)(ii)(B).

[157] Reg. §1.414(e)-1(b)(2)(i)(B).

[158] Reg. §1.414(e)-1(b)(2)(ii).

[159] Reg. §1.414(e)-1(b)(2)(ii).

[160] Reg. §1.414(e)-1(b)(2)(ii).

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strate on the basis of all facts and circumstances that it is maintained primarily for the benefit of employees who are not employed in connection with one or more unrelated trades or businesses. Among the facts and circumstances considered are:

- The margin by which the plan fails to meet the requirements.
- Whether the failure was due to a reasonable mistake as to what constituted an unrelated trade or business, or a reasonable mistake as to whether particular persons were employed in connection with an unrelated trade or business.[161]

b. Plan in Which Less Than Substantially All Participants Are Employees

In addition to the rule that less than half of the participants may be engaged in unrelated trades or businesses, §414(e)(2)(B) requires that "substantially all" of the participants must be employees described in §414(e)(1) or §414(e)(3)(B), that is, clergy or lay people employed by a church, convention or association of churches or a §501 organization controlled by or associated with the church. In other words, employees of nonprofit organizations not related to the church, and employees of for-profit organizations, even if owned or controlled by the church, must be excluded from participation in the plan if it would result in less than "substantially all" participants being clergy or lay employees employed by or associated with the church. The regulating agencies have not issued clear guidance on when the plan may not be substantially comprised of employees defined in §414(e)(1) or §414(e)(3)(B). As a result, care should be taken in covering non-church employees. However, several opinions and private letter rulings indicate that it is acceptable for a de minimis number of the individuals included in the plan to not be church employees.[162]

3. Church Plans, Chaplains and Self-Employed Ministers

A duly ordained, commissioned, or licensed minister of a church may participate in a church plan if the minister is: (1) a self-employed individual; or (2) is employed by an organization other than an organization described in §501(c)(3) and with respect to which the minister shares common religious bonds.[163] This latter clause is apparently intended to refer to chaplains working with unrelated, non-tax-exempt institutions, such as for-profit hospitals, prisons or the military. For purposes of §403(b)(1)(A) and §404(a)(10), a self-employed minister is treated as employed by the minister's own employer, which is an organization described in §501(c)(3) and exempt from tax under §501(a).[164] This is intended to clarify that contributions to a §403(b) plan or §401(a) plan by a minister are to be deductible or excludible from the minister's gross income as though they were made by a nonprofit employer of the minister. For purposes of the minister participating in a §403(b)(9) plan, includible compensation is determined by reference to the minister's earned income (within the meaning of §401(c)(2)) from his or her ministry.[165]

A chaplain engaged in the exercise of his or her ministry who is participating in a church plan but who is employed by an employer not participating in that plan may be excluded for purposes of nondiscrimination testing by that employer.[166]

As an anti-abuse rule, any compensation taken into account in determining the amount of contributions to or benefits under a church plan may not be taken into account in determining the amount of any contributions made to, or benefits provided under a non-church plan.[167]

4. Church Plan Definition Remedial Period

A plan that fails any of the church plan requirements may correct that failure and be deemed to meet the requirements for the year of the correction and for all prior years if the correction is made by the latest of the following dates:

- The period ending 270 days after the date the Secretary of the Treasury mails a notice of default with respect to the plan's failure to meet the requirements.
- Any period set by a court of competent jurisdiction after rendering a final determination that the plan fails to meet the requirements. If the court fails to specify the period, the period will be any reasonable time set by the Secretary of the Treasury, not to be less than 270 days from the date the determination becomes final.
- Any additional period deemed reasonable and necessary by the Secretary of the Treasury for correcting the default.[168] A plan that does not correct deficiencies within the appropriate correction period will be deemed to have failed the church plan requirements beginning with the date on which the earliest failure to meet any requirement occurred.[169] Once a plan has failed to meet the church plan requirements, and has not corrected any failure within the remedial period, it cannot thereafter become a church plan.[170]

Comment: Though it has now been settled that a church plan does not have to have been established by a church, it re-

[161] Reg. §1.414(e)-1(b)(2)(iii).

[162] In the following instances, participation by a relatively small number or percentage of employees employed in connection with unrelated trades or businesses did not impair status as a church plan: PLR 201230031 (four or five out of 450 participants (about 1%)), PLR 9810034 (130 out of 5,218 participants), PLR 9441040 (less than 7.5%), PLR 9204034 (less than 5%), PLR 8734045 (six out of 2,200 participants); DOL Adv. Op. 86-25A (one out of 5,924 participants — although this was deemed "not substantial"; DOL noted its position could change if additional for-profit corporations adopted the plan or if relative ratio of participants employed in connection with unrelated business increases, or if employers not sharing common religious convictions with church are approved for participation); DOL Adv. Op. 85-01A (37 out of 954 participants); and PBGC Op. Ltr. 82-3 (five to 10 participants out of 370).

[163] §414(e)(5)(A)(i).

[164] §414(e)(5)(A)(ii), §414(e)(5)(E), §404(a)(10).

[165] §414(e)(5)(B).

[166] §414(e)(5)(C).

[167] §414(e)(5)(D).

[168] §414(e)(4). *See* PLR 200235032 (amendment of plan within correction period of §414(e)(4)(C)(i) to establish retirement plan committee to administer plan allows amended plan to constitute church plan retroactive to plan's effective date); PLR 9217045 (plan's failure to meet certain church plan qualification requirements was corrected by termination of unaffiliated for-profit corporation's status as participating employer within allowable correction period so that plan meets requirements for year of correction and all prior years). *See* PLR 201442072 (formal establishment of pension committee to administer plan ruled within plan's correction period).

[169] §414(e)(4); ERISA §3(33)(D).

[170] Reg. §1.414(e)-1(a).

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mains possible that the availability of the retroactive correction period under the I.R.C. and ERISA could be implicated in further litigation should the question of consistently satisfying other elements of the definition, such as maintenance by a principal purpose organization, come into question.

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III. Tax Qualification

A. Pension Plans — Statutory Framework

The purpose of ERISA is to protect the interests of plan participants and their beneficiaries[171] by mandating certain minimum vesting, funding and disclosure requirements on plan sponsors. ERISA's substantive provisions are contained in four titles that set out the rules that employee benefit plans must meet, regardless of the tax qualification of the plan, and also delineate the division of regulatory responsibility among the DOL, IRS, and PBGC.[172]

ERISA exempts governmental plans from coverage under Titles I, III, and IV, and certain provisions of Title II.[173] In general, those same titles contain parallel exemptions for church plans that do not elect coverage provided in §410(d).[174]

B. Governmental Plans and Nondiscrimination Rules

All governmental plans (within the meaning of §414(d)) are exempted from the I.R.C.'s nondiscrimination and minimum participation rules for qualified plans.[175] Thus, a governmental plan is treated as satisfying the requirements of §401(a)(4), §401(a)(26), §401(k)(3), and §401(m). Further, state and local governmental plans are treated as meeting the nondiscrimination requirements of §403(b)(1)(D) and §403(b)(12)(A).[176] In the case of salary reduction §403(b) plans, the rule against discrimination in availability under §403(b)(12)(A)(ii) continues to apply to governmental plans.[177]

Governmental §457 plans are not subject to any nondiscrimination rules.

C. Church Plans and Nondiscrimination Rules

Church plans that are qualified under §401(a) are subject to the nondiscrimination requirements of §401(k), §401(m), and §401(a)(26) in the same manner as the plans of for-profit employers, with no exceptions for church plans,[178] other than a possible longer correction period if a requirement is violated.[179] The coverage requirements of §410(b), however, do not apply unless the plan makes an election under §410(d) (discussed at III.E., below). Instead, nonelecting §401(a) church plans must satisfy the requirements of §403(a) as in effect on September 1, 1974 (i.e., the pre-ERISA rule). For the text of pre-ERISA §401(a), see Worksheet 4 of this Portfolio. Pre-ERISA I.R.C. §401(a)(3) is discussed at III.F.4.b., below.

I.R.C. §401(a)(4) and §401(a)(5) have presented a greater potential problem for qualified nonelecting church plans.[180]

D. Advantages and Disadvantages of Qualification Under §401(a) and §403(b)

Although governmental and church plans, because of their tax-exempt status, do not benefit from the deductibility of employer contributions as do private sector plans, tax qualification of the plan and trust under §401 or satisfaction of the §403(b) requirements often is advantageous for plan sponsors and participants for the following reasons:

(1) The employer's contributions to the plan are not currently taxable to the participant even if the participant is 100% vested in his or her benefit under the plan. Taxation is deferred until the participant receives a distribution from the plan.[181] Deferral of taxation for plans other than governmental or church plans is often accomplished through unfunded nonqualified deferred compensation arrangements, including the use of grantor or rabbi trusts, which are not considered funded for this purpose.[182] Nonqualified plans are of limited use for governmental employees and for nonqualified church-controlled organizations, however, because of the strictures of §457. While an organization that is a church or a qualified church-controlled organization may use nonqualified deferred compensation arrangements (and may do so without having to limit participation to a select group of management or highly compensated employees, because nonelecting church plans are exempt from ERISA)[183] by reason that they are exempt from §457,[184] the applicability of employment taxes on nonelective contributions, at least for lay employees, often discourages their use.

(2) Qualifying distributions from a §401(a) or §403(b) plan may be rolled over to an eligible retirement plan,[185] thus, deferring the tax liability until subsequent distribution. After-tax contributions also may be directly rolled over from a qualified retirement plan to another qualified retirement plan or to a tax-sheltered annuity under §403(b) if the plan to which the direct rollover is made separately accounts for after-tax contributions (and earnings thereon).[186]

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[171] ERISA §2(b), ERISA §2(c).

[172] For a brief summary of these responsibilities, see 361 T.M., *Reporting and Disclosure Under ERISA*.

[173] ERISA §4(b)(1). Title II of ERISA includes the tax provisions of ERISA that were added to the I.R.C.

[174] ERISA §4(b)(2), ERISA §4021(b)(3).

[175] §401(a)(5)(G). Governmental plans are treated as satisfying I.R.C. §401(a)(3), §401(a)(4), §401(a)(26), §401(k), §401(m), §403(b)(1)(D), and §403(b)(12)(A)(i), and §410 for tax years beginning before August 5, 1997. Pub. L. No. 105-34, §1505(d)(2), as amended by Pub. L. No. 109-280, §861(a)(2).

[176] §403(b)(12)(C). This exemption does not extend to contribution and benefit limits of §401(a)(17). §403(b)(12)(C).

[177] §403(b)(12)(C).

[178] See the flush language following §401(a), discussed at III.F., below. For discussion of the employer aggregation rules that apply in determining whether church plans satisfy the nondiscrimination rules, see III.F.13., below.

[179] *See* discussion at III.G., below.

[180] Regulations under §401(a)(4), §401(a)(5), §401(l), and §414(s) do not apply to nonelecting church plans until further notice. Nonelecting church plans must be operated in accordance with a reasonable, good faith interpretation of these statutory provisions. Notice 2001-46.

[181] Conversely, §402(b)(1) provides that contributions to a nonqualified trust are taxable to plan participants in accordance with §83, i.e., generally at the time the contributions are made to the extent the contributions are vested.

[182] Rev. Proc. 92-64, Rev. Proc. 92-65.

[183] §457(e)(13).

[184] *See* ERISA §4(b); see discussion at III.I., below.

[185] §402(c). An eligible retirement plan includes a §401(a) plan, §403(a) annuity plan, §403(b) annuity contract, §457(b) government plan, and an IRA. §402(c)(8)(B). Rollovers from a §402A designated Roth account only can be made to another designated Roth account or Roth IRA. §402(c)(8) (flush language).

[186] §402(c)(2)(A), as amended by 2006 PPA, Pub. L. No. 109-280, §822(a), effective for tax years beginning after December 31, 2006.

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(3) Generally, nonelective employer payments to §401(a) and §403(b) plans are not subject to employment taxes,[187] although governmental plan salary reduction pick-up contributions are subject to such taxes.[188] Benefits under nonqualified deferred compensation arrangements, however, generally are subject to employment taxes, usually at the time the benefits are no longer subject to a substantial risk of forfeiture.[189] Contributions to nonqualified governmental deferred compensation plans such as §457(b) and §457(f) plans are subject to employment taxes.[190]

(4) The investment income on a tax-qualified trust generally is exempt from current federal income tax.[191]

E. Election of ERISA Coverage by Church Plans

A church plan may waive its exemption from ERISA if it makes a special election and, in the case of a defined benefit plan, notifies the PBGC that it is electing coverage.[192] Any church plan that makes this election is subject to Title I of ERISA and, if the plan is a §401(a) plan, all of the §401(a) qualification requirements, the excise tax on prohibited transactions imposed by §4975, and if a defined benefit plan, coverage by PBGC termination insurance. Only the plan administrator of the church plan may make this election.[193] The election is made by filing a statement either with the annual return required under §6058(a) (or an amended return) for the first plan year for which the election is effective or with the request for an IRS determination letter.[194] Once the election is made, it is irrevocable.[195] If the election is conditioned upon receipt of a favorable determination letter, it becomes irrevocable upon issuance of the letter.[196]

It is not clear whether a §410(d) election can be made for a church plan that is not a pension plan, such as a self-insured medical plan or other welfare plan. I.R.C. §410(d) and the regulations thereunder do not refer to any limitation of the election to pension plans. The DOL indicated a number of years ago that welfare plans could not make the election.[197] Some church organizations have expressed an interest in making such elections for welfare plans in order to obtain the benefit of ERISA preemption from state insurance regulation, at least where the plan is a single-employer welfare plan and not a multiple-employer welfare plan that does not receive the benefit of ERISA preemption. More recently, the interest in making such elections has been to preempt domestic partner laws. Courts generally have been receptive.[198] Prior to these cases, the interest in such elections for church health care plans had generally decreased as a result of the Church Plan Parity and Entanglement Prevention Act,[199] which among other things, generally provides that for purposes of certain state insurance laws, a self-insured church welfare plan will be treated as a single-employer plan. Notably, the act also provides that, "for purposes of enforcing provisions of State insurance laws that apply to a church plan that is a welfare plan, the church plan shall be subject to State enforcement as if the church plan were an insurer licensed by the State."[200] It often is not clear what state insurance laws may apply to a church plan, so the effect of this enforcement provision also is unclear.

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[187] §3121(a)(5)(A), §3121(a)(5)(D), §3121(v)(1)(A).

[188] §3121(v)(1)(B).

[189] §3121(v)(2).

[190] §3121(v)(3); *see* PLR 9024069.

[191] §501(a). Pension trusts generally are subject to the tax on unrelated business taxable income. *See* VI.B.6., below. In addition, §115 provides that gross income does not include: (1) income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof, or the District of Columbia; or (2) income accruing to the government of any possession of the United States, or any political subdivision thereof. Pension practitioners have suggested that providing pensions is an essential governmental function and that the income of a pension trust accrues to the benefit of a state or local government because it reduces the amount of future contributions needed to fund the benefits under the plan. In light of this interpretation and a broad reading of IRS News Release IR-1869, many practitioners have taken the position that fund income, including unrelated business taxable income, which is part of a governmental pension plan, could be considered tax exempt regardless of whether the plan is tax qualified.

[192] Section 410(d) and Reg. §1.410(d)-1(a) provide that certain provisions of the I.R.C. and ERISA will apply if the plan elects. An electing church plan also may choose to be covered by PBGC termination insurance. ERISA §4021(b)(3) requires that the PBGC be notified of the ERISA election if plan termination insurance is desired. A church plan would utilize the PBGC Request for Coverage Determination Form to provide such notice. *See* PBGC Request for Coverage Determination Form and Instructions (PBGC form for established plans to request determination of coverage under Title IV of ERISA; a pilot program, ending September 30, 2022 (extended from June 30, 2020), for certain proposed plans to request an opinion letter from PBGC for limited issues under ERISA §4021(b)).

[193] Reg. §1.410(d)-1(c)(2).

[194] Reg. §1.410(d)-1(c)(3). Maintaining and operating a plan as if it is subject to ERISA is insufficient to constitute an affirmative election as required under the regulations. PLR 201247023.

[195] §410(d)(2); Reg. §1.410(d)-1(b). In PLR 200350020, the IRS ruled that the merger of an electing church plan into a nonelecting church plan would adversely affect the status of the nonelecting merged plan because the merger effectively would revoke the electing plan's election. The IRS explained that although both plans had provisions that would protect accrued benefits in the case of a merger, the prohibition against revoking the election applied to the electing plan as a whole, not just to the benefits accrued. Thus, any transaction that served to directly or indirectly revoke the election would violate the irrevocability requirement.

[196] Reg. §1.410(d)-1(c)(4).

[197] *See* DOL Adv. Op. 95-07A ("It is the Department's understanding that an election pursuant to I.R.C. §410(d), as referenced in ERISA §4(b)(2), is available for purposes of Title I of ERISA only to a pension benefit arrangement").

[198] ERISA §514(b)(6)(A)(ii). In *Catholic Charities of Me., Inc. v. City of Portland*, 304 F. Supp. 2d 77, 32 EBC 1021 (D. Me. 2004), a city ordinance required Catholic Charities to extend its health and welfare benefits to the domestic partners of its employees. Catholic Charities refused and claimed the ordinance was preempted by ERISA and filed an irrevocable election so that its health plans would not be treated as church plans for purposes of ERISA. The district court ruled that the election also applies to church welfare plans and allowed Catholic Charities to make the election. Further, the court determined that the city ordinance had an impermissible connection with Catholic Charities' health and welfare plans and was preempted when the election was made. Subsequently, at least two other district court decisions have agreed that an I.R.C. §410(d) election may be made for a church welfare plan. *See Welsh v. Ascension Health*, 46 EBC 2672 (N.D. Fla. 2009) (plan administrators may make I.R.C. §410(d) election for church welfare benefit plans, but employer's election on behalf of disability plan in 2008 did not apply retroactively; thus, employee's claim that arose in 2003 was not governed by ERISA); *Geter v. St. Joseph Healthcare Systems, Inc.*, 575 F. Supp. 2d 1244 (D.N.M. 2008) (church welfare plan elected to be governed by ERISA pursuant to I.R.C. §410(d), but election was not retroactive when there is dispute as to benefits). *See also Flynn v. Ascension Health Long Term Disability Plan*, 73 F. Supp. 3d 1080 (E.D. Mo. 2014) (welfare benefits plan, whether a church plan or not, is subject to ERISA regulation on the basis of §410(d) election).

[199] Pub. L. No. 106-244, effective July 10, 2000.

[200] Pub. L. No. 106-244, §2(d).

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Several states have specific exemptions for church plans from state insurance laws.[201]

There is no means by which a governmental plan may elect to be subject to ERISA or PBGC insurance.

F. Section 401(a) Qualification Requirements

Section 401(a) sets out the requirements that a plan and trust must meet in order to be considered qualified. Many of these paragraphs cross-reference other I.R.C. sections that must be met in order to satisfy the §401(a) qualification requirements.

The flush language of §401(a) specifically exempts government and nonelecting church plans from many of the qualification requirements.[202] Governmental plans and church plans are exempt from the requirement that §401(k) plans established after December 29, 2022, have automatic enrollment for plan years beginning after 2024.[203] In addition to specific exemptions, many of the §401(a) provisions inherently are not applicable. For example, those paragraphs detailing the rules relating to stock ownership do not apply because government employers and churches do not issue stock.

Although these plans are exempt from numerous statutory requirements, some government and church entities elect to mirror some of the §401(a) qualification requirements applicable to private sector plans in order to provide participants with benefits similar to those provided by private sector plans subject to ERISA, or because they agree with the public policies underlining the provision. The method of counting service, spousal consent rules and treatment of qualified domestic relations orders are often among these.

For discussion of the employer aggregation rules that are used to determine whether a church plan satisfies the plan qualification requirements that apply to it, see III.F.13., below.

1. Determination Letters

Although not required to do so, many governmental and church plans have chosen to seek a favorable determination letter from the IRS. The IRS plan review and resulting letter safeguarded the qualified status of participant benefits, securing favorable tax treatment during accumulation and at time of distribution. The determination letter program in existence before 2017 provided for staggered five-year determination letter remedial amendment cycles for individually designed plans and six-year remedial amendment cycles for pre-approved qualified retirement plans. Beginning in 2017, however, the IRS no longer reviews interim amendments for individually designed plans on a five-year cyclical basis. Determination letters for individually designed plans are available only for initial plan qualification, qualification upon plan termination, qualification of individually designed plan resulting from merger of previously unrelated entities, and certain other limited circumstances that the IRS will identify in published guidance.[204] The IRS accepted determination letters with respect to certain individually designed statutory hybrid plans eligible for submission under Rev. Proc. 2019-20 during the 12-month period beginning September 1, 2019, and ending August 31, 2020.[205] In addition, effective October 2, 2017, and applicable solely to applications for opinion letters submitted with respect to a plan's third (and subsequent) 6-year remedial amendment cycles, IRS guidance combines the pre-approved advisory and opinion letter programs into an Opinion Letter program that covers standardized and non-standardized plans.[206]

A plan seeking a favorable determination letter from the IRS in reference to plan qualification must file the Form 5300 series. However, this filing does not require a governmental or nonelecting church plan to complete the annual Form 5500 series. See VI., below, for reporting requirements.

Note: Filing for a determination letter normally includes complying with the requirement that a notice to interested parties be sent to notify active participants and certain other interested parties that a determination letter request has been filed with the IRS. However, the notice requirement does not apply to governmental plans.[207]

2. Formal Requirements

The introductory clause of §401(a) sets out certain substantive requirements including the need for a formal plan and trust.[208] Neither governmental plans nor church plans are exempt from these requirements,[209] which raises certain administrative issues. For example, many governmental plans are created by state or local statute. If there is a formal trust document in addition to the statute, there should be no issue in meeting the trust requirement of this provision. However, although

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[201] *See, e.g.*, Florida Statutes Title XXXVII, art. 624.4031; Minnesota Statutes Annotated §317A.909; Oregon Insurance §731.036.

[202] Under this provision §401(a)(11), §401(a)(12), §401(a)(13), §401(a)(14), §401(a)(15), §401(a)(19) and §401(a)(20) apply only in the case of a plan to which §411 (relating to minimum vesting standards) applies without regard to §411(e)(2). Section 411(e)(1) exempts governmental plans described in §414(d) and church plans described in §414(e) that have not made a §410(d) election from the minimum vesting standards. Under §411(e)(2), a governmental or nonelecting church plan is treated as complying with §411, for §401(a) purposes, if it meets the vesting requirements of former §401(a)(4) and §401(a)(7) as in effect on September 1, 1974. For the text of pre-ERISA §401(a), see Worksheet 4 of this Portfolio.

[203] §414A(c)(3). Section 414A was added by the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §101, effective for plan years beginning after December 31, 2024.

[204] *See* Rev. Proc. 2022-40, *modifying and superseding* Rev. Proc. 2016-37, Parts I, II, IV. In Rev. Proc. 2022-40, the IRS expanded the determination letter program to allow plan sponsors to submit determination letter applications for §403(b) individually designed plans starting June 1, 2023, depending on the plan sponsor's EIN. For further discussion, see 388 T.M., *Section 403(b) Arrangements.*

[205] Rev. Proc. 2016-37, Part II §4.02 (effective January 1, 2017; superseded); Rev. Proc. 2020-4, §8.02, §8.04, §11.01 (superseded). For further discussion, see III.G.2., below.

[206] Rev. Proc. 2017-41, as amended (effective October 2, 2017, for use with third and future remedial amendment cycles), *modifying and superseding* Rev. Proc. 2015-36, as amended (used for applications submitted under the program in effect before October 2, 2017). *See* Rev. Proc. 2025-4, §12 and §13 (determination letter procedures for adopters of pre-approved plans).

[207] *See* Reg. §1.7476-2. Specifics about the notice requirements are set forth in Rev. Proc. 2025-4, §20A (qualified plans) and §20B (§403(b) plans).

[208] §401(a). In addition, effective for plans adopted for taxable years beginning after December 31, 2019, §401(b)(2), added by Pub. L. No. 116-94, Div. O, §201(a)(2), permits a pension, profit-sharing, or annuity plan that is adopted after the close of a taxable year to be treated as adopted as of the last day of the taxable year if it adopted before the employer's tax return is due (including extensions).

[209] *See* §401(a)(1). This section requires that if contributions to the plan are made by the employer and/or employees under the plan, the intent of the plan must be to distribute to employees and their beneficiaries the corpus and income accumulated under the plan.

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many of the statutes creating governmental plans state that the plan assets must be held in trust, there is no formal trust document. In this case, if the statutory language provides that the assets of the plan will be held in trust, or that an individual or board must act as trustee(s) of the plan's funds, the §401(a) trust requirement may be satisfied. On the other hand, if there is no clear statutory language that would create a trust relationship, the §401(a) trust requirement is generally considered to be satisfied if the statutory language imposes duties on the plan administrator equivalent to those imposed on a private sector trustee.

a. Definitely Determinable Benefits

In order to ensure that plan benefits are definitely determinable, and to protect against employer discretion in providing benefits, §401(a)(25) provides that the actuarial assumptions used to calculate the participants' benefits must be specified in the plan document.[210]

Under Reg. §1.401-1(b)(1)(i), failure to provide a definitely determinable benefit is grounds for plan disqualification. Many governmental plans created by statute do not provide in the statute the necessary actuarial assumptions for calculating the actual amount of alternate benefit forms. Some states have met this requirement through administrative procedures, board resolutions, or regulations.

In PLR 9645031, the IRS ruled that a governmental defined benefit cash balance pension plan met the definitely determinable benefit requirement despite the board's power to set the interest rate credited on contributions. The IRS explained that, for a cash balance plan, the selection of the interest rate credited to employee and employer contributions is an integral step in the determination of participants' benefits under the plan, and if the interest rate is subject to the discretion of the employer, it is highly unlikely that the plan will be able to satisfy §401(a)(25). Here, however, the IRS concluded there were two reasons why the employer did not have discretion in the selection of actuarial assumptions, including the minimum interest rate used in crediting participants' accounts, for determining participants' benefits. First, the retirement board selects these actuarial assumptions, not the employers that contribute to the plan, and the retirement board is independent of the employers which contribute to the plan and is composed of persons with widely differing backgrounds. Second, the interest rate crediting mechanism is not subject to discretionary control by the retirement board or the participating employers. Noting that the plan was not subject to §411(d)(6), the IRS ruled that the power of the retirement board to amend the plan to change the interest rate crediting mechanism does not mean that benefits under the plan are not definitely determinable under §401(a)(25).

b. Top-Heavy Rules

The top-heavy provisions of §401(a)(10) are applicable to qualified church plans, while government plans are exempt.[211] However, in most cases these rules will have little effect because church employers typically have few key employees. See 351 T.M., *Plan Qualification — Pension and Profit-Sharing Plans*, for a complete discussion.

3. Incidental Benefits

A qualified pension plan may provide for a disability pension and also may provide for the payment of incidental death benefits including payment of such death benefit through insurance.[212]

4. Participation Requirements

a. Governmental Plans

All governmental plans (within the meaning of §414(d)) are exempted from the I.R.C.'s minimum participation rules for qualified plans.[213]

b. Church Plans

(1) Participation and Coverage Requirements

The minimum participation and coverage requirements of §410 do not apply to nonelecting §401(a) church plans.[214] Instead, such qualified plans are treated as satisfying the requirements of §410 if they meet the requirements for coverage set out in former §401(a)(3) as in effect on September 1, 1974 (pre-ERISA).[215]

Prior to ERISA, former §401(a)(3) provided that a trust would be a qualified trust only if the plan benefited by either of the following:

> (1) Seventy percent or more of all the employees, or 80% or more of all eligible employees if at least 70% or more of all the employees were eligible to benefit under the plan.[216] In each case, a plan could exclude employees who failed to satisfy the minimum service requirement prescribed by the plan (not to exceed five years), employees whose customary employment did not exceed 20 hours in any one week and employees whose customary employment did not exceed five months in any calendar year.
>
> (2) Such employees that qualified under a classification established by the employer and found by the Secretary of the Treasury or his or her delegate not to be discriminato-

[210] Section 401(a)(25) further provides that such assumptions be specified in a way that precludes employer discretion.

[211] §401(a)(10)(B)(iii).

[212] Reg. §1.401-1(b)(1)(i). See Rev. Rul. 74-307 for a discussion of what is considered incidental.

[213] §401(a)(5)(G), added by Pub. L. No. 105-34, §1505(a)(1), effective for tax years beginning after August 5, 1997, and amended by Pub. L. No. 109-280, §861(a)(1) and §861(a)(2), effective for any plan year beginning after August 17, 2006. Under a special rule, all governmental plans are treated as satisfying the requirements of §401(a)(3), §401(a)(4), §401(a)(26), §401(k), §401(m), §403(b)(1)(D), and §403(b)(12)(A)(i), and §410 for tax years beginning before August 5, 1997. Pub. L. No. 105-34, §1505(d)(2), as amended by Pub. L. No. 109-280, §861(a)(2).

[214] §410(c)(1)(B).

[215] §410(c)(2). Pre-ERISA §401(a) is set forth in Worksheet 4 of this Portfolio.

[216] Whether rules analogous to the controlled group rules of §414 apply to determine which entity or group of entities constitutes the "employer" for purposes of determining whether the pre-ERISA participation and coverage tests are met is unclear. Presumably, the plan sponsor may make a reasonable, good faith determination in that regard. *See* Notice 96-64. See Reg. §1.414(c)-5, which applies to tax-exempt organizations for plan years beginning after December 31, 2008, but not to governmental employers or church plans, except in the case of certain nonqualified church-controlled organizations.

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ry in favor of employees who were officers, shareholders, persons whose principal duties consisted in supervising the work of other employees or highly compensated employees.[217] Such employees were referred to as the "prohibited group."

It appears that even though former §401(a)(3) did not provide for the exclusion of certain union members or nonresident aliens, such employees should not be included in applying the coverage tests in light of the fact that §401(a)(4) specifically excludes such employees for the purposes of determining whether contributions or benefits are discriminatory. The IRS's likely enforcement position on this issue is not clear.

(2) Minimum Participation Requirements

Qualified church plans are subject to §401(a)(26). Under §401(a)(26)(A), a defined benefit pension plan does not satisfy the minimum participation rule unless it benefits no fewer than the lesser of: (1) 50 employees; or (2) the greater of (a) 40% of all employees of the employer, or (b) two employees (one employee if there only is one employee). The requirement that a line of business have at least 50 employees does not apply in determining whether a plan satisfies the minimum participation rule on a separate line of business basis.[218]

(3) Sanctions for Failure to Satisfy Coverage Tests

If a trust under a qualified church plan is not exempt because the plan of which it is a part fails to meet the qualification requirements, so that the trust is not exempt under §501(a), highly compensated employees (HCEs) will have to include the total value of their vested accrued benefit (other than their investment in the contract) in income, including amounts that vested prior to the date on which the plan is disqualified.[219] If the failure to meet the requirements of §410(b) or §401(a)(26) is the sole reason the trust is not exempt, participants who are not HCEs within the meaning of §414(q) are not penalized; the trust is considered to be tax exempt with respect to them and they are, thus, subject to the general taxation rules of §402(a).[220]

These sanctions are applicable to participants in church plans. However, it also would appear that many failures of church plans to comply with qualification requirements may be corrected retroactively. This is because §251(d) of the Tax Equity and Fiscal Responsibility Act of 1982 (1982 TEFRA)[221] provided that a church plan (within the meaning of §414(e)) must not be treated as not meeting the requirements of §401 or §403 if: (1) the plan is required to be amended to satisfy §401 and §403 by reason of any change in a law, regulation, ruling or otherwise; and (2) the plan is so amended at the next earliest church convention or another time prescribed by the Secretary of the Treasury. The scope of this provision has not, however, been addressed in any guidance from the IRS.

Failing to meet participation requirements results in a severe outcome for the plan and its participants. To combat low participation rates, effective with the 2023 plan year, pursuant to the SECURE 2.0 Act, participants may be offered a de minimis financial incentive to contribute to the plan.[222] De minimis financial incentives cannot be paid for with plan assets.

c. Qualified Church Plans — Nondiscrimination in Contributions and Benefits

Qualified church plans are subject to the provisions of the I.R.C. that prohibit a plan from discriminating in favor of HCEs with respect to contributions or benefits.[223] This proscription on discrimination applies to the availability of optional forms of benefits.[224] The term "optional form of benefit" as defined in Reg. §1.411(d)-4, Q&A-1(b)(1), includes mode of payment, timing of benefit commencement and medium of distribution.

Generally, a plan will satisfy the nondiscrimination requirements of §401(a)(4) only if the optional form of benefit currently is available to a group of employees that meets coverage requirements of §410(b).[225] Qualified church plans will satisfy the rules if the group of employees to whom the optional form of benefit is currently available meets the requirements of former §401(a)(3) as in effect on September 1, 1974 (pre-ERISA).[226]

Qualified church plans also appear to be subject to the pre-termination restriction on the benefits of the 25 most highly compensated employees or former HCEs.[227]

If a minister is employed by an organization other than a church and the organization is not otherwise participating in the church plan, the retirement plan of the organization does not have to include the minister as an employee for purposes of satisfying the nondiscrimination rules.[228]

d. Permissible Classifications of Employees

Section 401(a)(5) sets out certain classifications of employees that will not be treated as discriminatory per se for purposes of §401(a)(4) and §410(b). These classifications are not exclusive. Prior to ERISA, the classifications described in former §401(a)(5) also were not to be treated as discriminatory for purposes of former §401(a)(3)(B).

A classification is not considered discriminatory merely because it is limited to salaried or clerical employees; or contributions or benefits for employees under the plan bear a uniform relationship to compensation of those employees; or contributions and benefits for employees under the plan favor HCEs as permitted by the integration rules in §401(l).[229] Further, a defined benefit plan can provide that the employer-derived bene-

[217] Former §401(a)(3). *See* Rev. Rul. 84-150 and Rev. Rul. 83-58, both modified by Rev. Rul. 93-87. "Facts and circumstances" will determine whether a plan is discriminatory in operation. *See, e.g.*, *Commissioner v. Pepsi-Cola Niagara Bottling Corp.*, 399 F.2d 390 (2d Cir. 1968); *Duguid & Sons, Inc. v. United States*, 278 F. Supp. 101 (N.D.N.Y. 1967).

[218] §401(a)(26)(F), cross-referencing §414(r).

[219] §402(b)(4)(A). *See* Rev. Rul. 2007-48.

[220] §402(b)(4)(B).

[221] Pub. L. No. 97-248.

[222] §401(k)(4)(A), as amended by the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §113(a), effective for plan years beginning after December 29, 2022. A gift card valued at $250 or less would be a permissible incentive. Notice 2024-2, Q&A D-1–D-6 (providing guidance on what constitutes a de minimis financial incentive).

[223] §401(a)(4).

[224] *See* Reg. §1.401(a)(4)-4.

[225] Reg. §1.401(a)(4)-1(b)(3), §1.401(a)(4)-4(a), §1.401(a)(4)-4(b).

[226] §410(c)(2); Reg. §1.410(b)-2(e).

[227] *See* Reg. §1.401(a)(4)-5(b)(3).

[228] §414(e)(5)(C).

[229] §401(a)(5)(A), §401(a)(5)(B), §401(a)(5)(C). For a discussion of the integration of governmental and church plans, see V., below.

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fit (ratably accrued over 35 years) may not exceed the excess of final pay over the Social Security benefit attributable to service with the employer.[230]

e. Participation of Employees Hired Within Five Years of Normal Retirement Age

The Equal Employment Opportunity Commission (EEOC) generally takes the position that if a plan sponsor is subject to the Age Discrimination in Employment Act of 1967 (ADEA),[231] the plan cannot exclude an employee from participation on the basis of age. EEOC regulations provide that no employee hired prior to normal retirement age may be excluded from a defined contribution plan.[232] However, with respect to defined benefit plans not subject to ERISA (i.e., a governmental plan and a nonelecting church plan), an employee hired at an age more than five years prior to normal retirement age may not be excluded unless the exclusion is justifiable on a cost basis.[233] An employee hired less than five years prior to normal retirement age may be excluded from a defined benefit plan, regardless of whether or not the plan is covered by ERISA. An employee hired after normal retirement age also may be excluded from a defined benefit plan.[234]

5. Vesting

Although qualified §401(a) governmental and nonelecting church plans specifically are exempted from ERISA vesting rules, they must meet the vesting requirement of former §401(a)(4) and former §401(a)(7) as in effect on September 1, 1974 (pre-ERISA).[235] Pre-ERISA §401(a)(4) sets out antidiscrimination requirements while pre-ERISA §401(a)(7) refers to plan termination and nonforfeiture of benefits.

Governmental and church §403(b) plans and governmental (funded) §457 plans are not subject to any vesting requirements under the I.R.C. or ERISA.

a. Vesting at Normal Retirement Age and at Plan Termination

Before ERISA, qualified plans had to provide fully vested benefits to plan participants only when they attained normal retirement age.[236] Complete or partial plan termination or complete discontinuance of contributions also triggered 100% vesting to the extent the benefits had been funded.[237] These rules are believed to continue to apply to qualified §401(a) governmental and nonelecting church plans.

If a §401(a) plan is terminated or contributions completely are discontinued, any funds not used to satisfy participant liabilities must be allocated to covered employees.[238] Any plan provision that specifies a method for distribution of unallocated funds is acceptable if it does not result in prohibited discrimination under §401(a)(4).[239] For example, an allocation may be satisfactory if priority is given to benefits for employees over the age of 40 at the time of plan termination or to those who have at least 10 years of service, if there is no possibility of discrimination in favor of employees who are officers, shareholders, supervisors or highly compensated individuals, i.e., members of the "prohibited group."[240] If assets remain after providing each participant with 100% of the present value of his or her accrued benefit, the excess may be returned to the plan sponsor or allocated to participants so long as the allocation does not cause the participant's benefit to exceed the §415 limits.[241]

b. Definition of Normal Retirement Age

Reg. §1.401(a)-1(b)(2) provides specifically that normal retirement age under a plan must be an age rather than years of service. Notice 2007-69 indicated that the regulations generally do not allow plans to use a normal retirement age that is conditioned (directly or indirectly) on the participant's completion of a certain number of years of service. If the participant's normal retirement age changes to an earlier date upon completing a stated number of years of service, the plan does not satisfy the vesting rules.[242]

Because of concerns by many governmental employers that this was inconsistent with how normal retirement age was defined under their plans, Notice 2007-69 also provided that:

> Sponsors of governmental plans and other plans not subject to the requirements of §411 are asked to submit comments on whether normal retirement age under such a plan may be based on years of service. Comments are requested on whether and how a pension plan with a normal retirement age conditioned on the completion of a stated number of years of service satisfies the requirement in §1.401(a)-1(b)(1)(i) that a pension plan be maintained primarily to provide for the payment of definitely determinable benefits after retirement or attainment of normal retirement age and how such a plan satisfies the pre-ERISA vesting rules.[243]

Notice 2012-29[244] provided that a governmental plan that is not subject to §411(a) through §411(d) and does not provide

[230] §401(a)(5)(D).

[231] Pub. L. No. 90-202, as amended; 29 U.S.C. §621 through 29 U.S.C. §634. Employers with at least 20 employees are subject to ADEA.

[232] 29 C.F.R. §1625.10(f)(1)(iii)(A).

[233] 29 C.F.R. §1625.10(f)(1)(iii)(A). *See* 29 C.F.R. §1625.10(a)(1) for cost considerations.

[234] 29 C.F.R. §1625.10(f)(1)(iii)(A).

[235] §411(e). *See, e.g., Coffey v. N.H. Judicial Ret. Plan*, 957 F.3d 45 (1st Cir. 2020) (state governmental plan that requires members to be in active service when applying for an service retirement allowance did not violate pre-ERISA I.R.C. §401(a)(4) and §401(a)(7) vesting requirements by denying a service retirement allowance to a former judge who resigned with sufficient years of creditable service, but before reaching the minimum retirement age, and applied for allowance upon later reaching the retirement age). For the text of pre-ERISA §401(a), see Worksheet 4 of this Portfolio. For a detailed discussion of vesting rules, see 351 T.M., *Plan Qualification — Pension and Profit-Sharing Plans.*

[236] Rev. Rul. 66-11. For the definition of normal retirement age under the pre-ERISA vesting rules, see Rev. Rul. 71-147, *modified by* Rev. Rul. 78-120, *and superseded by* Rev. Rul. 80-276. For general IRS guidance on pre-ERISA I.R.C. §401(a), see Worksheet 3 of this Portfolio.

[237] Former §401(a)(7).

[238] Reg. §1.401-6(a)(2).

[239] Rev. Rul. 71-314.

[240] Reg. §1.401-6(a)(2)(ii).

[241] Reg. §1.401-6(a)(2)(ii); Rev. Rul. 80-229.

[242] Notice 2007-69, §V.

[243] Notice 2007-69, §VI.

[244] For purposes of proposed amendments to the regulation defining normal retirement age, the earlier normal retirement age for a governmental plan would be treated as the age as of which an unreduced early retirement benefit is payable. REG-147310-12, 81 Fed. Reg. 4599, 4602 (Jan. 27, 2016).

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for the payment of in-service distributions before age 62 would not fail the definitely determinable requirement just because the pension plan has a normal retirement age that is earlier than otherwise permitted. In light of governmental employers' concerns, the IRS also indicated its intent to amend the normal retirement age regulation to extend its effective date for governmental plans. Also, until the regulations are amended, governmental plan sponsors may rely on guidance announcing the planned amendments.[245] Proposed regulations provide that governmental plans will have to comply with final regulations on pension plan distributions at normal retirement age for employees hired during plan years beginning on or after the later of (1) January 1, 2017, or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the final regulations are published in the Federal Register.[246] Under the proposed regulations, a governmental plan within the meaning of §414(d) that provides for distributions before retirement would satisfy the rule for normal retirement age either by satisfying the age 62 safe harbor[247] or by satisfying the rules proposed for governmental plans.[248] The rules proposed for governmental plans would provide for various age and service safe harbors at which normal retirement age is deemed to be not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. These proposed safe harbors are:[249]

- the later of age 60 or the age at which the participant has been credited with at least five years of service under the plan;
- the later of age 55 or the age at which the participant has been credited with at least 10 years of service under the plan;
- the age at which the sum of the participant's age plus the number of years of service credited to the participant under the plan equals 80 or more (e.g., a normal retirement age that is age 55 for a participant who has been credited with 25 years of service);
- the earlier of the participant's age at which the participant has been credited with at least 25 years of service under the plan and an age that satisfies any of the safe harbors described above (i.e., age 60 plus five years of service, age 55 plus 10 years of service, or sum of 80); or
- any of the proposed safe harbors for qualified public safety employees, discussed at III.F.9.b.(3), below.

If the normal retirement age under a governmental plan does not satisfy the age 62 safe harbor or any of these governmental plan safe harbors, all of the relevant facts and circumstances would be considered to determine whether the age is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.[250]

c. Vesting Upon Partial Termination

Under pre-ERISA law applicable to nonelecting church and governmental plans, all participants' benefits must vest upon plan termination.[251] The pre-ERISA tax regulation on vesting indicated that whether "eligibility or vesting requirements are made less liberal" could be something that might give rise to a partial termination, triggering the vesting rule.[252] The IRS has found that a partial termination occurred when "a significant percentage of the employees who had been participating in the employer contributions have been excluded from such participation and they are not sharing in the employer contributions under any comparable plan."[253] However, the partial termination of a plan affects only those participants who are terminated as part of such partial termination, not the plan as a whole.

d. Vesting to Prohibit Discrimination

Other than in the situations described above, vesting under a tax-qualified governmental or church plan is required only when necessary to prevent discrimination in favor of the prohibited group. Even though plan provisions may appear to comply with the law, they could fail to satisfy the requirements in operation.[254] Whether a plan's vesting schedule discriminates in favor of the prohibited group is determined on the basis of all facts and circumstances.

For example, a plan under which all employees were eligible regardless of service but which vested benefits only for employees who accrued at least 15 years of service and were employed until normal retirement age of 65, was found to be discriminatory in operation.[255] Most of the employees were migratory workers who remained on the job for a short period of time. As a result, they terminated employment without vested benefits. In contrast, executives who also were officers and shareholders actually received benefits from the plan. Amend-

[245] *See* Notice 2012-29 (normal retirement age regulations will be effective for governmental plans with annuity starting dates occurring in plan years beginning on or after later of January 1, 2015, or first regular legislative session beginning three months after publication of final regulations; intended modification to provide that governmental plan will not fail to meet the regulations if it does not permit in-service distributions before age 62, or if it deems age 50 or later to be a normal retirement age for qualified public safety employees), *modifying* Notice 2009-86 (providing for amendment of effective date to plan years beginning on or after January 1, 2013), *and* Notice 2008-98 (providing for amendment of effective date to plan years beginning on or after January 1, 2011).

[246] Prop. Reg. §1.401(a)-1(b)(4), REG-147310-12. Governmental plan sponsors may rely on the proposed regulations for periods preceding the effective date of final regulations. REG-147310-12, 81 Fed. Reg. 4599 at 4604.

[247] Reg. §1.401(a)-1(b)(2)(ii).

[248] Prop. Reg. §1.401(a)-1(b)(2)(v)(A), REG-147310-12. A governmental plan that does not provide for distributions before retirement would not have to comply with the general rule that normal retirement age must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed or these proposed rules. Prop. Reg. §1.401(a)-1(b)(2)(v)(A), REG-147310-12.

[249] Prop. Reg. §1.401(a)-1(b)(2)(v)(B) through §1.401(a)-1(b)(2)(v)(H), REG-147310-12.

[250] Prop. Reg. §1.401(a)-1(b)(2)(v)(J), REG-147310-12.

[251] Former §401(a)(7).

[252] Reg. §1.401-6(b).

[253] Rev. Rul. 72-439 (partial termination occurred where 120 out of 170 participants made ineligible). *See* Rev. Rul. 73-284 (partial termination occurred when 12 of 15 participants were discharged); Rev. Rul. 72-510, *obsoleted by* Rev. Rul. 81-27 (partial termination occurred when 95 of 165 participants were discharged).

[254] Reg. §1.401-1(b)(3).

[255] Rev. Rul. 71-263, *obsoleted by* Rev. Rul. 93-87.

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ing the plan to provide fully vested benefits after a reasonable waiting period might have rectified the problem.[256]

e. Forfeitures

A qualified §401(a) defined benefit plan is prohibited from using forfeitures to increase benefits any employee would otherwise receive under the plan.[257] Pre-ERISA regulations[258] specifically state that a defined benefit plan must expressly provide that forfeitures (arising from severance of employment, death or for any other reason) may not be used to increase the benefits employees would otherwise receive under the plan at any time prior to the termination of the plan or the complete discontinuance of employer contributions. Forfeitures are to be used as soon as possible to reduce future employer contributions.[259]

Governmental and nonelecting church qualified plans are subject to the exclusive benefit rule, and accordingly may use forfeitures to increase the benefits of other participants or to reduce future employer contributions, but forfeitures may not be diverted to uses other than for the benefit of participants and beneficiaries.[260]

Proposed regulations issued in 2023 would eliminate the requirement in the regulation that forfeitures be used as soon as possible to reduce employer contributions. Instead, a defined benefit plan would be required to expressly provide that forfeitures may not be applied to increase the benefits any employee would otherwise receive under the plan at any time before the termination of the plan or the complete discontinuance of employer contributions. The proposal would permit the effect of forfeitures to be anticipated in determining the costs under the plan.[261] The proposed regulations would apply for plan years beginning on or after January 1, 2024, but taxpayers may rely on them for periods before then.[262]

f. Discontinuance of Benefits

Under pre-ERISA vesting rules, as long as plan provisions do not discriminate in favor of the prohibited group, a plan may provide for discontinuance of a retiree's benefit, but the plan must clearly state the conditions that would cause such an action. For example, a retiree's benefit may be discontinued if the retired employee accepts a position with a competitor of the employer or divulges the employer's trade secrets to competitors.[263] Benefit payments also may be discontinued if the retiree accepts employment and Social Security primary insurance payments are stopped due to such employment.[264] Such loss of benefit may not occur after a plan has terminated or contributions have been discontinued.[265]

g. Governmental Plan Vesting Under State Law

Many governmental plans are subject to special vesting-like rules under state constitutions or state contract laws. Although a state-by-state review of those laws is beyond the scope of this Portfolio, a number of organizations have compiled summaries.[266] Law in this area is currently evolving as litigation is being pursued by employee groups against various changes to public plans, such as increased employee contributions or decreased cost-of-living adjustments.

The way courts characterize the legislative modification of public employee pension plan benefits has evolved over time. In the past, some courts considered public pensions gratuities that could be amended at any time. Over time, however, some courts have afforded a greater level of protection to public employee pension benefits. Many state courts have found that based on common law, state statute, or state constitution, public pension benefits plans create a contract between the state and plan participant, which can limit the ability of a state to amend its pension plan.[267] Applying the two-part test for determining whether a state law violates the Contract Clause, some courts have focused on whether a contractual relationship exists and whether an impairment of a contractual obligation may be permitted for being both reasonable and necessary to serve an important public purpose.[268] This issue has been litigated in a number of courts.[269]

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[256] Rev. Rul. 68-302, Rev. Rul. 71-151.

[257] §401(a)(8).

[258] Reg. §1.401-7(a).

[259] Reg. §1.401-7(a).

[260] §401(a)(2); Rev. Rul. 71-313.

[261] Prop. Reg. §1.401-7(a), REG-122286-18, 88 Fed. Reg. 12,282 (Feb. 27, 2023).

[262] 88 Fed. Reg. at 12,284.

[263] Rev. Rul. 71-92, *superseded by* Rev. Rul. 85-31 (reflecting changes enacted by ERISA).

[264] Rev. Rul. 82. *But see* Rev. Rul. 80-122 *superseding* Rev. Rul. 82 (discontinuance of benefit may result from re-employment with employer; restating Rev. Rul. 82 to reflect changes enacted by ERISA).

[265] §411(d)(3).

[266] For example, the Congressional Research Service prepared an overview of the subject in March 2011. *See* Staman, *State and Local Pension Plans and Fiscal Distress: A Legal Overview*, CRS Report R41736 (Mar. 31, 2011).

[267] CRS Report R41736 at 4–5 (citations omitted). For a review of state-by-state laws and cases in this area, see National Conference on Public Employee Retirement Systems, *State Constitutional Protections for Public Sector Retirement Benefits* (2007), http://www.ncpers.org/Files/News/03152007RetireBenefitProtections.pdf.

[268] *See United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977) (impairment of contractual obligation found unreasonable). *See also Puckett v. Lexington-Fayette Urban Cty. Gov't*, 833 F.3d 590 2016 BL 263154 (6th Cir. 2016) (no vested contractual right to specific COLA in effect at time of retirement exists, therefore legislative amendment to reduce annual COLAs is constitutional).

[269] *See, e.g.*, *Duncan v. Muzyn*, 833 F.3d 567, 2016 BL 261507 (6th Cir. 2016) (Tennessee Valley Authority Retirement System Rules do not vest COLAs, and board's decision to amend Rules to eliminate COLAs for 2010 and 2012, cap COLAs for 2011 and 2013, and increase COLA eligibility age did not deprive participants of protected property right); *Justus v. State*, No. 12SC906, 2014 BL 294041 (Colo. 2014) (while retired public sector employees have contractual right to their pensions, they do not have contractual right to perpetual receipt of the specific cost-of-living formula in place at eligibility for retirement or at retirement); *Wash. Educ. Ass'n v. Wash. Dep't of Ret. Sys.*, 332 P.3d 428 (Wash. Sup. Ct. 2014) (law that repealed gain-sharing provisions for certain public employee retirement systems without replacing them with comparable benefits does not unconstitutionally impair any preexisting contractual right; state is not estopped from repealing the benefit, as explanatory materials provided by retirement system do not make a promise or create an inconsistent statement); *Swanson v. State of Minn.*, No. 62-CV-10-05285 (Minn. Dist. Ct. June 29, 2011) (no contract or promise to particular COLA formula exists, and therefore amendments modifying formula were not unconstitutional impairments); *AFSCME Council 25 v. State Employees Ret. System*, 294 Mich. App. 1 (Ct. App. 2011) (law requiring public employees to contribute 3% of their wages to retirement fund was unconstitutional because Michigan Civil Service Commission has constitutional control over state employee compensation).

ISBN 978-1-63359-446-3

6. Limitations on Benefits and Contributions

Section 401(a)(16) provides that a pension, profit-sharing or stock bonus plan will not be considered tax-qualified if it provides for benefits or contributions that exceed the limits of §415.[270] Governmental and church plans are subject to these limitations.[271] Although no specific plan provision is required under §415 to maintain a plan's qualified status, plan provisions must preclude the possibility that the limits of §415 will be exceeded.[272] These limitations may be incorporated into a plan document or governmental statute by reference.[273]

a. Defined Benefit Plan Limitations

(1) General §415(b) Limitation

In order for the trust of a defined benefit plan to remain qualified, §415 requires that the annual amount payable to a plan participant may not exceed certain limits. In general, §415(b) provides that for a defined benefit plan, the annual benefit, when expressed as a straight-life annuity commencing at "normal" retirement age, cannot exceed the lesser of $160,000 (as indexed pursuant to §415(d)) or 100% of the average of the participant's highest three consecutive years of compensation.[274] Other restrictions apply under certain circumstances.[275] Other forms of retirement income benefits (except for a qualified joint and survivor annuity as defined in §417) must be actuarially adjusted to a straight-life annuity to determine whether the maximum benefit limitations are satisfied.[276] In addition, the early retirement reduction and the 10-year phase-in of the defined benefit pension plan dollar limit are inapplicable to certain disability and survivor benefits.[277]

(2) Special Governmental and Church Plan Rules

(a) Percentage Limit Not Applicable to Governmental Plans and Certain Church Employees

The 100% of compensation limitation on defined benefit pension plan benefits is inapplicable to governmental plans, and it also does not apply to church plans described in §3121(w)(3)(A), except with respect to highly compensated benefits.[278] For this purpose, highly compensated benefits are any benefits accrued for an employee in any year on or after the first year in which that employee is a highly compensated employee (as defined in §414(q)) of the organization. In applying the 100% of compensation limit to highly compensated benefits, all benefits of the employee that would otherwise be taken into account in applying the limit are taken into account.

(b) Defined Benefit Plan Dollar Limit Adjustments

The commencement of benefits under a defined benefit plan before age 62 requires that the $160,000 limit be reduced to an amount actuarially equivalent to a straight-life annuity equal to the dollar amount beginning at age 62.[279] The early retirement reduction does not apply to a participant in a defined benefit plan of a state or local government or Indian tribal government if the service for which the participant's benefits are based includes at least 15 years as a full-time employee of a police or fire department or a member of the U.S. Armed Forces.[280]

Conversely, the $160,000 limit is increased if retirement benefits begin after age 65.[281]

(c) Purchase of Past Service Credit

Section 415(n) permits a governmental qualified defined benefit plan to include in the annual benefit for §415(b) limitation purposes under the plan the accrued benefit derived from all contributions to purchase permissive service credit.[282] In the alternative, contributions by a participant in a defined benefit governmental plan to purchase permissive service credits must be taken into account in determining whether the $40,000 limit[283] on annual additions (as adjusted for inflation) to a defined contribution plan is met for the year (taking into account any other annual additions to qualified defined contribution plans of the participant's employer).[284] Under the first alternative, a plan will not fail to satisfy the §415 defined benefit plan limit

[270] §415(b) (defined benefit plan limits) and §415(c) (defined contribution plan limits). For a detailed discussion of these limits, see 371 T.M., *Employee Plans — Deductions, Contributions, and Funding.*

[271] DOL Adv. Op. 76-131 and DOL Adv. Op. 76-127. For discussion of the employer aggregation rules that apply in determining whether church plans satisfy these limits, see III.F.13., below.

[272] Reg. §1.415(a)-1(d)(1). *See* Reg. §1.401(a)-1(b)(1)(iii), which provides that a plan provision that automatically freezes or reduces the rate of benefit accrual or annual additions to ensure compliance with §415 will not violate the requirement of definitely determinable benefits provided that the provision precludes employer discretion.

[273] Reg. §1.415(a)-1(d)(3); Notice 87-21.

[274] §415(b)(1). For the current and prior year dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments.*

[275] §415(b)(4), §415(b)(5), §415(b)(7).

[276] §415(b)(2)(A), §415(b)(2)(B). The applicable mortality table under §417(e)(3)(B) is used for adjusting benefits or limitations under §415(b)(2), pursuant to §415(b)(2)(E)(v). For the modified unisex version of the mortality tables used for distributions subject to §417(e)(3), as published annually, see Tables, Charts & Lists, *Mortality Table for Use Under Code Section 417(e)(3).*

[277] §415(b)(2)(I).

[278] §415(b)(11), as amended by 2006 PPA, Pub. L. No. 109-280, §867(a), effective after December 31, 2006. *See* Reg. §1.415(b)-1(a)(6)(i), §1.415(b)-1(a)(6)(iv), §1.415(b)-1(a)(7)(iv). This relief does not apply to qualified church-controlled organizations described in §3121(w)(3)(B). For discussion of the aggregation rules that apply for church-related organizations, see III.F.13., below.

[279] §415(b)(2)(C). For years ending before 2002, the actuarial reduction was required for retirement benefits beginning before Social Security retirement age (SSRA) as defined in §415(b)(8). Former §415(b)(2)(C), prior to amendment by Pub. L. No. 107-16, §611(a)(2). For governmental plan and plans of tax-exempt organizations for years prior to 2002, the dollar limitation reduction was based on an early retirement benefit beginning before age 62, rather than SSRA. Former §415(b)(2)(F), prior to repeal by Pub. L. No. 107-16, §611(a)(5)(A). In addition, the reduction could not have reduced the dollar limitation below either: (i) $75,000 if the benefit began at or before age 55; or (ii) the equivalent of the $75,000 limitation for age 55 if the benefit began after age 65 rather than the SSRA. Former §415(b)(2)(F).

[280] §415(b)(2)(G), §415(b)(2)(H). *See* PLR 201347028 (employees of agency that worked closely with state and local police departments, but had a stated purpose, and overall mission and nature, of a state corrections department, were not employees of a police department).

[281] §415(b)(2)(D). For governmental plans and plans of tax-exempt organizations for years ending before 2002, the increase was made if benefits began after age 65, even if the SSRA was higher. Former §415(b)(2)(F).

[282] §415(n)(1)(A).

[283] §415(c)(1)(A), §415(d)(1)(C). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments.*

[284] §415(n)(1)(B).

ISBN 978-1-63359-446-3

that applies to early retirement due to accrued benefits derived from the purchase of permissive service credits.[285] These limits may be applied on a participant-by-participant basis. That is, contributions to purchase permissive credits by all participants in the same plan do not have to satisfy the same limit. Under the second alternative, a plan will not fail to meet the percentage limitation for contributions and annual additions to a defined contribution plan due to the annual additions derived from the purchase of permissive service credits.[286]

"Permissive service credits" are credits for a period of service that are recognized by the governmental plan only if the participant voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of service and that is in addition to the regular employee contributions, if any, under the plan.[287] Permissive service credit may include service credit for periods for which there is no performance of service and may include credit purchased to provide an increased benefit for a period of service already credited under the plan (e.g., if a lower level of benefit is converted to a higher benefit level otherwise offered under the same plan) as long as it relates to benefits to which the participant is not otherwise entitled.[288] The IRS has ruled that an election to purchase prior service with after-tax funds that is made by a former employee who never participated in the plan is not a purchase of permissive service credit.[289]

Section 415(n) is not met if more than five years of "nonqualified service credit" are taken into account.[290] Nonqualified service credit is permissive service credit *other* than that allowed with respect to service: (1) as a federal, state, or local government employee; (2) as an employee of an association representing federal, state, or local government employees; (3) as an employee of an educational institution that provides elementary or secondary education or a comparable level of education, as determined under the law of the jurisdiction in which the service was performed; or (4) in the military.[291] Service under (1), (2), or (3) is not "nonqualified" if it enables a participant to receive a retirement benefit for the same service under more than one plan.[292] Section 415 also is violated if nonqualified service credit is taken into account for an employee who has less than five years of participation under the plan.[293]

Comment: Thus, double counting of service under two different retirement systems may be permissible if it does not exceed five years.

There is a special rule for the repayment of cash-outs under governmental plans. For repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a state or local government employer within the same state), any such repayment will not be taken into account for purposes of §415.[294] The service credit obtained as a result of the repayment will not be considered permissive service credit.

Note: Section 415(n) is not intended to affect the application of "pick-up" contributions to purchase permissive service credit or the treatment of pick-up contributions under §415.[295] The provision does not apply to purchases of service credit for qualified military service under the rules relating to veterans' reemployment rights.[296] Except as discussed below, §415(n) generally does not apply when funds merely are transferred between governmental plans to purchase service credit. For example, in PLR 200317027, the IRS ruled that §415(n) did not apply to the transfer of §401(k) funds on behalf of and at the direction of participants to purchase service credit under a defined benefit plan. The IRS ruled that such transfers did not constitute an annual benefit under §415(b)(2)(A) for purposes of determining defined benefit plan limitations, nor did the transfers constitute an annual addition within the meaning of §415(c)(2) for purposes of determining defined contribution plan limitations. The IRS further ruled that such a transfer did not result in income to participants under §72.

Section 403(b) monies and §457 plan monies may be transferred to §401(a) defined benefit plans to purchase permissive service credit under §415(n)(3)(A) or repay past withdrawals of employee contributions and earnings under §415(k)(3).[297] Furthermore, trustee-to-trustee transfers under §457(e)

[285] §415(n)(2)(A).

[286] §415(n)(2)(B).

[287] §415(n)(3)(A). *See* PLR 200805026 (after-tax employee contributions made before December 31, 1997 (the general effective date of §415(n)), by a participant who is grandfathered under the transition rule of Pub. L. No. 105-34, §1526(c)(2), to purchase service credit are treated as permissive service credit contributions).

[288] §415(n)(3)(A) (flush language), as amended by 2006 PPA, Pub. L. No. 109-280, §821(a)(2), effective as if included in the amendments made by Pub. L. No. 105-34, §1526. Prior to 2006 PPA, the IRS ruled in PLR 200229051 that §415(n) did not apply to inactive, fully vested participants in a governmental defined benefit plan who made voluntary contributions in order to purchase enhancements under a program providing for an alternative superannuation retirement benefit. In light of the amendment made to §415(n)(3)(A) (flush language) it would seem that the IRS would reach the opposite conclusion. Also, in PLR 200617038, prior to 2006 PPA, the IRS ruled that §415(n) did not apply to a plan participant's purchase of an optional enhanced benefit under a defined benefit governmental plan using prior years' contributions and the transfer of §457(b) account funds from another plan with that employer. The IRS stated, however, that if a participant made an elective purchase in the employer's plan in the form of a transfer from the participant's eligible §457(b) deferred compensation plan to purchase up to an additional five years of service credit for time spent working for another employer, that elective purchase would be for the purchase of permissive service credit.

[289] PLR 202344010 (county employees defaulted to non-participant status after they missed the election period to participate in the new plan because they had not been notified of the right to elect). In PLR 202344010, the IRS also ruled that those former employees would not be able to use a rollover from another qualified plan to obtain a benefit calculated on service previously performed as employees of the county, stating that §402(c)(1)(A) does not provide that someone who is not a plan participant or an employee may roll over funds to obtain a benefit for prior service performed.

[290] §415(n)(3)(B)(i).

[291] §415(n)(3)(C).

[292] §415(n)(3)(C) (flush language).

[293] §415(n)(3)(B)(ii).

[294] §415(k)(3).

[295] *See* PLR 199921057.

[296] §415(n)(3)(C)(iv).

[297] §403(b)(13), §457(e)(17). IRS Info. Letter 2005-0010 addresses the tax consequences of a proposed transfer of funds from a §457(b) plan to a governmental defined benefit plan to purchase permissive service credits. Under Reg. §1.457-10(b)(4)(iv), the value of the amount transferred into the new plan must equal the amount transferred out of the prior plan. In addition, under Reg. §1.457-10(b)(8), §415(n) does not apply to the transfer if the actuarial value of the benefit increase that results from the transfer does not exceed the amount transferred. To the extent that the benefits purchased under the defined benefit plan exceed the amount transferred from the §457(b) plan, taxable consequences could result from the excess, but it is unlikely that the eligible status of the §457(b) plan would be affected by such an excess.

ISBN 978-1-63359-446-3

(17) and §403(b)(13) may be made regardless of whether the transfer is made between plans maintained by the same employer. In addition, the limits regarding nonqualified service do not apply in determining whether a trustee-to-trustee transfer from a §403(b) annuity or a §457 plan to a governmental defined benefit plan is for the purchase of permissive service credit.[298] Thus, the participant is not liable for income tax if the transferee plan improperly allows service purchase and allows the transfer between plans of unrelated employers. Further, amounts transferred from a §403(b) annuity or a §457 plan to a governmental defined benefit plan to purchase permissive service credit are subject to the distribution rules that apply to the defined benefit plan.

(d) Section 415(b)(10) Election

Many states prohibit cutbacks in the pension benefits of public employees.[299] Courts have interpreted state and federal laws to require that the right to a pension attaches upon acceptance of employment.[300] However, §415(b)(10) offers state, Indian tribal and local government plans a means of resolving the conflict between complying with the §415 limits under federal law and violating state anti-cutback laws. Under this provision, the maximum defined benefit limitations for an employee who first became a plan participant before January 1, 1990, will not be less than his or her accrued benefit determined without regard to any plan amendments made after October 14, 1987.[301] However, for this provision to apply, each employer maintaining the plan must have elected before the close of the first plan year beginning in 1990 to apply the lower §415 limits applicable to private plans to employees who first became plan participants after 1989.[302] The special rule of §415(b)(2)(G) for participants in police and fire department plans benefits is not affected by this provision.[303]

(e) When the §415(b) Limit Is Applied

In the case of a governmental defined benefit plan, because it is not subject to the vesting requirements of §411, the defined benefit plan limitations of §415(b) are not required to be applied to the annual benefit accrued by a participant before the benefit is actually payable. At any time the annual benefit is payable to a participant under the plan, the §415(b) limitations apply.[304]

(3) Treatment of Employee (After-Tax) Contributions

Only benefits attributable to employer contributions are considered for the purposes of the §415(b) limits. After-tax employee contributions under a qualified defined benefit plan, whether voluntary or mandatory, are treated as a separate qualified defined contribution plan, subject to the maximum contribution limitations of §415(c).[305] In the case of a qualified defined benefit plan with mandatory after-tax employee contributions, the portion of the benefit attributable to employer contributions (and, hence, subject to §415(b)) is determined by converting the employee contributions to an annual benefit amount pursuant to §411(c)(2)(B) and subtracting such amount from the total annual plan benefit.[306] These rules are particularly significant for governmental plans because many require or permit after-tax employee contributions.

In the event a participant's after-tax employee contributions are converted to before tax "pick-up" contributions, such contributions are treated as employer contributions for the purposes of §415.[307] For a detailed discussion of the treatment of pick-up contributions, see III.F.8., below.

(4) Section 415(m) Excess Plans

Benefits provided under a qualified governmental excess benefit arrangement are not taken into account in determining whether a governmental plan meets the §415 requirements.[308] Qualified excess benefit arrangements (also known as QEBAs or §415(m) plans) also are not subject to the §457 limits on unfunded deferred compensation arrangements or the §409A rules for nonqualified deferred compensation.[309] For more information on such plans, see III.K., below.

b. Defined Contribution Plan Limitations

The defined contribution plan limitations of §415(c) provide, in general, that the maximum annual addition with respect to any plan year cannot exceed the lesser of $40,000 (as indexed pursuant to §415(d)) or 100% of the participant's compensation (as described in Reg. §1.415(c)-2(d)).[310] These limits

[298] §415(n)(3)(D). However, if a former employee who never participated in the employer's qualified defined benefit plan makes a transfer from a §403(b) plan or a §457(b) plan to obtain a benefit under the qualified plan, the transfer is not a trustee-to-trustee transfer for the purchase of permissive service credit. PLR 202344010.

[299] *E.g.*, Cal. Const. Art. I, §9; N.Y. Const., Art. V, §7.

[300] *Legislature v. Eu*, 816 P.2d 1309 (Cal. 1991); *Miller v. State*, 557 P.2d 970 (Cal. 1977); *Kern v. City of Long Beach*, 179 P.2d 799 (Cal. 1947); *Valdes v. Cory*, 139 Cal. App. 3d 773, 4 EBC 1124 (Cal. Ct. App. 1983); *Birnbaum et al. v. N.Y. State Teachers' Ret. System*, 176 N.Y.S.2d 984 (1958). These cases held that the right to pension benefits vest(s) upon the acceptance of employment even though the right to immediate payment of the full pension may not mature until certain conditions are fulfilled. For a good explanation of the rationale for these holdings, see *Miller. See also* Annotation, Vested Right of Pensioner to Pension, 52 ALR 2d 437 (1957). Note, however, that because of the evolving nature of this issue, the reader should focus on the later cases except as needed for an historical perspective.

[301] §415(b)(10)(A), §415(b)(10)(B). *See* PLR 9721027 (county's adoption of resolution offering police and fire personnel, who retired between March 16 and 30, 1995, up to two additional years of service credit was amendment of benefit structure of county's plan made after October 14, 1987, to increase benefits for participants taking advantage of early retirement window).

[302] §415(b)(10)(C).

[303] §415(b)(10)(C).

[304] Reg. §1.415(b)-1(a)(7)(iii).

[305] Reg. §1.415(c)-1(a)(2)(ii)(B). *See* Reg. §1.415(b)-1(b)(2)(iv) (voluntary contributions) and §1.415(b)-1(b)(2)(iii) (mandatory contributions). Mandatory employee contributions are defined in §411(c)(2)(C) and Reg. §1.411(c)-1(c)(4). Section 414(h)(2) contributions that are picked up by the employer are not considered employee contributions. Section 401(m) requires that after-tax contributions be subject to a special nondiscrimination test intended to prohibit discrimination in favor of the highly compensated.

[306] *See* Reg. §1.415(b)-1(b)(2)(iii).

[307] §414(h)(2); Reg. §1.415(c)-1(a)(2)(ii)(B).

[308] §415(m)(1). A qualified governmental excess benefit arrangement is a portion of a governmental plan that is maintained solely for the purpose of providing to participants benefits in excess of the §415 limits, but only if participants have no election to defer compensation under this portion of the plan and benefits are either paid directly by the employer or are paid from a trust maintained solely to provide excess benefits. §414(m)(3).

[309] §415(m)(1), §409A(d)(2)(C). *See* PLR 201031043 and PLR 199923056.

[310] §415(c)(1). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments*. For

ISBN 978-1-63359-446-3

apply to §401(a) and §403(b) governmental and church plans. For a discussion of §415(c)(7), which concerns special contribution rules under §415(c) for annuities purchased for certain church employees under §403(b), see 388 T.M., *Section 403(b) Arrangements.*

After-tax employee contributions, including those made under a defined benefit plan where employee contributions are treated as a separate account, are considered annual additions.[311] In the case of qualified church plans, such contributions are subject to the special nondiscrimination test of §401(m).[312]

c. Aggregation of Benefits from Unrelated Employers

Benefit aggregation requirements applicable under §415 may pose particular problems for both governmental plans and church plans. If a plan, annuity contract or arrangement is subject to a special limitation in addition to, or instead of, the regular limitations described in §415(b) or §415(c), and is aggregated under Reg. §1.415(f)-1 with a plan that only is subject to the regular §415(b) or §415(c) limitations: (1) each plan, annuity contract or arrangement that is subject to a special limitation must meet its own applicable limitation and each plan subject to the regular limitations of §415 must meet its applicable limitation; and (2) the limitation for the aggregated plans is the larger of the applicable limitations for the separate plans.[313] Aggregation of benefits or contributions from all employers under the same plan is not required, however, if the plan is a multiemployer plan as described in §414(f).[314]

d. Limit on Compensation Under §401(a)(17)

Section 401(a)(17) places a $200,000 limit (as indexed for inflation)[315] on the annual compensation of any employee for plan purposes. Although few participants in governmental and church plans receive compensation that exceeds this limit, such plans are not exempt from the limitation. The definition of compensation for qualified plan purposes includes an individual's net earnings that would be subject to self-employment tax (SECA) but for the fact that the individual is covered by a religious exemption.[316]

Unlike the rule for the §415 limits, the §401(a)(17) limit is applied separately to each employer maintaining the plan in the case of a multiple-employer plan.[317]

The regulations continue to implement the grandfather rule in the Revenue Reconciliation Act of 1993 (1993 RRA)[318] for individuals who first became participants in governmental plans before the first plan year beginning after December 31, 1995, or, if earlier, the first plan year for which the plan is amended to comply with the 1993 RRA.[319] Under the grandfather rule, the annual compensation limit will not apply for those individuals to the extent that the limit would reduce the amount of compensation taken into account under the plan below the amount that was allowed to be taken into account under the plan as in effect on July 1, 1993. Thus, if a plan as in effect on July 1, 1993, determined benefits without any limit on compensation, then §401(a)(17) will not apply to grandfathered participants in any future years. For this grandfather rule to apply to a plan, the plan must have been amended, effective for plan years beginning after December 31, 1995, to incorporate by reference the annual compensation limits of §401(a)(17) for those participants who are not grandfathered under the 1993 RRA.[320]

7. Funding Requirements

Governmental plans and nonelecting church plans are exempt from the minimum funding standards of §412.[321] However, in order to be treated as a qualified plan under §401(a), governmental and nonelecting church plans that are pension plans must meet the requirements of former §401(a)(7) as in effect on September 1, 1974 (pre-ERISA).[322]

Former §401(a)(7) as in effect immediately before the enactment of ERISA did not prescribe any specific funding standards, but instead required that a qualified plan provide that in the event of a plan termination or a complete discontinuance of contributions, the rights of employees to benefits accrued to the date of such plan termination or discontinuance of contributions, to the extent then funded, would become nonforfeitable.[323] Insofar as funding was concerned, a qualified plan simply had to be able to meet current and/or anticipated near-future benefit payments.[324] Thus, as long as a qualified governmental or nonelecting church plan provided for full vesting on termination or discontinuance and the plan met its current or near-future benefit commitments, the employer generally was free to fund benefits in any manner it chose, provided that it actually set aside assets for that purpose.[325] Some governmental and church employers fund under the "pay-as-you-go" method in which contributions approximate current benefit payments and expenses. Others fund on an actuarial basis, making contributions (and/or requiring employee contributions) to fund benefits well before they must be paid.[326]

discussion of the aggregation rules that apply in determining whether church plans satisfy these limits, see III.F.13., below.

[311] Reg. §1.415(b)-1(b)(2)(iii) (cross-referencing Reg. §1.415(c)-1(a)(2)(ii)(B)) and §1.415(c)-1(b)(3). *See* Reg. §1.415(b)-1(a)(2) (defined benefit §403(b) plans — which largely means grandfathered defined benefit church retirement income account plans — are treated as defined benefit plans for §415 purposes though they also may be treated as defined contribution plans for purposes of §415(c)).

[312] *See* III.C., above.

[313] Reg. §1.415(f)-1(h).

[314] §415(f)(2)(B); Reg. §1.415(f)-1(g)(1). *See* PLR 201229012 (contributions on behalf of individual participant in two separate multi-employer defined contribution plans are not aggregated for purposes of §415(c), even if made by same employer).

[315] The limit is indexed in the same manner as the maximum defined benefit plan annual benefit. §401(a)(17)(B). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments.*

[316] §401(c)(2)(A) (referencing §1402(c)).

[317] Reg. §1.401(a)(17)-1(b)(4).

[318] Pub. L. No. 103-66.

[319] Reg. §1.401(a)(17)-1(d)(4)(ii).

[320] *See* Reg. §1.401(a)(17)-1(d)(4)(ii)(C). *See also* Announcement 95-48, *obsoleted by* Rev. Rul. 2009-18.

[321] §412(e)(2)(C), §412(e)(2)(D).

[322] §412(e)(2) (flush language).

[323] Former §401(a)(7). *See* discussion at III.F.5., above.

[324] GCM 36813 (Aug. 16, 1976).

[325] *See, e.g.*, Rev. Rul. 71-91 (plan that contained no funding arrangement but provided that employer would pay monthly pension benefit to employee directly did not qualify under §401(a)).

[326] A survey of over 200 public employee retirement systems conducted by the Government Finance Research Center in conjunction with the Governmental Accounting Standards Board showed that most defined benefit plans fund for future benefit obligations on an actuarial basis. *See* Government Finance

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An important issue that arises particularly with respect to "pay-as-you-go" funding is when a failure to make regular, substantial contributions under the plan constitutes a complete discontinuance of contributions requiring full vesting. The regulations state that whether a complete discontinuance of contributions under a plan has occurred will be determined based on all the facts and circumstances in a particular case.[327] However, they further provide that a suspension of contributions will not be treated as a discontinuance as long as the following conditions are met:

- the benefits to be paid or made available under the plan are not affected at any time by the suspension; and
- the unfunded past service cost at any time (which includes the unfunded prior normal cost and unfunded interest on any unfunded cost) does not exceed the unfunded past service cost as of the date of establishment of the plan, plus any additional past service or supplemental costs added by amendment.[328]

ERISA legislative history indicates that these conditions merely are a "safe haven" for governmental plans, but are not a requirement.[329] A plan that cannot meet them will be scrutinized under the facts and circumstances test.[330]

8. Governmental Pick-Up Contributions

Government employees frequently are required to make contributions to a governmental plan. Section 414(h)(1) generally provides that if a contribution to a qualified plan is designated as an employee contribution, it will not be treated as an employer contribution.[331] As a result, the amount of the employee contribution is includible in the income of the employee in the year made.[332]

However, §414(h)(2) provides an exception to this rule for contributions to governmental plans if the employing unit "picks up" the contribution that the employee is required to make.[333] Pick-up contributions are treated as employer contributions for federal income tax purposes.[334] Thus, they are not included in compensation in the year made[335] and are not subject to income tax withholding.[336] Taxation only occurs upon distribution.[337] Pick-up contributions may be treated as employee contributions for all other purposes, such as for calculating benefits under the plan, state taxes, cost-of-living increases, salary increases, and bonuses.[338] The employer may "pick-up" the required contributions by a reduction in cash salary, by an offset against future salary increases or by a combination of both.[339]

Pick-ups pursuant to a salary reduction agreement are taken into account as wages for purposes of FICA. Section 3121(v)(1)(B) generally provides that "wages" for FICA purposes include any amount treated as an employer contribution under §414(h)(2) when the pick-up is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise). The IRS previously took the position that pick-ups mandated by state statute, were not wages for FICA purposes.[340] However, the IRS repudiated this approach and ruled that §3121(v)(1)(B) encompasses any salary reduction arrangement, even if the salary reduction was mandated by a state law that applies to all employees and/or no individual agreements were signed by employees.[341] The IRS has ruled, however, that FICA taxes do not apply to retirement plan contributions picked up by state government under §414(h)(2) without a corresponding deduction from the employee's salary.[342]

Research Center of the Government Finance Officers Association, "Public Pension Accounting and Reporting: A Survey of Current Practices." The actuarial assumptions are sometimes legislated by state statute; the other instances, the retirement board may accept or reject the assumptions used by the actuary. *See* Committee on Education and Labor, U.S. House of Representatives, "Pension Task Report on Public Employee Retirement Systems" (1978). For a discussion of actuarial funding methods, see 371 T.M., *Employee Plans — Deductions, Contributions, and Funding.*

[327] Reg. §1.401-6(c)(1).

[328] Reg. §1.401-6(c)(2).

[329] Conf. Rep. No. 93-1280. Some practitioners believe that qualified nonelecting church pension plans are subject to the pre-ERISA requirement that the plan must fund at least the normal cost plus interest on past service costs. *See* former IRS Publication 778 (2-72), Part 2(b), reprinted in Worksheet 3 of this Portfolio.

[330] Conf. Rep. No. 93-1280.

[331] Employer contributions, which are amounts in addition to an employee's stated salary, are not taxable income for the employee until distributed by the plan. *See* Reg. §1.402(a)-1(a)(1)(i).

[332] §61.

[333] Governmental pick-up contributions also apply to certain plans established and maintained by Indian tribal governments. §414(h)(2).

[334] §414(h)(2). *See* PLR 201529009 and PLR 8630073.

[335] Reg. §1.402(a)-1.

[336] See Rev. Rul. 77-462, citing §3401(a)(12)(A), which excludes remuneration paid on behalf of an employee to a qualified trust from the definition of wages. *See* PLR 9402028 (amounts picked up by employer on behalf of employees who participate in state retirement system or pension system are treated as employer contributions and are excepted from being wages as defined in §3401(a)(12)(A)).

[337] PLR 8539036. Pick-up plans are subject to the minimum distribution rules. *See, e.g.*, PLR 200807023 (amendments to governmental plan/qualified pick-up plan that limit retirees' ability to elect "pop-up" and "pop-down" of annuity benefit forms satisfy requirements of §401(a)(9)). Special government plan distribution rules are discussed at III.F.9.b., below.

[338] *See* GCM 39540 (Mar. 31, 1986); PLR 8630073.

[339] *See, e.g.*, GCM 38820 (Feb. 4, 1982); PLR 9402028, PLR 8801050. Changing the method of picking up mandatory contributions from an offset against future salary increases to a salary reduction does not change the federal tax or income tax withholding treatment of the contributions. PLR 201305021.

[340] *See, e.g.*, PLR 8750033.

[341] *See* PLR 9231044 (pick-up contributions on behalf of employees covered by agreement under §218 of Social Security Act (SSA) are wages for OASDI portion of FICA taxes under §3101(a) and §3111(a), and for Medicare tax purposes under §3101(b) and §3111(b); if employee is member of government retirement system under §3121(b)(7)(F), pick-up contributions to plan on behalf of continuing employee are not wages for either OASDI or Medicare tax purposes, and pick-up contributions to plan on behalf of newly hired employees are wages for Medicare tax purposes but not for OASDI purposes); PLR 8842073 (IRS revoked prior ruling that pick-ups were not subject to FICA and indicated that government entity could be retroactively liable for FICA taxes for all years open under statute of limitations). *See also Public Employees' Ret. Bd. v. Shalala*, 153 F.3d 1160 (10th Cir. 1998) (salary reduction agreement includes when state law mandates state pick-up of member contributions, covered by agreement under §218 of SSA, with concomitant reduction in member salaries).

[342] PLR 9836005. In CCA 200714018, the IRS advised that a public school district's contributions were not paid pursuant to a salary reduction and, thus, not wages for FICA tax purposes because the term "salary reduction" relates to amounts treated as an employer contribution under §414(h)(2) that would have been included in wages for FICA tax purposes but for the employer contribution. Thus, a salary reduction occurs if the amounts included in wages for FICA tax purposes (without regard to §3121(v)(1)(B)) are less than they otherwise would have been but for the employer contribution, and no salary reduction occurs if the amounts included in wages for FICA tax purposes are equal to what they otherwise would have been but for the employer contribution. In this case, the amounts included in wages for FICA tax purposes were equal to what they otherwise would have been, and the employer's contributions in accordance with state law did not reduce or offset any amounts due to the employ-

ISBN 978-1-63359-446-3

a. Pick-Up Requirements

Section 414(h)(2) does not contain rules for determining whether a contribution qualifies as a pick-up contribution. However, the IRS uses the following criteria for this purpose:

> (1) The employer must formally specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. For this purpose, a person duly authorized by the employer may take such formal action, which only must apply prospectively and be evidenced by a contemporaneous written document (e.g., meeting minutes, resolution, or ordinance).[343]
>
> (2) The employees must not be permitted to opt out of the "pick-up" or to receive the contributed amounts directly instead of having them paid by the employer to the plan.[344]

The IRS has previously ruled that the existence of a one-time election to opt out of a plan, or a one-time irrevocable election to begin early participation in a plan, does not give the employee sufficient control of the employer contribution to taint the amounts contributed on the employee's behalf.[345] Other examples of participant elections that have been held not to interfere with pick-up treatment include: (1) an irrevocable election to buy back (in effect, recontribute) accumulated contributions withdrawn upon a prior separation from service through installment payments made pursuant to plan rules;[346] (2) an election, only revocable upon a showing of mistake or misunderstanding, to make an additional contribution of $2 per month in order to provide for survivor benefits;[347] (3) an irrevocable election to receive credit for prior public service through payment of a prescribed amount by the employee to the plan before retirement;[348] and (4) an irrevocable election to participate in two employer plans.[349]

Comment: Caution should be exercised in implementing any pick-up elections, even one-time irrevocable ones. It is understood that the IRS may issue more restrictive guidance in this area in the future. Rev. Rul. 2006-43 holds that for §414(h)(2) to apply there must be no "cash or deferred election right (within the meaning of Reg. §1.401(k)-1(a)(3))." That regulation, in turn, states that "[a] cash or deferred election does not include a one-time irrevocable election made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer … (whether or not such other plan or arrangement has terminated), to have contributions equal to a specified amount or percentage of the employee's compensation (including no amount of compensation) made by the employer on the employee's behalf to the plan."[350] Consequently, the IRS may believe that no such one-time irrevocable election can be made after the employee has first begun to participate in any plan of the employer, whether or not such plan is the plan to which the election would apply.[351]

In PLR 202041004, two separate retirement systems existed for state judges and legislators who could elect membership in their respective single-employer defined benefit tier of their system. Employees who elect membership on or after Date 2 may participate only in their respective system's hybrid cash balance plan, which is a new benefit tier created by state legislation as of Date 2. State law requires each member to contribute: (1) if membership began on or before Date 1, a percent of the member's creditable compensation to the member's respective defined benefit plan; (2) if membership began on or after Date 1 but before Date 2, a set percent to the member's defined benefit plan, including an actuarially determined amount to pay medical benefits under §401(h); and (3) if membership began after Date 2, a set percent of creditable compensation to the hybrid cash balance plan, including a set percent contribution to an account to pay medical benefits under §401(h). Employee contributions are picked up by each employer and treat-

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ees. Only by determining what the employee's total salary would have been but for the employer contribution is it possible to determine whether the employer contribution is made pursuant to a salary reduction or a salary supplement, and merely because the employer could have further increased the employees' compensation in lieu of making an employer contribution did not support the determination that it would have further increased the employees' compensation but for the employer contribution.

[343] Rev. Rul. 2006-43, *modifying and amplifying* Rev. Rul. 81-35, Rev. Rul. 81-36, *and* Rev. Rul. 87-10. Rev. Rul. 2006-43 generally was effective August 28, 2006, however, the IRS will not treat any plan that on or before August 28, 2006, included designated employee contributions that were intended to be employer pick-up contributions as failing to meet the §414(h)(2) requirements prior to January 1, 2009, solely on account of failure to satisfy the formal written action requirement in Rev. Rul. 2006-43 if: (1) the employer takes contemporaneous action showing intent to establish a "pick-up" and the plan has operated accordingly; and (2) the employer takes the required formal written action prior to January 1, 2009, with respect to future contributions.

[344] Rev. Rul. 81-35 and Rev. Rul. 81-36. *See, e.g.*, PLR 201606029. Thus, contributions made pursuant to a voluntary agreement whereby the employer contributed a percentage of the employee's salary to satisfy the employee's contribution obligation did not qualify for pickup treatment because it was the employee's decision not to receive the amount as part of his salary. Rev. Rul. 81-35. In contrast, contributions made under a union-negotiated agreement whereby the employer contributed a percentage of employees' salaries to a pension plan to satisfy the employees' obligation did qualify for pick-up treatment because the employees were not given the opportunity to receive the contributed amounts directly. Rev. Rul. 81-36; PLR 8751061, PLR 8625085.

[345] *See* GCM 39881 (Oct. 8, 1992) (where employee made one-time, irrevocable election to participate in plan and, acting in his capacity as agent of his employer, was only competent authority to initiate pick-up plan, requirements of §414(h)(2) were met); GCM 38820; PLR 9610033, PLR 9536033, PLR 8641055, PLR 8551082.

[346] PLR 200011071, PLR 200035033, PLR 8745053. In PLR 9441042, the IRS revoked a portion of PLR 8745053 relating to the pick-up of contributions because the plans gave an employee the option of terminating the picked-up contributions at any time and receiving the amounts directly. The IRS concluded that under the lump-sum payment plan provisions, employees could terminate the picked-up contributions at any time by making a lump-sum payment from their own funds directly to their plans to buy back the accumulated contributions or to buy past service credit. PLR 8745053 otherwise remains in full force and effect.

[347] PLR 8745053.

[348] PLR 8745053. *See* PLR 9034069 (transfer of part of participant's account from one governmental plan to another to purchase service credit does not result in income for participant).

[349] PLR 202304001 (employee contributions to the two employer plans following the irrevocable election are treated as picked-up employer contributions when the total employee contributions remain the same as if the election is not made).

[350] Reg. §1.401(k)-1(a)(3)(v).

[351] *Compare* PLR 201532036 (one-time, irrevocable elections permitted to members under state statute with respect to employee contribution rates and statutory multiplier, if implemented, would constitute cash or deferred arrangement; elections could not constitute one-time irrevocable elections under Reg. §1.401(k)-1(a)(3)(v) because employees are already participating in plan) *with* PLR 201351030 (member's transfer of participation from one plan to another, and concurrent transfer of assets, does not constitute a cash or deferred election under §401(k); providing employees with choice of whether to be covered under one plan or another, by itself, is not a CODA).

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ed as employer contributions. Employees who became members of the systems before Date 2 could make a one-time irrevocable election to receive benefits under and participate in the hybrid plan instead of their defined benefit plan. The IRS ruled that the mandatory employee contributions required to be made by members who elect to participate in the hybrid plan instead of the defined benefit tiers, and which are picked up by the participating employer, continue to be treated as employer contributions pursuant to a valid pick-up, as long as the mandatory, pre-tax employee contributions to the hybrid plan are exactly the same as the employee contributions to the defined benefit tier. The election to switch to the hybrid cash balance plan by employees who became members on or after Date 1 but before Date 2 would not create an impermissible cash or deferred arrangement, assuming the mandatory employee contributions are the same between the defined benefit plan and the hybrid plan, the IRS ruled. The election by employees who were members before Date 1, however, would create an impermissible cash or deferred arrangement, the IRS concluded, because there is a difference in total contributions between the two options due to the contribution to the §401(h) account for the hybrid cash balance plan.[352]

In PLR 201417025, a state retirement system that had a governmental defined benefit plan under §414(d) added a qualified defined contribution plan. Employees who participated in or were eligible to participate in the defined benefit plan had a one-time opportunity to move to the defined contribution plan, and also were permitted to make a subsequent election to move to the defined benefit plan. In 2001, the IRS ruled that: (1) amounts transferred, either upon initial election or during the one-time additional opportunity to transfer, are not distributions, and the transfers do not result in currently taxable income to the participant under §72 or §402 or imposition of an early distribution tax under §72(t); and (2) neither the initial election to permit an eligible employee to participate in the defined contribution plan nor the additional one-time election to transfer between plans while an employee constitutes a cash or deferred arrangement under §401(k).[353] In 2011, the state adopted legislation that: requires mandatory employee contributions (3% of compensation) to the plan in which the employee participated, which must be designated as employee contributions, but are picked up by participating employers and treated as employer contributions; does not allow employees the option of choosing to receive the contributed amounts directly; and, specifying that the contributions are being paid by the employer in lieu of contributions by employees, requires that they be treated as employer contributions under §414(h)(2). The IRS ruled that the 2011 legislation satisfied the IRS's criteria for a contribution to be a pick-up contribution. The IRS also ruled that neither the initial election to participate nor the additional one-time election to transfer while an employee constitutes a cash or deferred arrangement.

In PLR 9033072, the IRS ruled that employee contributions to a state employees' retirement plan based on worker's compensation do not constitute picked-up contributions and are treated as a return of an employee's investment in the contract as defined in §72(c)(1) and §72(e)(6). Due to the protected nature of worker's compensation benefits under state law, the employer did not consider or treat the applicable employee contributions as picked-up contributions. Further, the applicable state statutes contained no language specifying that contributions otherwise designated as employee contributions would be paid by the employer in lieu of contributions by the employee but simply required the employer to pay employer contributions.

b. Treatment of Pick-Ups Under §415

Contributions picked up by a government employer are not includible as compensation for purposes of §415.[354] Thus, they cannot be considered in computing the amount used for determining the maximum annual benefit for defined benefit plans under §415(b)(1)(B)[355] nor in computing the maximum contribution limitation for defined contribution plans under §415(c)(1)(B).[356] Although pick-up contributions apparently are treated as part of the employer-provided benefit for purposes of §415(b), they are counted as annual additions for purposes of the §415(c) limits for defined contribution plans because they are considered to be employer contributions.[357]

c. Effect of Pick-Ups on Other Plans

A government employer may sponsor more than one type of plan for its employees. For example, under certain circumstances an employee of a state or political subdivision could be eligible to participate in a §401(a) defined benefit pension plan, a §403(b) tax-sheltered annuity plan, a §457 plan and/or a §401(k) plan.[358] Pick-up contributions to the §401(a) defined benefit plan could affect the employee's benefits under the other plans because they are not treated as compensation for the purpose of calculating certain limitations on benefits under these plans. Whether pick-ups are treated as compensation for the purpose of benefit calculations is controlled by state or local law.

d. Pick-Ups and §403(b) Annuity Plans

Contributions to a §403(b) annuity plan are excludible from gross income in the year made to the extent they are less than the annual limit on contributions contained in §415(c)(1).[359] The §415(c)(1) limit generally is the lesser of $40,000 (as

[352] *Accord* PLR 202020006.

[353] *See* PLR 200130057.

[354] See Reg. §1.415(c)-2(c)(1), which provides that compensation does not include contributions made by the employer to a plan of deferred compensation to the extent that the contributions are not includible in the gross income of the employee for the taxable year in which contributed. As noted above, contributions picked up under §414(h)(2) are not includible in gross income in the year made.

[355] *See* Reg. §1.415(b)-1(b)(2)(ii)(A); PLR 8151074.

[356] *See* Reg. §1.415(c)-1(a)(2)(ii)(B). E.g., PLR 202041004.

[357] *See* Reg. §1.415(c)-1(b)(1), §1.415(c)-1(b)(2)(i); PLR 8514092, PLR 8230132 (§415(c)(2) provides that for purposes of §415(c)(1), annual additions mean the sum for any year of employer contributions, employee contributions and forfeitures).

[358] A government entity may not establish or maintain a §401(k) plan unless it adopted the plan before May 6, 1986. *See* §401(k)(4)(B)(ii). However, Indian tribal governments may maintain §401(k) plans. §401(k)(4)(B)(iii). *See* PLR 200028042. *See* 388 T.M., *Section 403(b) Arrangements*, 385 T.M., *Deferred Compensation Arrangements*, and 358 T.M., *Section 401(k) Cash or Deferred Arrangements*, respectively.

[359] *See* Reg. §1.403(b)-3(a)(9), §1.403(b)-4(b)(1), T.D. 9340, 72 Fed. Reg. 41,128 (July 26, 2007), as corrected, 75 Fed. Reg. 65,566 (Oct. 26, 2010), generally effective for taxable years beginning in 2009.

ISBN 978-1-63359-446-3

adjusted for inflation),[360] or 100% of the participant's includible compensation within the meaning of §403(b)(3).[361]

Pick-up contributions affect the maximum amount that may be excluded from income under this limitation because pick-up contributions, as well as contributions used to purchase a §403(b) annuity, are treated as annual additions for purposes of the §415 limits.[362] As a result, to the extent that they affect compensation or "use up" the annual limitation on annual additions, pick-up contributions may reduce the amount of employer contributions that may be made to purchase a tax-sheltered annuity contract.

Though §414(h) by its terms applies only to §401(a) plans, the term "pick-up contribution" also is frequently used to refer to elections made pursuant to a one-time irrevocable election to reduce salary and make contributions to other plans. Such contributions appear to be permissible for §403(b) plans, though they still may be subject to FICA.[363]

e. Pick-Ups and §457 Plans

Pick-up contributions reduce the maximum amount that a participant may defer under a §457(b) plan in a taxable year insofar as they reduce the amount of compensation that the employee would otherwise have to include in income for the taxable year. The maximum amount of compensation a participant may defer under a §457(b) plan in a taxable year generally cannot exceed the lesser of: (1) the annual inflation-adjusted dollar amount limit;[364] or (2) 100% of the participant's includible compensation for the taxable year.[365] Because pick-ups are not currently includible in gross income, they do not meet the definition of includible compensation for purposes of §457[366] and, therefore, are not taken into account in determining the maximum deferral amount based on a percentage of includible compensation.[367]

f. Pick-Ups and §401(k) Plans

Contributions picked up under §414(h) are not subject to the requirements of §401(k) because they fail to meet the basic requirements for a qualified cash or deferred arrangement under that section, e.g., the employee is not given the opportunity to take the amount of the picked-up contributions in cash.[368]

Some governmental plan sponsors have created §401(k)-styled qualified plans that provide the participant with a one-time irrevocable election to select the amount of the pick-up contribution (generally some percentage of compensation).[369]

In PLR 202126001, the IRS addressed whether an amendment to a defined benefit plan that is a governmental plan within the meaning of §414(d) and a qualified plan within the meaning of §401(a) and provides for mandatory employee contributions that are picked up by the employer in accordance with §414(h)(2) creates an election of cash or deferred arrangement under §401(k). The IRS ruled that the plan amendment permitting the hiring of retired plan participant schoolteachers to return to the classroom as "special employees" did not create an employee election that could constitute a cash or deferred arrangement under §401(k), because the rehired retirees could not make an election as to whether to receive cash or to make a contribution to plan, continued to receive retirement benefits from the plan, were ineligible to accrue further benefits under the plan, and were not eligible to elect a position that would result in eligibility for further benefit accruals (and therefore require contributions to the plan). For a complete discussion of §401(k) plans, see 358 T.M., *Section 401(k) Cash or Deferred Arrangements*.

g. Pick-Ups and Participant Bankruptcy

Court holdings vary with respect to the issue of whether mandatory pick-up contributions may be stopped when the participant declares bankruptcy. The Second Circuit has held that bankruptcy law may preempt a state law that makes pension contributions mandatory.[370] However, other courts have held that if state law makes such contributions a condition of employment, the contributions should be allowed if the debtor is not likely to obtain other employment with an equivalent income.[371]

h. Pick-Ups and Accumulated Leave

The IRS has issued several private letter rulings permitting pick-up elections with respect to accumulated and unused sick pay and other types of leave.[372] At least one ruling suggests that the leave does not have to be earned before the election is made.[373] However, it is understood that the IRS has the area under study and may disavow its prior rulings in the area.

9. Plan Distributions

In general, governmental and church §401(a) and §403(b) plans are subject to the same distribution rules as private sector

[360] §415(c)(7)(A)(ii), §415(d)(1)(C). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments*.

[361] §415(c)(3)(E); Reg. §1.415(c)-2(g)(1).

[362] *See* Reg. §1.415(c)-1(a)(2)(ii)(B), §1.415(c)-1(b)(1)(i)(A) and §1.415(c)-(2)(i) (pick-up contributions), and §1.403(b)-4(b)(1) (§403(b) annuity); PLR 8514092.

[363] See Reg. §1.403(b)-5(b)(2), which cross-references Reg. §1.401(k)-1(a)(3), where a similar rule applies for §401(k) plans.

[364] §457(e)(15). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments*.

[365] §457(b)(2). There also are additional catch-up contributions available upon attainment of age 50 and for a participant's last three taxable years ending before the participant attains the plan's normal retirement age. *See* §414(v) and §457(b)(3), respectively, discussed in III.I., below.

[366] *See* PLR 8512060. "Includible compensation" for purposes of §457 is defined as "participant's compensation" under §415(c)(3). §457(e)(5).

[367] *See* PLR 8539036.

[368] In order to be a qualified cash or deferred arrangement under §401(k), a plan must give the employee the opportunity to elect either to have the employer make payments as contributions to a trust on his or her behalf, or to take such amounts directly in cash. A one-time irrevocable election to participate in the plan when the employee first becomes eligible to participate is not considered an election for this purpose. Reg. §1.401(k)-1(a)(3)(v). As discussed above, contributions may not be picked up under §414(h) if the employee could have chosen to take cash instead. For a complete discussion of §401(k) plans, see 358 T.M., *Section 401(k) Cash or Deferred Arrangements*.

[369] *See, e.g.*, PLR 200118056, PLR 201529009. The IRS has informally indicated that it is reviewing these types of pick-up contributions. Plan sponsors may wish to obtain their own private letter ruling regarding such plans.

[370] *In re Taylor*, 243 F.3d 124, 25 EBC 2284 (2d Cir. 2001).

[371] *See, e.g.*, *In re Tibbs*, 242 B.R. 511 (Bankr. N.D. Ala. 1999); *In re Davis*, 241 B.R. 704 (Bankr. D. Mont. 1999).

[372] *See, e.g.*, PLR 200302032, PLR 200301032, and PLR 200252095.

[373] *See* PLR 200249009. *Compare* PLR 200252095.

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plans.[374] Required minimum distribution rules determine the latest date by which benefit payments under a qualified plan must begin and establish the maximum time period over which such payments may be made. Governmental plans are treated as having complied with the required minimum distribution rules for all years to which the required minimum distribution provision applies to the plan as long as the terms of the plan or contract reflect a reasonable, good faith interpretation of the provision.[375]

The I.R.C. and regulations require plans to provide systematically for the payment of benefits after retirement; thus, participants' ability to receive benefits prior to retirement (i.e., separation from service after a specified age) are limited.[376] However, working retirement distributions may be made to an employee who has attained age 59½ (age 62 for plan years beginning before January 1, 2020) and who is not separated from employment at the time of the distribution.[377] See III.F.9.b.(1), below, for a discussion of working retirement rules applicable to governmental plans.

Special rules apply to governmental and church plans in certain situations.

a. Special Church Plan Rules

Annuity payments provided with respect to any retirement income account maintained for a participant or beneficiary under a qualified church plan does not fail to meet the minimum distribution rules of §401(a)(9) just because the payments are not made under an annuity contract purchased from an insurance company (i.e., the plan self-annuitizes), as long as the payments would not fail the distribution rules provided for a retirement income account under §403(b)(9).[378] The term "qualified church plan" means, for this purpose, any money purchase plan described in §401(a) that is a church plan under §414(e) for which the §410(d) election has not been made and which was in existence on April 17, 2002.[379]

b. Special Governmental Plan Distribution Rules

(1) Working Retirement Rules for Governmental Plans

Section 401(a)(36) permits distributions from retirement plans to employees who have attained age 59½ (age 62 for plan years beginning before January 1, 2020) prior to separation from service.[380] The regulations generally require plans to define "normal retirement age" in accordance with the typical retirement age for the industry in which the covered workforce is employed.[381] In Notice 2012-29, the IRS indicated that a governmental plan that is not subject to §411(a) through §411(d) and does not provide for the payment of in-service distributions before age 62 need not define normal retirement age under the plan, or may include a definition of normal retirement age that fails to satisfy the regulations, without violating these rules. The IRS also extended the effective date of the working retirement rules for governmental plans.[382] Proposed regu-

[374] §401(a)(9), §403(b)(10); Reg. §1.401(a)(9)-1 through §1.401(a)(9)-9, as amended by T.D. 10001, 89 Fed. Reg. 58,886 (July 19, 2024), generally applicable for purposes of determining required minimum distributions for calendar years beginning on or after January 1, 2025. See 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification*, for a detailed discussion of these rules. The minimum required distribution was waived temporarily for calendar year 2020 for defined contribution plans, including governmental §457(b) defined contribution plans, and IRAs. §401(a)(9)(I), added by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, §2203(a). See Notice 2020-51 for IRS guidance on the temporary waiver.

[375] Reg. §1.401(a)(9)-1(a)(3) (applicable to governmental plan under §414(d) or eligible §457(b) plan maintained by a government) and Reg. §1.403(b)-6(e)(8) (extending rule to §403(b) contract that is part of governmental plan under §414(d)), as amended by T.D. 9459, 74 Fed. Reg. 45,993 (Sept. 8, 2009), effective September 8, 2009, and applicable to all years for which §401(a)(9) applies to the plan, and T.D. 10001; former Reg. §1.401(a)(9)-1, Q&A-2(d). *See* PLR 202143002 (option under state enacted bill allowing prospective change in survivorship benefit election within the first 90 days of the first benefit payment does not cause governmental plans to fail to satisfy underlying requirements of §401(a)(9)(A); thus, plans comply with reasonable, good faith interpretation of §401(a)(9)(A); accordingly, minimum distribution requirements are not violated due to change in survivorship benefit election).

[376] *See* Reg. §1.401(a)-1(b)(1)(i). For a discussion of pre-retirement distributions, see 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification.*

[377] §401(a)(36), added by Pub. L. No. 109-280, §905(b), effective for distributions in plan years beginning after 2006, and amended by Pub. L. No. 116-94, Div. M, §104(a), effective for plan years beginning after December 31, 2019. Under regulations issued before the age for working retirement distributions was lowered, plans representing workers in certain industries may make working retirement distributions earlier than age 62, but no earlier than the earliest age that is reasonably representative of the typical retirement age for the industry. Reg. §1.401(a)-1(b)(2), T.D. 9325, 72 Fed. Reg. 28,604 (May 22, 2007), generally applicable May 22, 2007, subject to special effective date rules for governmental and collectively bargained plans. For governmental plans, these regulations are effective for plan years beginning on or after the later of (1) January 1, 2015, or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the final regulations are published in the Federal Register. Notice 2012-29, *modifying* Notice 2009-86 (extending effective date for governmental plans from plan years beginning on or after January 1, 2011 to plan years beginning on or after January 1, 2013).

[378] Pub. L. No. 109-280, §865(a), effective for any plan year ending after August 17, 2006. See Reg. §1.403(b)-6(e)(5), generally effective for taxable years beginning in 2009, as amended by T.D. 10001, applying for purposes of determining required minimum distributions for calendar years beginning on or after January 1, 2025 (clarifying application to annuity contracts purchased under a defined contribution plan; specifying that insurance company must be licensed to do business under the laws of a state).

[379] Pub. L. No. 109-280, §865(b).

[380] §401(a)(36), as amended by Pub. L. No. 116-94, Div. M, §104(a) (reducing minimum phased retirement age), effective for plan years beginning after December 31, 2019. A plan is not required to permit in-service distributions and does not need to lower the minimum age for permitting in-service distributions. Therefore, a qualified plan that provides for in-service distributions commencing at age 62 is not required to be amended to provide for in-service distributions commencing at age 59 ½ as a result of the changes made by Pub. L. No. 116-94, Div. M, §104(a). *See* Notice 2020-68, Q&A F-1.

[381] Reg. §1.401(a)-1(b)(2)(i). If a plan lowers its minimum age for in-service distributions from 62 to 59 ½ pursuant to §401(a)(36) and Pub. L. No. 116-94, Div. M, §104(a), such change does not affect the definition of normal retirement age and the requirements of Reg. §1.401(a)-1(b)(2). *See* Notice 2020-68, Q&A F-2. *See also* IRS Info. Letter 2015-0023 (summary of working retirement distribution rules relevant to retiring public safety employee who continues to volunteer for the fire department (for a stipend) and as a crossing guard); IRS Info. Letter 2015-0022 (summary of working retirement distribution rules relevant to retiring municipal employee who continues to volunteer for fire department).

[382] Notice 2012-29 (normal retirement age regulations will be effective for governmental plans with annuity starting dates occurring in plan years beginning on or after later of January 1, 2015, or first regular legislative session beginning three months after publication of final regulations; intended modification to provide that governmental plan will not fail to meet the regulations if it does not permit in-service distributions before age 62, or if it deems age 50 or later to be a normal retirement age for qualified public safety employees),

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lations further extend the effective date for governmental plans and provide that governmental plans will have to comply with final regulations on pension plan distributions at normal retirement age for employees hired during plan years beginning on or after the later of (1) January 1, 2017, or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the final regulations are published in the Federal Register.[383] Under the proposed regulations, a governmental plan within the meaning of §414(d) that provides for distributions before retirement would satisfy the rule for normal retirement age either by satisfying the age 62 safe harbor[384] or by satisfying the rules proposed for governmental plans.[385] The rules proposed for governmental plans would provide for various age and service safe harbors at which normal retirement age is deemed to be not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. These proposed safe harbors are:[386]

- the later of age 60 or the age at which the participant has been credited with at least five years of service under the plan;
- the later of age 55 or the age at which the participant has been credited with at least 10 years of service under the plan;
- the age at which the sum of the participant's age plus the number of years of service credited to the participant under the plan equals 80 or more (e.g., a normal retirement age that is age 55 for a participant who has been credited with 25 years of service);
- the earlier of the participant's age at which the participant has been credited with at least 25 years of service under the plan and an age that satisfies any of the safe harbors described above (i.e., age 60 plus five years of service, age 55 plus 10 years of service, or sum of 80); or
- any of the proposed safe harbors for qualified public safety employees, discussed at III.F.9.b.(3), below.

If the normal retirement age under a governmental plan does not satisfy the age 62 safe harbor or any of these governmental plan safe harbors, all of the relevant facts and circumstances would be considered to determine whether the age is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.[387]

The Moving Ahead for Progress in the 21st Century Act (MAP-21)[388] provided the Office of Personnel Management (OPM) the authority to establish a phased retirement program for qualified employees of the federal government.[389] Under this program, distributions from federal retirement plans to qualified phased retirees are not subject to the 10% additional tax for early distributions.[390]

(2) Qualified Public Safety Officers Exclusion for Payments from Governmental Plans for Retiree Health or Long-Term Care Insurance

Section 402(l)[391] allows eligible retired public safety officers to elect to exclude from gross income up to $3,000 in annual distributions from an eligible governmental retirement plan[392] to pay qualified health insurance premiums[393] on a pre-tax basis. Retired public safety officers eligible for the exclusion are individuals who served a public agency in an official capacity, with or without compensation as a law enforcement officer, a firefighter, a chaplain, or a member of a rescue squad or ambulance crew.[394] The officer must have separated from service from the employer because of reaching normal retirement age or a disability.[395]

Amounts excluded from income under §402(l) are not taken into account in determining the itemized deduction for med-

modifying Notice 2009-86 (providing for amendment of effective date to plan years beginning on or after January 1, 2013), *and* Notice 2008-98 (providing for amendment of effective date to plan years beginning on or after January 1, 2011).

[383] Prop. Reg. §1.401(a)-1(b)(4), REG-147310-12, 81 Fed. Reg. 4599 (Jan. 27, 2016). Governmental plan sponsors may rely on the proposed regulations for periods preceding the effective date of final regulations. REG-147310-12, 81 Fed. Reg. 4599 at 4604.

[384] Reg. §1.401(a)-1(b)(2)(ii).

[385] Prop. Reg. §1.401(a)-1(b)(2)(v)(A), REG-147310-12.

[386] Prop. Reg. §1.401(a)-1(b)(2)(v)(B) to §1.401(a)-1(b)(2)(v)(H), REG-147310-12.

[387] Prop. Reg. §1.401(a)-1(b)(2)(v)(J), REG-147310-12.

[388] Pub. L. No. 112-141.

[389] 5 U.S.C. §8336a and §8412a, added by Pub. L. No. 112-141, §100121(a) and §100121(b), effective on the effective date of OPM implementing regulations. *See* RIN 3206-AM71, 79 Fed. Reg. 46,608 (Aug. 8, 2014), effective November 6, 2014.

[390] §72(t)(2)(A)(viii), added by Pub. L. No. 112-141, §100121(c).

[391] Added by Pub. L. No. 109-280, §845, and amended by Pub. L. No. 110-458, §108(j), effective as if included in Pub. L. No. 109-280, §845 (i.e., applicable to distributions in taxable years beginning after December 31, 2006). Pub. L. No. 110-458, §112. *See* Notice 2007-7, §VI, Q&A-20 through -27, *modified by* Notice 2007-99.

[392] An eligible governmental retirement plan is a §414(d) governmental plan that is either a §401(a), §403(a), §403(b), or §457(b) plan. §402(l)(4)(A), cross-referencing §402(c)(8)(B)(iii) through §402(c)(8)(B)(vi). If an employer has more than one eligible retirement plan, the plans are aggregated and treated as a single plan for purposes of the exclusion. §402(l)(5)(B); Notice 2007-7, Q&A-26.

[393] Qualified health insurance premiums are premiums for accident or health insurance or a qualified long-term care insurance contract covering the employee, the employee's spouse and dependents. §402(l)(4)(D), as amended by Pub. L. No. 110-458, §108(j)(1)(B), effective as if included in Pub. L. No. 109-280, §845 (i.e., applicable to distributions in taxable years beginning after December 31, 2006). Pub. L. No. 110-458, §112. Prior to December 29, 2022, the premium payments were required to be deducted from amounts distributed from the retirement plan and paid directly to the provider of the health plan. §402(l)(5)(A), as amended by Pub. L. No. 110-458, §108(j)(1)(C); Notice 2007-7, Q&A-22. However, effective December 29, 2022, direct payment is no longer required. §402(l)(5)(A), as amended by the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §328. The accident or health plan receiving the payments can be self-insured. Notice 2007-7, Q&A-23, as modified by Notice 2007-99. If the employee dies, the exclusion does not apply to the employee's surviving spouse or dependents. Notice 2007-7, Q&A-25. *See* IRS Info. Letter 2015-0017 (income tax exclusion under §402(l) is available only if an eligible governmental plan pays qualified health insurance premiums directly to an insurer).

[394] §402(l)(4)(C); Notice 2007-7, Q&A-21. The benefits eligible for favorable tax treatment can be attributable to service other than as a public safety officer as long as the individual meets the criteria for an eligible retired public safety officer. Notice 2007-7, Q&A-24.

[395] §402(l)(4)(B); Notice 2007-7, Q&A-20. If an employer offers this exclusion, the election for the exclusion is made after separation from service. §402(l)(6)(A); Notice 2007-7, Q&A-22.

ISBN 978-1-63359-446-3

ical expenses under §213 or the deduction for health insurance of self-employed individuals under §162.[396]

Previously, it was not clear whether these excluded distributions counted toward the minimum required distributions under §401(a)(9). While distributions of premiums for health and accident insurance continue to be disregarded when determining whether the required minimum distribution from a defined contribution plan has been satisfied, under regulations that apply for distributions on or after January 1, 2025, this disregard does not extend to distributions for retired public safety officers that are subject to §402(l).[397]

(3) Tax Relief for Early Distributions to Public Safety Employees

Plan distributions made after an employee has separated from service generally are not subject to a 10% additional tax on early distributions if the separation from service occurs after the individual attains age 55.[398] However, a qualified public safety employee may receive a distribution from a governmental defined benefit plan under §414(d) after separation from service without incurring the early distribution penalty if the officer is at least age 50 or has completed at least 25 years of service under the plan, whichever is earlier, in the calendar year when the separation from service occurs.[399] The exception is not available if the employee rolls over distributions from a governmental defined benefit plan into an IRA (or a defined contribution plan) and later takes an early distribution from the IRA.[400]

Under normal retirement age regulations that will take effect for governmental plans no sooner than plan years beginning in 2017, plans in which substantially all of the participants are qualified public safety employees may define normal retirement age for the qualified public safety employees using any of the following safe harbors:

- age 50 or later;[401]
- the age at which the sum of the participant's age plus the number of years of service credited to the participant under the plan equals 70 or more; or
- the age at which the participant has been credited with at least 20 years of service under the plan (e.g., a normal retirement age that covers only qualified public safety employees and that is an employee's age when the employee has been credited with 25 years of service).[402]

As a result, a governmental pension plan that provides for distributions before retirement could satisfy the normal retirement age requirement using a normal retirement age as low as age 50 for a group substantially all of whom are qualified public safety employees and a later normal retirement age that otherwise satisfies the requirements for other participants.[403] However, there does not appear to be a provision under §72(t) that would exempt a distribution at age 50 from the 10% additional tax if the recipient does not qualify as a public safety employee.

A qualified public safety employee is, for this purpose, any employee of a state, city, county, or other political subdivision of the state who provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of the state or political subdivision.[404] Effective for distributions after December 31, 2015, a qualified public safety employee also means certain federal law enforcement officers, federal customs and border protection officers, federal firefighters, air traffic controllers, certain nuclear materials couriers, any member of the U.S. Capitol Police, any member of the Supreme Court Police, or any diplomatic security special agent of the Department of State.[405] Effective for distributions after December 29, 2022, a qualified public safety employee also means a corrections officer or a forensic security employee providing for the care, custody, and control of forensic patients.[406]

c. Required Beginning Date

Plan distributions generally are required to begin by April 1 of the calendar year following the later of: (1) the calendar year in which the employee attains the applicable age triggering required minimum distributions; or (2) the calendar year in which the employee retires.[407] However, except for governmen-

[396] §402(l)(7), §402(l)(8); Notice 2007-7, Q&A-27.

[397] Reg. §1.401(a)(9)-5(g)(2) and Reg. §1.402(c)-2(c)(3)(ix), as amended by T.D. 10001.

[398] §72(t)(2)(A)(v).

[399] §72(t)(10), added by the Pension Protection Act of 2006 (2006 PPA), Pub. L. No. 109-280, §828, effective for distributions made after August 17, 2006, and modified by the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §329, effective for distributions made after December 29, 2022. *See* Notice 2007-7, §IV, Q&As-6 through -10. *See also* IRS Info. Letter 2015-0023 (summary of working retirement distribution rules relevant to retiring public safety employee who continues to volunteer for the fire department (for a stipend) and as a crossing guard); IRS Info. Letter 2015-0022 (summary of working retirement distribution rules relevant to retiring municipal employee who continues to volunteer for fire department).

[400] Notice 2007-7, Q&A-9.

[401] Reg. §1.401(a)-1(b)(2)(v), T.D. 9325, 72 Fed. Reg. 28,604 (May 22, 2007), generally applicable May 22, 2007, subject to special effective date rules for governmental and collectively bargained plans. *See* Prop. Reg. §1.401(a)-1(b)(2)(v)(F), REG-147310-12, 81 Fed. Reg. 4599 (Jan. 27, 2016) (redesignation in connection with proposed guidance on applicability of normal retirement age regulations to governmental plans). For governmental plans, the normal retirement age regulation would be effective for employees hired during plan years beginning on or after the later of (1) January 1, 2017, or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the final regulations are published in the Federal Register. Prop. Reg. §1.401(a)-1(b)(4), REG-147310-12, 81 Fed. Reg. 4599 (Jan. 27, 2016). Governmental plan sponsors may rely on the proposed regulations for periods preceding the effective date of final regulations. 81 Fed. Reg. 4599 at 4604.

[402] Prop. Reg. §1.401(a)-1(b)(2)(v)(G) and §1.401(a)-1(b)(2)(v)(H), REG-147310-12.

[403] Governmental plans would be permitted to use one normal retirement age for one classification of employees and one or more other normal retirement ages for different classifications. Also, governmental plans generally could use a different normal retirement age for employees hired before a certain date from the one used for employees hired on or after that date without failing to satisfy the applicable pre-ERISA requirements. REG-147310-12, 81 Fed. Reg. 4603–04. *See* Notice 2012-29, §III.

[404] §72(t)(10)(B); Notice 2007-7, Q&A-6.

[405] §72(t)(10)(B), as amended by Pub. L. No. 114-26, §2(a), and the Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, §308 (both effective for distributions after December 31, 2015).

[406] §72(t)(10)(B)(i), as amended by Pub. L. No. 117-328, Div. T, §330, effective for distributions made after December 29, 2022.

[407] §401(a)(9)(C)(i), as amended by the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §107(a), effective for individuals who attain age 72 after December 31, 2022.

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tal and church plans,[408] a 5% owner of the employer is required to begin distributions no later than April 1 of the calendar year following the year in which the 5% owner attains the applicable age triggering required minimum distributions.[409] The age triggering required minimum distributions is 70½ for individuals who attained age 70½ before January 1, 2020. The age 70½ threshold increases to age 72 for an individual who attained age 70½ after December 31, 2019, and must take distributions after that date, but has not reached age 72 before January 1, 2023.[410] The age triggering required minimum distributions is age 73 for an individual who attains age 72 after December 31, 2022, and attains age 73 before January 1, 2033. The age threshold rises to age 75 for individuals who attain age 74 after December 31, 2032.[411] As the statute is written, it is unclear which age (age 73 or age 75) applies to individuals born in 1959. Proposed regulations would set the applicable age for an individual born in 1959 at age 73.[412]

For plans other than church and governmental plans, for an employee (other than a 5% owner) who retires in a calendar year after attaining age 70½, the employee's accrued benefit must be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan, so that the employee's accrued benefit is required to reflect the value of benefits that the employee would have received if the employee had retired at age 70½ and had begun receiving benefits at that time.[413] Regulations that apply for purposes of determining required minimum distributions for calendar years beginning on or after January 1, 2025, provide that a plan will not be treated as a church plan unless at least 85% of the individuals covered are employees of a church or a qualified church-controlled organization. In addition, whether an individual is an employee of a church or qualified church-controlled organization is determined in accordance with the rules for defining a church employee under §414(e)(3)(B) (discussed at II.B., above) other than employees of a church or a convention or association of churches.[414]

d. Qualified Domestic Relations Orders

The qualified domestic relations order (QDRO) rules of the I.R.C. do not apply to governmental or nonelecting church plans because they are not subject to the vesting rules.[415] However, this does not appear to mean that such plans need not honor domestic relations orders, because such orders are not preempted by ERISA in the case of governmental and nonelecting church plans.

If a governmental or church plan implements a domestic relation order, then distributions from the plan is treated, for tax purposes, as made pursuant to a QDRO if the domestic relations order meets the requirements of §414(p)(1)(A)(i).[416] Thus, even if a domestic relations order does not specify the facts that are required in QDROs for other qualified plans, and even if it alters the amount and form of benefits otherwise prohibited by §414(p)(3), the basis allocation rules of §72(m)(10) and the tax, rollover, and lump-sum distribution rules of §402 still may apply.[417]

e. Return of Employee Contributions

For governmental plans, the pre-1986 TRA[418] basis recovery rules apply to the amount of a participant's account as of December 31, 1986, provided that such plan provided for withdrawals of employee contributions as of May 5, 1986.[419]

10. Fiduciary Standards

a. Exclusive Benefit Rule

Qualified government plans and nonelecting church plans are subject to the "exclusive benefit rule" of §401(a)(2), which provides that no part of the assets of the trust may be used for or diverted to anyone other than employees or their beneficiaries before the satisfaction of all trust liabilities. Although regulations provide that this prohibition encompasses "all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries," the IRS has ruled that a transaction will not violate the exclusive benefit rule if its primary purpose is to benefit employees.[420] Section 457 and §403(b) plans at one time were not subject to an exclusive ben-

[408] For this purpose, a "church plan" is a plan maintained by a church for church employees. A "church" means a church defined in §3121(w)(3)(A) as a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated or principally supported by a church or by a convention or association of churches, or a qualified church-controlled organization defined in §3121(w)(3)(B) as a church-controlled tax-exempt organization described in §501(c)(3), other than one that offers goods, services or facilities for sale, except on an incidental basis, to the general public, unless such sale is at a nominal charge substantially less than costs; and normally receives more than 25% of its support from either governmental sources and/or from receipts from admissions or sales of goods, services or facilities. §401(a)(9)(C)(iv).

[409] §401(a)(9)(C)(ii)(I), as amended by Pub. L. No. 117-328, Div. T, §107(b), effective for individuals who attain age 72 after December 31, 2022.

[410] Former §401(a)(9)(C)(i)(I), as amended by the SECURE Act of 2019, Pub. L. No. 116-94, Div. O, §114(a).

[411] §401(a)(9)(C)(v), as added by Pub. L. No. 117-328, Div. T, §107(c). *See* Reg. §1.401(a)(9)-2(b)(2), added by T.D. 10001.

[412] Prop. Reg. §1.401(a)(9)-2(b)(2)(v), REG-103529-23, 89 Fed. Reg. 58,644 (July 19, 2024), proposed to apply for determining required minimum distributions for calendar years beginning on or after January 1, 2025. Members of Congress have indicated to the IRS that their intent was for the applicable age to be age 75 for individuals who attain age 73 (not age 74) after December 31, 2032. Letter from Cong. Chairs and Ranking Members of House Comm. on Ways and Means and Senate Comm. on Fin. to Janet Yellen, Sec'y of Treasury, and Daniel Werfel, Comm'r of Internal Revenue (May 23, 2023).

[413] §401(a)(9)(C)(ii), §401(a)(9)(C)(iii), §401(a)(9)(C)(iv). Although the SECURE Act of 2019, Pub. L. No. 116-94, Div. O, §114, and the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §107 amended §401(a)(9) to increase the age for mandatory minimum distributions from age 70½, neither the SECURE Act nor the SECURE 2.0 Act amended §401(a)(9)(C)(iii) to increase the age from age 70½ with respect to actuarial adjustments.

[414] Reg. §1.401(a)(9)-6(g)(4), added by T.D. 10001. *See* T.D. 10001, 89 Fed. Reg. at 58,898-99 (preamble). If plan that is not a church plan covers an individual who is also covered by other plans, the actuarial increase requirement does not apply to benefits accrued for that individual's service as an employee of a church. Reg. §1.401(a)(9)-6(g)(4)(iii).

[415] §414(p)(11).

[416] For a more complete discussion of QDROs, see 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification.*

[417] Distributions from §457(b) plans pursuant to QDROs are to be treated as taxable to the alternate payee subject to §402(a) and §72. §414(p)(12).

[418] Pub. L. No. 99-514.

[419] 1988 TAMRA, Pub. L. No. 100-647, §1011A(b)(11); Notice 87-13. For a discussion of these rules, see 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification.*

[420] Compare Reg. §1.401-2(a)(3) with language in Rev. Rul. 73-380. *See* IRS letter addressed to Paul R. Thompson (Oct. 30, 1981), 8 Pens. & Ben. Rep. (BNA) J-9 (Dec. 7, 1981).

ISBN 978-1-63359-446-3

efit requirement under the I.R.C., but that has since been added by regulation.[421] Where multiple benefit provisions existed under a public retirement system and assets could not be transferred from one arrangement to another, the IRS has ruled that each benefit provision constituted a single plan because the assets of each arrangement were only available to pay the benefits for that particular arrangement. Because all of the assets of the public retirement system were not available to pay benefits for all covered employees the public retirement system was not a single plan.[422]

(1) Reversions to Employer

One issue that involves the exclusive benefit rule is the return of contributions to the employer. A qualified plan may provide for the return of an employer's contribution (but not earnings thereon) within one year of payment if the plan fails to initially qualify[423] or if contributions were made as a result of a mistake of fact.[424] Qualified plan assets may revert to an employer upon plan termination after the liabilities to employees and their beneficiaries are satisfied.[425]

(2) Plan Investments

(a) Purchase of Employer Obligations

Another exclusive benefit issue, particularly with respect to governmental plans, concerns the investment of plan assets in bonds or other employer obligations. Such investments are not prohibited *per se* by the I.R.C., but will come under close scrutiny by the IRS. Based on pre-ERISA IRS rulings, a private plan trust investment in employer stock or securities will be consistent with the exclusive benefit rule only if the following four investment requisites are satisfied: (1) the cost must not exceed fair market value at the time of purchase; (2) a fair return commensurate with the prevailing rate must be provided; (3) sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plans; and (4) the safeguards and diversity that a prudent investor would adhere to must be present.[426] In the case of a §401(a) qualified plan, the transaction also must not constitute a prohibited transaction under §503(a). Prohibited transactions are discussed at III.F.10.c., below.

The most well-known investment in employer obligations involving a governmental plan was the purchase by five New York City pension plans of obligations of the City of New York when the city faced a fiscal crisis during the mid-1970s and was unable to market its securities. Congress passed legislation permitting the New York City public employee retirement systems to purchase $2.5 billion in New York City bonds as part of a plan to prevent the city's bankruptcy. The legislation was designed to ensure that the sale of assets to fund the purchase and the acquisition of the securities by the plans would not be treated as violating the exclusive benefit rule and prohibited transaction rules under §503.[427] The bill provided that the requirements with respect to these rules would be set aside only to the extent the investments would maintain the ability of the city to make future contributions to the plans and trust and to satisfy its future obligations to pay pension and retirement benefits.[428] It also authorized the plan trustees to balance the interest of the employees and the city by taking into account the extent to which the investments, by helping the city, would protect the sources of funds for retirement benefits.[429] Congress noted that, generally, the IRS treats an asset purchase or sale that violates the prohibited transaction rule as a violation of the exclusive benefit rule.[430]

Congress explicitly stated that the bill was not to be considered a precedent for other state or local pension plans to acquire obligations of their sponsoring employers.[431] In the absence of IRS rulings setting out acceptable investment criteria for governmental plans, government obligations which typically provide a lower rate of return than those issued by private companies, could fail to meet the investment requirements of Rev. Rul. 69-494.

(b) Acceptance of Employer Obligations as Plan Contributions

Accepting a percentage of a bond issue in partial settlement of a claim for delinquent contributions against a financially troubled city may violate the exclusive benefit rule. The IRS has at least tacitly concluded that, for purposes of the exclusive benefit rule, the economic circumstances of the city employer may be taken into account in establishing the terms, including the interest rate, for the portion of the delinquent contributions that would be satisfied by the bonds.[432]

[421] Reg. §1.403(b)-8(d)(2)(iii), §1.403(b)-9(a)(2)(i)(C), §1.457-8(a)(1). The conference report to the enactment of §403(b)(9) in the 1982 TEFRA, Pub. L. No. 97-248, indicated that church §403(b)(9) retirement income account plans are subject in some manner to the exclusive benefit rules, but it was not clear prior to the §403(b) regulation that such legislative history had the force of law. *See* Conf. Rep. No. 97-760, 97th Cong., 2d Sess. at 80. *See also* CCA 201742022 (participant's investment in LLC constitutes indirect loan of retirement income account assets to employer in violation of exclusive benefit requirement where LLC's primary function is to offer loans to employer or when LLC is controlled by employer and makes a loan to employer).

[422] PLR 200216034.

[423] ERISA §403(c)(2)(B); Rev. Rul. 91-4.

[424] ERISA §403(c)(2)(A); Rev. Rul. 91-4. The contribution must be returned within one year after payment. The plan also may provide for the return of an employer contribution that is conditioned on its deductibility under I.R.C. §404, to the extent the deduction is disallowed, provided the contribution is returned within one year after the disallowance. ERISA §403(c)(2)(C). *See* Rev. Proc. 90-49.

[425] Reg. §1.401-2(a).

[426] Rev. Rul. 69-494.

[427] Pub. L. No. 94-236. An agreement by the pension funds to purchase the securities had been conditioned on a favorable ruling by the IRS or the passage of legislation by Congress that the purchases would not constitute prohibited transactions or otherwise adversely affect the tax-qualified status of the pension funds. The initial law applied only to an agreement to purchase obligations entered into on November 26, 1975. In 1978, it was extended to apply to obligations purchased between July 1, 1978, and June 30, 1983. *See* Pub. L. No. 95-497. The issue of whether the purchase would violate the exclusive benefit rule arose because: (1) the holding of such securities was for a purpose other than for providing benefits for employees; and (2) the purchase of the securities required the funds to liquidate investments that might have been more favorable to employees.

[428] H.R. Rep. No. 851, 94th Cong., 2d Sess.

[429] H.R. Rep. No. 851, 94th Cong., 2d Sess.

[430] H.R. Rep. No. 851, 94th Cong., 2d Sess.

[431] H.R. Rep. No. 851, 94th Cong., 2d Sess.

[432] GCM 38972 (Mar. 25, 1983).

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(3) Assignment of Benefits in Bankruptcy

Section 401(a)(13) generally prohibits the assignment or alienation of retirement benefits. The IRS has taken the position that nothing in the legislative history or language of §401(a)(13) would protect a private qualified plan from disqualification if it paid a portion of an employee's retirement benefits to a bankruptcy trustee as part of a debt repayment plan under an involuntary or voluntary bankruptcy proceeding.[433] However, the IRS has also ruled that a governmental plan that honors a bankruptcy assignment made to a participant in pay status does not face disqualification because the plan is not subject to §401(a)(13)[434] and such an assignment does not violate the exclusive benefit rule.[435] The IRS's rationale with respect to the exclusive benefit rule is that the payment of an employee's debt is in fact a benefit to him or her and any benefit that inures to the employee's creditors is merely incidental.[436]

In *Patterson v. Shumate*,[437] the U.S. Supreme Court held that the assets of a plan subject to ERISA may not be included in the bankruptcy estate of a bankrupt plan participant.

The Court determined that ERISA is an "applicable nonbankruptcy law" for purposes of §541(c)(2) of the federal Bankruptcy Code, which exempts from the bankruptcy estate property of the debtor that is subject to a restriction on the transfer of a beneficial interest of the debtor enforceable under applicable nonbankruptcy law. Because I.R.C. §401(a)(13) and ERISA §206(d)(1) restrict the transfer or assignment of assets, ERISA-covered plans are exempted.[438]

However, this left open the question of whether church and governmental plans, which are not ERISA-covered plans or subject to I.R.C. §401(a)(13), are excluded from the bankruptcy estate. Under §522 of the Bankruptcy Code, a debtor may exempt certain specific property from the bankruptcy estate under either a federal or state law list of exemptions. An exemption is allowed for a payment under a stock bonus, pension, profit-sharing, annuity or similar plan or contract on account of illness, death, age or length of service, to the extent reasonably necessary for the support of the debtor or any dependent.[439] Further, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Bankruptcy Act)[440] expanded the federal bankruptcy protection for tax-favored retirement plans or arrangements that may not already have been protected under Bankruptcy Code §541(c)(2) pursuant to *Patterson* or other state or federal law. Under the 2005 Bankruptcy Act, a debtor may exempt retirement funds held in a qualified pension or profit-sharing plan (including governmental and church plans), annuity plan, traditional or Roth IRA, hybrid plan, eligible governmental or tax-exempt organization deferred compensation plan, or employee-contribution-only plan that is exempt from taxation and has received a favorable determination letter from the IRS that is in effect as of the date of the commencement of the bankruptcy case.[441] The exemption also applies to certain direct transfers and eligible rollover distributions and ensures that the specified retirement funds are exempt under state as well as federal law.[442]

For further discussion of these issues, see 351 T.M., *Plan Qualification — Pension and Profit-Sharing Plans*; and 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification.*

b. Fiduciary Responsibility

Governmental plans and nonelecting church plans are not subject to the rules governing fiduciary conduct contained in ERISA §404.[443] However, the IRS has interpreted the "exclusive benefit rule" of I.R.C. §401(a)(2) as requiring the exercise of prudence in the investment of plan assets.[444] In light of the legislative history of ERISA, it appears that satisfaction of the ERISA rules would be sufficient to satisfy the I.R.C. requirements.[445] Plan fiduciaries also may be subject to the requirements of state law that contain standards for regulating trust or charitable organization investments.

State fiduciary standards have varied widely from state to state, and have changed frequently. In the past, the standards

[433] *See* cases cited in GCM 39267 (Aug. 2, 1984).

[434] Section 401(a)(13) only applies to plans subject to §411. Thus, governmental plans and nonelecting church plans are not subject to §401(a)(13). *See* Reg. §1.401(a)-13(a).

[435] GCM 39267; PLR 8426124.

[436] GCM 39267; PLR 8426124.

[437] 504 U.S. 753, 15 EBC 1481 (1992), aff'g 943 F.2d 362, 14 EBC 2340 (4th Cir. 1991).

[438] The IRS changed its litigating position concerning the application of Bankruptcy Code §506(a) to pension plans that are excluded from the bankruptcy estate under Bankruptcy Code §541(c)(2). Under Bankruptcy Code §506(a), a creditor with a lien on property of the bankruptcy estate holds a secured claim to the extent of the value of the creditor's interest in the estate's interest in such property. The IRS has argued that its secured claim includes the value of a debtor's interest in a pension plan that is subject to a federal tax lien. However, in *IRS v. Snyder*, 343 F.3d 1171, 31 EBC 1236 (9th Cir. 2003), *acq.*, 2004-41 I.R.B., AOD 2004-06, the Ninth Circuit held that the IRS did not hold a secured claim with respect to the debtor's interest in an ERISA-qualified pension plan because the interest was excluded from bankruptcy under Bankruptcy Code §541(c)(2). In Notice CC-2004-033, the Chief Counsel's Office advised that it will no longer argue that the IRS may include in the value of its secured claim the debtor's interest in a pension plan that is excluded from the property of the estate under Bankruptcy Code §541(c)(2). However, the federal tax lien against the debtor's interest in the pension plan is not extinguished and will continue to exist outside of the bankruptcy proceeding.

[439] Bankruptcy Code §522(d)(10)(E).

[440] Pub. L. No. 109-8, §224(a) and §224(e), amending Bankruptcy Code §522(b), §522(d), and §522(n).

[441] The provision refers to accounts exempt from taxation under I.R.C. §401, §403, §408, §408A, §414, §457, or §501(a). If the funds are in a retirement fund that has not received a favorable determination, they are exempt if the debtor demonstrates that no prior unfavorable determination has been made by a court or the IRS and the retirement fund is in substantial compliance with the applicable requirements of the I.R.C. If the retirement fund fails to be in substantial compliance with applicable requirements of the I.R.C., the debtor may claim the retirement funds as exempt if he or she is not materially responsible for such failure.

[442] The 2005 Bankruptcy Act also expands the list of property excluded by definition from the bankruptcy estate to include contributions withheld from employees' wages or received by an employer from employees for (1) all employee welfare and pension benefit plans subject to Title I of ERISA or a governmental plan under I.R.C. §414(d), (2) a deferred compensation plan of a state or local governmental unit under I.R.C. §457, (3) a tax-deferred annuity under I.R.C. §403(b), or (4) a health insurance plan regulated by state law. Bankruptcy Code §541(b)(7), as amended by Pub. L. No. 109-8, §323.

[443] ERISA §401(a) and §4(b). For a full discussion of the ERISA rules on fiduciary responsibility, see 365 T.M., *ERISA — Fiduciary Responsibility and Prohibited Transactions.*

[444] *See, e.g.*, Rev. Rul. 69-494 and Rev. Rul. 73-380 (investment consistent with exclusive benefit rule if safeguards and diversity that prudent investor would adhere to are present).

[445] *See* H.R. Rep. No. 1280, 93d Cong. 2d Sess. 302. For a detailed discussion of the exclusive benefit rule, see GCM 38495 (Sept. 15, 1980).

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have included "legal lists" that specify acceptable investments, a "prudent man" standard that was something less than a "prudent expert" standard, and standards that approximate the ERISA prudent expert standard. State laws have been moving closer to the latter since the introduction of the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) in 1997.[446]

Under the UMPERSA, a trustee has the power to invest in any property or investment provided that it is consistent with the duties of the act, principally that the trustee must invest as a prudent investor would invest his or her own assets. Such a prudent investor must take all factors into account, and there is a positive duty to diversify. The UMPERSA also addresses trustee liability for breach of duty and required disclosures to participants and enforcement. Many of these provisions are similar to the ERISA requirements in these areas.

c. Prohibited Transaction Rule

Although the excise tax on prohibited transactions imposed by §4975 does not apply to governmental plans and nonelecting church plans,[447] those plans that are §401(a) qualified plans are subject to the prohibited transaction rules of §503. A violation of these rules may result in the loss of tax-exempt status of the trust associated with the plan[448] and, consequently, the loss of benefits to participants associated with such tax-exempt status.[449] The exemption will be lost only for taxable years after the year in which the trust is notified by the Secretary of the Treasury that it has engaged in a prohibited transaction, unless the prohibited transaction involved a substantial part of the corpus of income of the trust and was intended to divert funds from the exempt purposes of the trust.[450] The trust that has lost its exemption may file a claim for exemption with the Secretary of the Treasury in any year following such loss, and if the Secretary is satisfied that the trust will not knowingly commit a prohibited transaction, the exemption will be restored for the year subsequent to the year in which the claim is filed.[451]

Section 503 generally requires arm's-length dealings between the creator of the trust and the trustee.[452] Thus, §503 prohibits transactions that would result in a substantial diversion of trust income or corpus to the creator of the trust or of any substantial contributor to the trust.[453] Among the specific transactions proscribed are: (1) the lending of any part of the trust income or corpus without the receipt of adequate security and a reasonable rate of interest to the creator or contributor;[454] (2) the substantial purchase of securities or other property for more than adequate consideration from the creator or contributor;[455] and (3) the sale of a substantial part of its securities or property for less than adequate consideration to the creator or contributor.[456] Whether a particular transaction constitutes a prohibited transaction depends upon the specific facts and circumstances.[457]

Discussion of the application of §503 to governmental and nonelecting church plans has arisen almost exclusively in the context of trust acquisition of employer obligations. Such an acquisition may be treated as a loan made without adequate security from the trust to the employer and, thus, could be a prohibited transaction under §503(b)(1).[458] For example, the concern with respect to the acquisition of New York City debt obligations by certain city pension plans that prompted the enactment of Pub. L. No. 94-236, discussed above in III.F.10.a.(2)(a), centered on whether the New York debt obligation was adequately secured, given that it was backed only by the credit of the city, which at that time was in poor financial condition.[459] The IRS had previously taken the position with respect to private employers that the pledge of an employer's general assets did not provide adequate security for purposes of the prohibited transaction rules.[460] The IRS subsequently concluded that the acceptance of city employer-issued bonds by two employees' trusts as part of a settlement of delinquent contributions was a loan rather than debt collection, and as such, would be a prohibited transaction unless structured to fall within the special rules of §503(e).[461]

d. Prohibited Tax Shelter Transactions

Section 4965 imposes excise taxes on the entity managers of certain tax-exempt entities for entering into a prohibited tax shelter transaction.[462] For this purpose, a tax-exempt entity includes, among other things: (1) an eligible deferred compensation plan under §457(b) that is maintained by a state, its political subdivision, or an agency or instrumentality of either entity; (2) a church or government-sponsored plan intended to meet the qualification requirements of §401(a); and (3) a §403(b)

[446] See the National Conference of Commissioners on Uniform State Laws (NCCUSL) website, www.uniformlaws.org. For text of UMPERSA, see the National Association of State Retirement Administrators (NASRA) website, www.nasra.org.

[447] §4975(g)(2), §4975(g)(3). For a discussion of the operation of §4975, see 365 T.M., *ERISA — Fiduciary Responsibility and Prohibited Transactions.*

[448] §503(a)(1), as amended by Pub. L. No. 113-295, Div. A, §221(a)(63)(A), generally effective December 19, 2014. Presumably, this would be the case even though such an organization might otherwise be exempt under §501(c)(3).

[449] For example, if the trust forming part of a plan is not tax exempt, contributions on behalf of employees are taxable when made and distributions from the trust will not be available for rollover. *See* §402(b) and §402(e), respectively.

[450] *See* §503(a)(2), as amended by Pub. L. No. 113-295, Div. A, §221(a)(63)(B).

[451] *See* Reg. §1.503(c)-1.

[452] S. Rep. No. 2375, 81st Cong., 2d Sess. 36–37.

[453] §503(b)(6). The proscription only applies to the creator of the trust or to a substantial contributor. Section 503 does not apply to individuals or entities that do not fit this description. *See* PLR 8715056 (§503 not applicable to investment advisor to governmental plans).

[454] §503(b)(1).

[455] §503(b)(4).

[456] §503(b)(5).

[457] Reg. §1.503(b)-1(a).

[458] The purchase of debt obligations issued by the creator of, or substantial contributor to, a trust is considered to be a loan by the trust for purposes of §503(b)(1). *See* Reg. §1.503(b)-1(b). However, §503(e) provides that such an acquisition will not be treated as a loan made without receipt of adequate security if it is: (1) acquired at a price no less favorable than the price paid by persons independent of the issuer; and (2) immediately following the acquisition, not more than 25% of the outstanding issue is held by the trust and at least 50% of the outstanding issue is held by persons independent of the issuer.

[459] *See* H.R. Rep. No. 851, 94th Cong., 2d Sess.

[460] Rev. Rul. 70-131.

[461] GCM 38972 (Mar. 25, 1983).

[462] *See* Reg. §53.4965-1 through §53.4965-8. *See also* Notice 2006-65, Q&A-19.

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plan.[463] An entity manager is defined as the person who approves (e.g., plan administrator) or otherwise causes the plan to be a party to a prohibited tax shelter transaction.[464] A prohibited tax shelter transaction is a listed transaction or a prohibited reportable transaction.[465]

The entity manager who approves the plan as (or otherwise causes the plan to be) a party to a prohibited tax shelter transaction at any time during the taxable year and who knows or has reason to know that the transaction is a prohibited tax shelter transaction is liable for an excise tax of $20,000 for each such approval or act causing the plan to participate.[466] Previously, no excise taxes were imposed on entity managers (or tax-exempt entities) for approving the entity as a party to such transaction (or for becoming a party to a prohibited tax shelter transaction).

The IRS must be notified of each incident of participation in a prohibited tax shelter transaction and the names of other known parties to the transaction.[467] The penalty imposed on the entity manager for failure to disclose is $100 (as adjusted for inflation) for each day that the failure to disclose continues, not to exceed $50,000 (as adjusted for inflation) for a required disclosure.[468] For a table listing the annual penalty adjustments, see Tables, Charts & Lists, *Penalties, Failure to File Certain Information Returns, Registration Statements, Etc.*

For further discussion of §4965 and related provisions, see 351 T.M., *Plan Qualification — Pension and Profit-Sharing Plans*; and 373 T.M., *Employee Benefits for Tax-Exempt Organizations.*

11. Section 401(k) Requirements

Except for governmental employers, tax-exempt organizations can maintain §401(k) cash or deferred arrangements.[469] A grandfather rule exists for governmental plans that existed on May 6, 1986.[470] However, a grandfathered §401(k) plan of one governmental employer within a state cannot be amended to permit other governmental employers within the state to participate.[471] Thus, identifying the specific governmental unit that adopted the §401(k) plan on or before May 6, 1986 (or its successors), is important to determine which governmental employers may participate in the plan.[472]

12. Qualified Military Service

Church and governmental plans must provide that the survivors of a participant who died while performing qualified military service receive any additional benefits (other than benefit accruals) provided under the plan as if the participant were employed at the time of death.[473]

13. Special Employer Aggregation Rules Related to Church Plans

In determining whether applicable plan qualification, participation, vesting, contribution and benefit limitation, and top-heavy rules that apply to church plans are satisfied, special rules apply to determine whether employees of organizations that are eligible to participate in a church plan are treated as employed by a single employer under the common control rules of §414(c) or the affiliated service group rules of §414(m). Organizations that are otherwise eligible to participate in a church plan are not aggregated and treated as a single employer for a plan year beginning in a taxable year unless:

- one of the organizations provides, either directly or indirectly, at least 80% of the operating funds for the other organization during the preceding taxable year of the recipient organization; and
- 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.[474]

[463] §4965(c)(4), §4965(c)(6). The term also includes an Indian tribal government and a §501(c) organization. §4965(c)(1), §4965(c)(3). *See* Reg. §53.4965-2; Notice 2006-65, Q&A-2.

[464] §4965(d)(2); Reg. §53.4965-5(b)(1); Notice 2006-65, Q&A-3. For nonplan tax-exempt entities (e.g., Indian tribal governments and §501(c) organizations), the entity manager is the person whose authority or responsibility is similar to that of an officer, director, or trustee and who has authority or responsibility for an act. §4965(d)(1). Except in the case of a fully self-directed plan or other savings arrangement for which a participant or beneficiary decides to invest in the prohibited tax shelter transaction, a plan participant or beneficiary generally is not an entity manager. H.R. Conf. Rep. No. 455, 109th Cong., 2d Sess. 112 (2006). *See* Reg.§53.4965-5(b)(2); Notice 2006-65, Q&A-3. A tax-exempt entity is a party to a transaction if it: (1) facilitates the transaction by reason of its tax-exempt, tax-indifferent or tax-favored status; or (2) is identified in published guidance, by type, class or role, as a party to a prohibited tax shelter transaction. Reg. §53.4965-4; Notice 2007-18, §III.

[465] §4965(e)(1); Reg. §53.4965-3(a). Pursuant to §6707A(c)(2), a listed transaction is a reportable transaction that is the same as or substantially similar to a transaction that the IRS specifically identifies as a tax avoidance transaction. *See* §6011. A prohibited reportable transaction is any confidential transaction or any transaction with contractual protection (as defined under IRS regulations) which is a reportable transaction (as defined in §6707A(c)(1)).

[466] §4965(a)(2), §4965(b)(2); Reg. §53.4965-7(b). Section 457(b) plans, church plans, government-sponsored plans, and §403(b) plans are not subject to a separate excise tax under §4965; however, Indian tribal governments and §501(c) organizations are subject to a separate excise tax for each year that they are a party to a prohibited tax shelter transaction. The amount of the tax is based on the entity's net income or 75% of proceeds received for the taxable year. §4965(a)(1), §4965(b)(1); Reg. §53.4965-7(a). Disclosure and filing obligations apply under §6011(g) and §6071 for the entity- and manager-level excise taxes. *See* Reg. §301.6011(g)-1 (disclosures), §54.6011-1(c) and §53.6071-1(g) (filing returns).

[467] §6033(a)(2); Reg. §1.6033-5.

[468] §6652(c)(3)(A). For returns required to be filed after 2014, the amount of the penalty is adjusted to reflect inflation. §6652(c)(7), added by Pub. L. No. 113-295, Div. B, §208(b), redesignated by Pub. L. No. 114-113, Div. Q, §405(c), and amended by Pub. L. No. 115-97, §11002(d)(1)(LL) (reflecting change to §1(f)(3) inflation adjustment formula), applicable to taxable years beginning after December 31, 2017. In the case of nonplan tax-exempt entities that are parties to the transaction (such as Indian tribal governments and §501(c) organizations), this penalty is imposed on the entity. §6652(c)(3)(A). *See* Notice 2006-65, Q&A-16.

[469] §401(k)(4)(B). This prohibition does not apply to plans of Indian tribal governments and rural cooperatives. §401(k)(4)(B)(ii), §401(k)(4)(B)(iii); Reg. §1.401(k)-1(e)(4)(ii); *see* §401(k)(7) (rural cooperative plan).

[470] Reg. §1.401(k)-1(e)(4)(i), §1.401(k)-1(e)(4)(iii), §1.401(k)-1(e)(4)(iv).

[471] *See* PLR 9842064 (state transportation provider can adopt §401(k) plan because it is part of larger state agency that previously adopted §401(k) plan that was grandfathered).

[472] PLR 9449021.

[473] §401(a)(37), added by Pub. L. No. 110-245, §104(a), effective with respect to deaths occurring on or after January 1, 2007. *See* Notice 2010-15, §II, Q&A-1 through -4.

[474] §414(c)(2)(A). Section 414(c)(2) was added by Pub. L. No. 114-113, Div. Q, §336(a)(1), effective for years beginning before, on or after December 18, 2015. Regulations governing employer aggregation for tax-exempt organizations do not yet address their application to certain church entities under §3121(w)(3). *See* reserved Reg. §1.414(c)-5(e).

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The church or convention or association of churches, or an organization designated by any of those entities, may make an election to treat the organizations as a single employer for a plan year. Unless this election is revoked, aggregation applies to all succeeding plan years.[475] An employer also may elect to treat churches, as defined in §403(b)(12)(B), separately from non-church entities, without regard to whether they maintain separate church plans. Unless this disaggregation election is revoked, it continues to apply for succeeding plan years.[476] Once an election is made, it applies to all succeeding plan years unless revoked with notice to the IRS provided in the manner specified by the IRS. There is no requirement to notify the IRS when making a permissive aggregation or disaggregation election under §414(c)(2)(C) or §414(c)(2)(D), respectively. Notice 2018-81 directs that notice of revocation of an election to aggregate or disaggregate church-related entities is accomplished by maintaining the revocation in accordance with general substantiation and recordkeeping requirements under §6001 and, upon request by the IRS, providing a copy of the revocation.[477]

A different rule applies for a nonqualified church-controlled organization (i.e., a church-controlled §501(c)(3) organization that is not a qualified church-controlled organization under §3121(w)(3)(B)). A nonqualified church-controlled organization will be aggregated with other nonqualified church-controlled organizations, or with an organization that is not tax exempt under §501, and treated as a single employer with the other organization, if at least 80% of the directors or trustees of the other organization are either representatives of, or directly or indirectly controlled by, the nonqualified church-controlled organization.[478]

An anti-abuse rule would allow the IRS to treat an entity as under common control with the exempt organization if the IRS determines that the structure of one or more exempt organizations has the effect of avoiding or evading statutory requirements.[479]

14. Church Plan Transfers and Mergers

A transfer may be made after December 18, 2015, of any of the accrued benefit of a participant or beneficiary from a church plan that is either a §401(a) plan or a §403(b) annuity contract to a 403(b) annuity contract, or from a §403(b) annuity contract to a church plan that is a §401(a) plan, without inclusion in gross income by the participant or beneficiary, if the church plan and annuity contract are both maintained by the same church or convention or association of churches. The rule applies without regard to whether the accrued benefit is vested.[480]

Similarly, no amount is included in the income of a participant or beneficiary due to a merger occurring after December 18, 2015, of a church plan that is a §401(a) plan or a §403(b) annuity contract with a §403(b) annuity contract as long as the plan and annuity contract are both maintained by the same church or convention or association of churches.[481] For purposes of this transfer or merger rule, a "church or convention or association of churches" includes an organization described in §414(e)(3)(A) or §414(e)(3)(B)(ii) (discussed at II.B., above)[482] and an annuity contract includes a custodial account under §403(b)(7) and a retirement income account under §403(b)(9).[483]

The participant's or beneficiary's total accrued benefit immediately after the transfer or merger cannot be less than it was before the event. In addition, the total accrued benefit is nonforfeitable after the transfer or merger.[484] For this purpose, the total accrued benefit for a defined benefit plan is the employee's accrued benefit determined under the plan. For other types of plans, it is the balance of the employee's account under the plan.[485]

These plans and annuity contracts do not lose their tax-favored status simply by engaging in a permitted transfer or merger.[486]

G. Remedial Amendment Periods

1. General Remedial Amendment Period

Section 401(b)(1) sets out the period during which a plan may be amended retroactively in order to meet the requirements of §401(a).[487] In the case of a new plan that contains a disqualifying provision,[488] this remedial amendment period begins on the date the plan is put into effect.[489] The remedial amendment period for an existing plan that contains a disqualifying provision as the result of an amendment, begins on the date such amendment was adopted or put into effect, whichever

[475] §414(c)(2)(C).

[476] §414(c)(2)(D). Reg. §1.414(c)-5(d), which preceded §414(c)(2), permits disaggregation so that entities that contribute to a church plan under §414(e) but are not treated as a church may treat themselves as being under common control with each other, but not with the church and organizations treated as a church.

[477] Notice 2018-81. These requirements apply to all revocations of permissive aggregation or disaggregation elections under §414(c)(2)(C) and §414(c)(2)(D), respectively, made after October 22, 2018. For revocations made before October 22, 2018, the notice permits the revoking entity to use "any reasonable method of notifying the Secretary," including the §6001 recordkeeping requirements.

[478] §414(c)(2)(B).

[479] Reg. §1.414(c)-5(f); Pub. L. No. 114-113, Div. Q, §336(a)(2) (stating that anti-abuse rule applies to §414(c)(2), effective December 18, 2015.

[480] §414(z)(1)(A), §414(z)(1)(B). Section 414(z) was added by Pub. L. No. 114-113, Div. Q, §336(d)(1), effective for transfers or mergers occurring after December 18, 2015.

[481] §414(z)(1)(C).

[482] §414(z)(4)(A).

[483] §414(z)(4)(B).

[484] §414(z)(2).

[485] §414(z)(4)(C).

[486] §414(z)(3).

[487] *See* Reg. §1.401(b)-1(a). For a more complete discussion of the remedial amendment period, see 360 T.M., *Qualified Plans — IRS Determination Letter Procedures.*

[488] A "disqualifying provision" means: (1) a provision of a new plan, the absence of a provision from a new plan, or an amendment to an existing plan that causes the plan to fail to satisfy §401(a); (2) a plan provision that causes the plan to fail to satisfy the I.R.C.'s qualification requirements because of a legislative change in those requirements; or (3) at the IRS's discretion, a provision designated as a disqualifying provision that results in the plan's failure to satisfy the I.R.C.'s qualification requirements because of a change in those requirements or is integral to a qualification requirement that has been changed. Reg. §1.401(b)-1(b). The term also refers to a plan provision that fails to meet qualification requirements because of changes required by ERISA. Reg. §1.401(b)-1(b)(2)(i).

[489] Reg. §1.401(b)-1(d)(1)(i).

ISBN 978-1-63359-446-3

is earlier.[490] The remedial amendment period for plans that contain a disqualifying provision as a result of a change in the law generally begins on the day the change in law became effective with respect to the plan.[491]

Unless an extension is granted,[492] the remedial amendment period ends at the close of the time prescribed by law for filing the employer's income tax return for the taxable year in which falls the latest of the following: (a) the date on which the remedial amendment period begins;[493] (b) the date on which an amendment containing a disqualifying provision is adopted;[494] or (c) the date on which such amendment becomes effective.[495] However, if later, the period will end at the close of the plan year encompassing the latest of these dates.[496] See III.G.2., below, for discussion of the IRS's extension of the remedial amendment period.

a. Governmental §401(a) Plans

Government employers are not required to file income tax returns or annual returns or reports for their plans.[497] However, Notice 89-8[498] provides that in determining the end of the remedial amendment period for an employer that is not required to file a tax return, an annual information return under §6033, or an annual report under §6058, the due date for filing the employer's tax return is deemed to be the last day of the seventh month following the end of the plan year. Thus, the remedial amendment period for a governmental plan ends seven months after the close of the plan year in which the remedial amendment period begins or in which an amendment containing a disqualifying provision is either adopted or becomes effective, whichever is latest.

b. Church §401(a) Plans

Church plans electing coverage under §410(d) are required to file an annual report (Form 5500), but nonelecting plans are not.[499] Churches also are not required to file an annual information return (generally Form 990) pursuant to §6033.[500] Because churches and church plans generally are not required to file tax returns or annual reports, the determination of the end of the remedial amendment period for church plans appears to be governed by Notice 89-8. Thus, the remedial amendment period under §401(b)(1) for a church plan would generally end seven months after the close of the plan year in which the remedial amendment period begins or in which an amendment containing a disqualifying provision is either adopted or becomes effective, whichever is latest.

For tax-exempt employers that are not required to file federal income tax returns but are required to file annual return reports on their plans under §6058 (Form 5500) (e.g., electing church plans) or §6033 (Form 990), the remedial amendment period ends on the due date (including extensions) of the annual report filed with respect to the plan.[501]

c. Special Rules for §401(a) and §403(b) Church Plans

In some instances, the time for amending a church plan to comply with a change in tax law may be extended beyond the period described above. Accordingly, if a church plan is required to be retroactively amended by reason of "any change in any law, regulation, ruling or otherwise," the plan will not be treated as failing to qualify under §401(a) or §403, as applicable if the required amendment is made not later than the next earliest church convention.[502] This provision reflects congressional recognition that church governing bodies typically meet at lengthy intervals.[503] However, the remedial amendment period cannot be less than that prescribed in §401(b).[504]

Comment: This provision is broadly worded, and would appear to permit retroactive amendments by church plans in a wide array of events.

d. Special Governmental §457(b) Correction Period

Section 457(b) does not require that an eligible deferred compensation plan under that provision be in writing. However, the flush language of §457(b) provides that a governmental §457(b) plan that is administered in a manner that is inconsistent with the requirements of §457(b) is treated as not meeting the requirements of §457(b) as of the first plan year beginning more than 180 days after the date of notification by the Secretary of the Treasury of the inconsistency, unless the employer corrects the inconsistency before the first day of such plan year.

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[490] Reg. §1.401(b)-1(d)(1)(ii).

[491] Reg. §1.401(b)-1(d)(1)(iii).

[492] Reg. §1.401(b)-1(e) and §1.401(b)-1(f) set out the circumstances under which the remedial amendment period may be extended. Reg. §1.401(b)-1(e)(3) provides that if a request for a determination letter is made on or before the date the remedial amendment period would otherwise expire, the period for retroactively amending the plan will be extended to 91 days after the date on which the notice of final determination is issued, withdrawn or otherwise disposed of. If a timely petition challenging the final determination is filed with the U.S. Tax Court, the period will expire 91 days after the court issues its final ruling. At its discretion, the IRS may extend the remedial amendment period or may permit a particular plan to be amended after the expiration of its remedial amendment period. A request for an extension must be made before the expiration of the remedial amendment period. *See* Reg. §1.401(b)-1(e).

[493] *See* Reg. §1.401(b)-1(d)(2)(i)(A).

[494] Reg. §1.401(b)-1(d)(2)(i)(B).

[495] Reg. §1.401(b)-1(d)(2)(i)(C).

[496] Reg. §1.401(b)-1(d)(2)(ii).

[497] *See* Rev. Rul. 79-227 and Announcement 82-146.

[498] *Superseded by* Rev. Proc. 89-65.

[499] Announcement 82-146.

[500] For a discussion of IRS reporting and disclosure requirements, see VI.B., below.

[501] Rev. Rul. 79-227, §3.02 and §3.01, respectively. This also applies to Form 990-T filers.

[502] Tax Equity and Fiscal Responsibility Act of 1982 (1982 TEFRA), Pub. L. No. 97-248, §251(d). This subsection is codified as a note provision under §403. While this subsection is not integrated into the main text of the I.R.C., legal scholars maintain that "… law found in the notes to the United States Code … is no less 'the law' than the codified sections themselves." Triffin, Questions & Answers, 77 Law Libr. J. 182, 183–84 (1984). Moreover, courts have affirmed this view and declared that "… the fact that [a law] was not codified with the substantive provisions … but, instead, was set out as … a note to a particular provision does not make it any less binding …" *In re TMI Litigation Cases Consol. II*, No. 1:CV-88-1452, 1996 WL 506522, at * 2 (M.D. Pa. Aug. 16, 1993).

[503] H.R. Rep. No 760, 97th Cong., 2d Sess. at 637.

[504] H.R. Rep. No 760, 97th Cong., 2d Sess. at 637.

ISBN 978-1-63359-446-3

2. Extension of General Remedial Amendment Period

a. In General

Through its determination letter program,[505] the IRS extends the general remedial amendment period under Reg. §1.401(b)-1 (see III.G.1., above) for a disqualifying provision, provided the plan sponsor has a good faith intention that the plan be qualified. For this purpose, a disqualifying provision is a plan provision (or absence of a provision) that, because of changes after 2001, causes a plan to fail the qualification requirements or a provision that is integral to those requirements.[506] Under the program in effect before 2017, the IRS generally extended the period to the end of the five-year remedial amendment cycle assigned to the plan sponsor;[507] however, the IRS modified its determination letter program so that remedial amendment cycles are no longer available to individually designed plans. Instead, under the IRS program as of 2017, individually designed plans can apply for a determination letter only for initial plan qualification, qualification upon plan termination, and for certain other limited circumstances that the IRS will identify in published guidance. Beginning June 1, 2023, the IRS program also permits §403(b) individually designed plans, other than TEFRA church defined benefit plans and grandfathered plans, to apply for a determination letter under these circumstances.[508]

The remedial amendment period for individually designed plans to correct disqualifying provisions or §403(b) plan form defects that arise as a result of a change in qualification requirements or §403(b) requirements, respectively, expires on the last day of the second calendar year that begins after the issuance of the Required Amendments List (RA List) on which the change in qualification requirements or §403(b) requirements appears.[509] In the case of governmental plans under §414(d), the remedial amendment period for a disqualifying provision or form defect for §403(b) plans that arises as a result of a change in qualification requirements or §403(b) requirements, respectively, expires 90 days after the close of the third regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date of issuance of the RA List on which the change in qualification requirements or §403(b) requirements appears, if that deadline is later.[510]

Pre-approved plans continue to be eligible to apply for a determination letter on a six-year remedial amendment cycle.[511] In an effort to simplify the pre-approved plan program, provide greater flexibility in plan design, and make more types of plans eligible for pre-approved status, including nonelecting church plans, the IRS combined the pre-approved master and prototype (M&P) and volume submitter (VS) programs into a single Opinion Letter program that covers standardized and non-standardized plans. This revised program applies to applications for Opinion Letters submitted regarding a plan's third 6-year remedial amendment cycle and subsequent cycles.[512]

Pre-approved plans generally have a 12-month period following the opening of the cycle to submit applications for opinion letters.[513] The IRS may extend this deadline.[514] When a six-year cycle is near completion, the IRS will announce a date for employer adoption of the newly approved plan that should give employers a window of approximately two years to adopt approved documents.[515] The IRS's review of pre-approved plan application is based on the Cumulative List of Changes in Plan Qualification Requirements that is published in the year before the commencement of the plan's cycle.[516]

b. Interim Amendments

When plan qualification requirements change, pre-approved plan providers must adopt timely interim amendments

[505] For a detailed discussion of the program, see 360 T.M., *Qualified Plans — IRS Determination Letter Procedures.*

[506] *See* Reg. §1.401(b)-1(b)(3); *cf.* Rev. Proc. 2022-40, Part I, §4.01(1) (individually designed plans; effective November 7, 2022), *modifying and superseding* Rev. Proc. 2016-37, Part II, §5.01, §5.03 (effective January 1, 2017); Rev. Proc. 2023-37 Part I, §4.02(1) (pre-approved plans; effective November 21, 2023).

[507] Rev. Proc. 2007-44, Part II, §5 (superseded).

[508] Rev. Proc. 2022-40, Part I, §3.01, Part II, §5, *modifying and superseding* Rev. Proc. 2016-37, Part II §4.02.

[509] Rev. Proc. 2022-40, Part II, §5.03(1), *modifying and superseding* Rev. Proc. 2016-37, Part II, §5.05(3). The plan amendment deadline with respect to a disqualifying provision in a qualified individually designed plan, or form defect first occurring after June 30, 2020, in a §403(b) individually designed plan, is the date on which the remedial amendment period ends with respect to the disqualifying provision or §403(b) plan form defect. Rev. Proc. 2022-40, Part II, §6.01, *modifying and superseding* Rev. Proc. 2016-37, Part II, §8.01. For discussion of remedial amendment period deadlines announced in the Required Amendments Lists, starting with the 2016 Required Amendments List, see 360 T.M., *Qualified Plans — IRS Determination Letter Procedures.*

[510] Rev. Proc. 2022-40, Part II, §5.03(2), *modifying and superseding* Rev. Proc. 2016-37, Part II, §5.06(3).

[511] Rev. Proc. 2023-37, *modifying* and *superseding* Rev. Proc. 2016-37, Part III, *modified by* Rev. Proc. 2020-10, §3.

[512] Rev. Proc. 2023-37, generally effective on November 21, 2023, applies to applications for Opinion Letters submitted regarding a qualified pre-approved plan's fourth 6-year remedial amendment cycle and subsequent cycles and regarding a §403(b) pre-approved plan's third and future cycles. Rev. Proc. 2017-41, effective on October 2, 2017, applies to applications for Opinion Letters submitted regarding a qualified plan's third 6-year remedial amendment cycle. See Rev. Proc. 2021-37 and Rev. Proc. 2019-39 for §403(b) pre-approved plan program guidance for the second 6-year remedial amendment cycle.

[513] *See* Rev. Proc. 2023-37, Part II, §8, Part III, §14, *modifying and superseding* Rev. Proc. 2016-37, Part III, §16, *as amended by* Rev. Proc. 2020-10, §3 (third 6-year cycle submission period for pre-approved defined benefit plan providers).

[514] *See* Rev. Proc. 2023-37, Part II, §8; e.g., Rev. Proc. 2017-41, §9; Rev. Proc. 2018-42, §3, *modifying* Rev. Proc. 2017-41 (third cycle submission period for pre-approved defined contribution plans extended to October 2, 2017, through December 31, 2018); Rev. Proc. 2020-10, §3.01, *modifying* Rev. Proc. 2017-41, *modified by* Notice 2020-35, §III.B.2.e (start of third 6-year remedial amendment cycle for pre-approved defined benefit plans delayed to August 1, 2020, and submission period runs from August 1, 2020, through July 31, 2021).

[515] Rev. Proc. 2023-37, Part II, §5.02, Part III, §11.02, *modifying and superseding* Rev. Proc. 2016-37, Part III, §21.02. *See, e.g.*, Announcement 2023-6 (March 31, 2025, deadline for employers using pre-approved plan documents to adopt newly approved defined benefit plan within the third 6-year remedial amendment cycle; also, adopting employers may apply for an individual determination letter, if otherwise permitted, beginning April 1, 2023, and ending March 31, 2025). *See also* Announcement 2024-38 (December 31, 2026, deadline for employers using pre-approved plan documents to adopt newly approved §403(b) plan within the second 6-year remedial amendment cycle; adopting employers may apply for an individual determination letter, if otherwise permitted, beginning January 1, 2025, and ending December 31, 2026).

[516] Rev. Proc. 2023-37, Part III, §17 (Cumulative List is used for pre-approved plan review), *superseding* Rev. Proc. 2016-37, Part III, §17. Cumulative Lists since 2017 are used for pre-approved plan applications only. For a chart of the prior and current Cumulative Lists, see the Worksheets of 360 T.M., *Qualified Plans — IRS Determination Letter Procedures.*

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on behalf of employers that adopt their plans.[517] Interim amendments keep written plan documents up to date between a plan's submission periods during the remedial amendment cycles. The IRS identifies whether an interim amendment is needed at the same time guidance regarding the change(s) is issued.

c. SECURE Act of 2019 and SECURE 2.0 Act of 2022 Remedial Amendment Period

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019[518] and the SECURE 2.0 Act of 2022[519] made a significant number of changes to ERISA and the I.R.C. that must be reflected in a plan document. Although the SECURE Act of 2019 contained a remedial amendment period generally ending on the last day of the first plan year beginning on or after January 1, 2022 (January 1, 2024 for governmental plans described in I.R.C. §414(d)),[520] the SECURE 2.0 Act of 2022 adjusted these dates to January 1, 2025 and January 1, 2027, respectively.[521] The IRS further extended the deadline to amend plans for the SECURE Act, the SECURE 2.0 Act, and regulations under either, to December 31, 2026 or December 31, 2028 for collectively bargained plans (December 31, 2029 for governmental plans described in I.R.C. §414(d)).[522]

H. Governmental and Church §403(b) Plans

1. Governmental §403(b) Plans

Governmental §403(b) plans exist in the case of plans for public school and college and university teachers[523] and in the somewhat rarer case of separate §501(c)(3) organizations, such as hospitals, which are controlled by a governmental entity.[524] Such plans generally are subject to the same rules as §403(b) plans of tax-exempt organizations, with the exception of the nondiscrimination rules. Thus, a written plan must be adopted and the plan must be operated in accordance with the written terms of the adopted document.[525] The plan that is adopted may be a pre-approved plan.[526]

From time to time, Congress and the IRS provide relief related to distributions from eligible retirement plans, including governmental and church §403(b) plans, to individuals who were adversely affected by disasters. For discussion of relief due to disaster situations or Armed Forces service, see 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification.*

2. Church §403(b) Plans

a. In General

A §403(b) plan also may be a church plan if it meets the definition of §414(e). Generally, church §403(b) plans come within the definition of a "retirement income account" described in §403(b)(9).[527] Section 403(b)(9) defines a retirement income account to mean a defined contribution program established or maintained by a church, a convention or an as-

[517] *See* Rev. Proc. 2023-37, Part II, §6.04, §7, Part III, §11.02 (Cycle 4 or later pre-approved plan), *modifying and superseding* Rev. Proc. 2016-37, Part III, §15, *modified by* Rev. Proc. 2020-40, §3, and Rev. Proc. 2021-38, §3. *See also* Rev. Proc. 2017-41, §8.02 (superseded).

[518] Pub. L. No. 116-94, Div. O (Dec. 20, 2019). The Setting Every Community Up for Retirement Enhancement Act of 2019, typically referred to as the SECURE Act, also is referred to as SECURE 1.0 following the enactment of the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T.

[519] Pub. L. No. 117-328, Div. T, enacted December 29, 2022.

[520] Pub. L. No. 116-94, Div. O, §601(b)(1).

[521] Pub. L. No. 117-328, Div. T, §501(c)(1).

[522] Notice 2024-2, Q&A J-1.

[523] §403(b)(1)(A)(ii).

[524] §403(b)(1)(A)(i). *See* Rev. Rul. 60-384, Rev. Rul. 67-290, Rev. Rul. 74-14; PLR 7811044. *See also* DOL Adv. Op. 97-26A, DOL Adv. Op. 99-02A. Note that a separately incorporated governmental hospital or other charity might not have filed a Form 1023 to seek recognition of §501(c)(3) status if it was created prior to October 9, 1969, the date when such filings became required. *See* Reg. §1.508-1(a)(1). A streamlined process is available for eligible entities using Form 1023-EZ. *See* Reg. §1.508-1(a)(2), added by T.D. 9819, 82 Fed. Reg. 29,730 (June 30, 2017), applicable on and after July 1, 2014.

[525] Reg. §1.403(b)-3(b)(3). *See* Notice 2009-3 (relief from written plan requirement for §403(b) plans for 2009). Rev. Proc. 2007-71 provides model plan language that a public school may use to adopt a written plan to reflect the requirements of §403(b) and the regulations thereunder or to amend its §403(b) plan to reflect those requirements. The public school employer may rely on the model language only if the employer adopts the model language on a word-for-word basis or to the extent the employer adopts an amendment that is substantially similar in all material respects. Adoption of the model language has the same status as a private letter ruling providing that the written form of the plan satisfies §403(b). Rev. Proc. 2007-71, §3 and §4. A §501(c)(3) organization may modify or use the sample language, as appropriate, with respect to its employees; however, the organization's adoption of the model language does not have the same status as a private letter ruling. Rev. Proc. 2007-71, §5 and §7.

[526] Governmental plans that adopt a §403(b) pre-approved plan (standardized or nonstandardized) plan may rely on an opinion letter issued by the IRS under procedures that are similar to the procedures for §401(a) plans. *See* Rev. Proc. 2023-37 (generally effective November 21, 2023; applies to submissions for Cycle 3 and future cycles); Rev. Proc. 2021-37 (effective on start of Cycle 2 (July 1, 2020) and generally applies to applications for an opinion letter submitted for Cycle 2 and subsequent cycles); Rev. Proc. 2013-22, *modified by* Rev. Proc. 2014-28, Rev. Proc. 2015-22, §3 (updating address for application), *and* Rev. Proc. 2019-39 (for Cycle 1, adopter of pre-approved §403(b) prototype plan or volume submitter plan may rely on opinion letter or advisory letter); *see* Rev. Proc. 2025-4. Whether an employer sponsors an individually designed §403(b) plan or adopts a pre-approved §403(b) plan, the employer has a remedial amendment period in which to amend the plan to correct any form defects. The initial remedial amendment period began on the later of January 1, 2010, or the effective date of the plan. The deadline for the initial amendment is the later of June 30, 2020, or the end of the second calendar year following the calendar year in which the change in §403(b) requirements is effective for the plan. The initial remedial amendment period for certain form defects first occurring during Cycle 1 ends on the last day of the cycle in which an application for an opinion letter that considers the form defect may be submitted. Subsequent remedial amendment periods apply to correct form defects first occurring after June 30, 2020. Rev. Proc. 2021-37, §23, *modifying* Rev. Proc. 2013-22 (Cycle 1 of §403(b) pre-approved plan program), §21, *as modified by* Rev. Proc. 2019-39, §5, §11, *and* Notice 2020-35, III.B.2.e; Announcement 2009-89. *See* Rev. Proc. 2017-18 (last day of §403(b) plan initial remedial amendment period), *modified by* Rev. Proc. 2019-39, §7 and §13 (limited extension of initial remedial amendment period), *modified by* Rev. Proc. 2021-37, §23.01; Rev. Proc. 2019-39, §5.03, §11.03 (end of remedial amendment period for form defects first occurring after last day of remedial amendment period), *modified by* Rev. Proc. 2021-37, §23.02. Effective November 7, 2022, Rev. Proc. 2022-40 modifies and supersedes Rev. Proc. 2019-39, §5 and §6, relating to the remedial amendment period and plan amendment deadline and permits the submission of determination letter applications for individually designed §403(b) plans on a staggered basis beginning June 1, 2023. *See* Rev. Proc. 2022-40.

[527] Reg. §1.403(b)-9(a)(1).

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sociation of churches, including an organization described in §414(e)(3)(A), to provide benefits under §403(b) to an employee whose employer is described in §501(c)(3) or to a minister described in §414(e)(5)(A).[528] A retirement income account also may provide benefits under §403(b) to an employee who is a duly ordained, commissioned, or licensed minister of a church in the exercise of the ministry, regardless of the source of the minister's compensation; an employee of an organization that is tax-exempt under §501 and is controlled by or associated with a church or a convention or association of churches; and an employee who is included in a church plan under certain circumstances after separation from the service of a church, a convention or association of churches, or a related organization described above.[529]

A defined benefit plan also may meet this definition if it was established on or before September 3, 1982.[530] These grandfathered plans are also known as TEFRA church defined benefit plans.[531]

Unlike other §403(b) plans, retirement income accounts under §403(b)(9) need not be invested exclusively in annuity contracts or mutual funds held in a custodial account.[532] The assets of the accounts may be commingled in a common fund made up of such accounts, and the part of the common fund which equitably belongs to any account must be separately accounted for (i.e., it must be possible at all times to determine the account's interest in the fund, and cannot be used for, or directed to, any purposes other than the exclusive benefit of employees and beneficiaries). If this requirement is met, the assets of the §403(b)(9) account may be commingled with tax-qualified plan (i.e., §401(a)) assets without adversely affecting the status of the account or the qualification of the §401(a) plan.[533]

The exclusive benefit rule also prohibits loans from the plan to the employers.[534]

b. Church §403(b) Plan Alternative Contribution Limit

Church §403(b) plans have an alternative contribution limit intended to increase the amount that may be contributed under the limit on annual additions under §415(c).

Under §415(c)(7)(A), contributions for participants who are employees of a church, convention or association of churches, or an organization described in §414(e)(3)(B)(ii), may exceed the normal limit on defined contribution annual additions by up to $10,000 in a limitation year, up to a $40,000 lifetime maximum.[535] For this purpose, all years of service by a duly ordained, commissioned or licensed minister of a church or a lay person with a church, convention or association of churches, or an organization described in §414(e)(3)(B)(ii) (i.e., a §501(c)(3) entity controlled by or associated with a church or convention or association of churches) is treated as service with one employer, and all contributions for such minister or lay person is considered to have been contributed to one employer.[536]

In addition, for any individual who is a church employee performing any services for the church outside the United States, additions for a §403(b) annuity contract for any year are not treated as exceeding the §415(c) limitations if those annual additions for the year do not exceed $3,000 (but only if the individual's adjusted gross income does not exceed $17,000).[537]

For a more complete discussion of §403(b) plans in general, including other contribution limits such as the §402(g) limit on elective deferrals, see 388 T.M., *Section 403(b) Arrangements.*

[528] §403(b)(9)(B), §403(b)(1)(A). *See* Reg. §1.403(b)-9(a)(2)(i). Reg. §1.403(b)-9(a)(2)(ii) requires that the retirement income account be maintained pursuant to a written plan document. Rev. Proc. 2007-71, provides model plan language that may be used to adopt a written plan or to amend a plan to meet requirements of §403(b). The language is tailored for use by a public school; nevertheless, the model plan language may be used by the §501(c)(3) organization or the minister's employer with respect to the minister (as they are eligible employers under Reg. §1.403(b)-2(b)(8)) to comply with one or more of the requirements imposed by the §403(b) final rules. However, that use does not have the same status as a private letter ruling with respect to adoption of the language by a public school. Rev. Proc. 2007-71 also provides rules for when plan amendments or a written plan are required to be adopted by eligible employers to comply with the final §403(b) rules, as well as guidance relating to the application of §403(b) to certain contracts issued before 2009. Church plans (including retirement income accounts) that adopt a pre-approved §403(b) plan (standardized or nonstandardized) may rely on an opinion letter issued by the IRS, just as governmental plans may rely (see III.H.1., above). Determination letters are available for individually designed §403(b) plans. *See* Rev. Proc. 2022-40.

[529] §403(b)(9)(B), as amended by the SECURE Act of 2019, Pub. L. No. 116-94, Div. O, §111 (adding reference to §414(e)(3)(B)), applicable to years beginning before, on, or after December 20, 2019 (date of enactment). Under initial guidance for the §403(b) pre-approved plan program, employees of a qualified church-controlled organization (QCCO) or a non-QCCO could not participate in a §403(b) pre-approved plan that is intended to be a retirement income account. *See* Rev. Proc. 2021-37, §2.05, Rev. Proc. 2013-22, §3.04, §3.15. Because the SECURE Act of 2019 amendments permit a retirement income account to provide benefits for employees of a tax-exempt organization that is controlled by or associated with a church or convention or association of churches, such as employees of a QCCO or a non-QCCO, Rev. Proc. 2021-37 provides rules for the amendment of a Cycle 1 §403(b) pre-approved plan that is intended to be a retirement income account to permit the participation of these employees retroactive to the beginning of Cycle 2 (i.e., July 1, 2020). Rev. Proc. 2021-37, §4.26, §25.

[530] Pub. L. No. 97-248 (1982 TEFRA), §251(e)(5). Other than a grandfathered retirement income account under §403(b)(9), a §403(b) plan may not be created as a defined benefit plan. Reg. §1.403(b)-10(f)(1).

[531] Opinion and advisory letters are not issued for TEFRA church defined benefit plans (discussed below). Rev. Proc. 2013-22, §13.04.

[532] A retirement income account that is treated as an annuity contract is not a custodial account (as defined in Reg. §1.403(b)-8(d)(2)), even if it is invested solely in stock of a regulated investment company. Reg. §1.403(b)-9(a)(4).

[533] Reg. §1.403(b)-9(a)(2)(i), §1.403(b)-9(a)(6). However, unless otherwise permitted by the IRS, no assets of the plan sponsor, other than retirement income account assets, may be combined with custodial account assets or any other assets permitted to be combined under Reg. §1.403(b)-8(f). *See* PLR 200229050. Furthermore, the legislative history to §403(b)(9) provides that assets of a §414(e) church plan may be commingled in a common fund with other amounts exclusively devoted to church purposes, provided that the part of the fund which equitably belongs to the plan is separately accounted for and cannot be used for or diverted to purposes other than the exclusive benefit of employees and their beneficiaries. The reasonable costs of administering a retirement income account, including costs associated with informing employees and employers of the availability of the program, may be charged against the account. *See* Conf. Rep. No. 97-760, 97th Cong., 2d Sess. at 80.

[534] Reg. §1.403(b)-9(a)(2)(i)(C). The prohibition of loans includes indirect loans to the employer. E.g., CCA 201742022. Loans entered into before July 26, 2007, generally were required to be eliminated before the effective date of Reg. §1.403(b)-9(a)(2)(i)(C), which, for church §403(b) plans, is the first day of the first plan year that begins after December 31, 2009. Reg. §1.403(b)-11(c).

[535] *See* Reg. §1.403(b)-9(b) (cross-referencing §415(c)(7)), §1.415(c)-1(d).

[536] §415(c)(7)(B); Reg. §1.415(c)-1(d)(2). For discussion of the employer aggregation rules that apply in determining whether a church plan satisfies the contribution limit rules, see III.F.13., above.

[537] §415(c)(7)(C); Reg. §1.415(c)-1(d)(3).

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c. Special Rule for Applying §415 to §403(b)(9) Defined Benefit Church Plans

A TEFRA church defined benefit plan (i.e., a §403(b) defined benefit plan that is a defined benefit arrangement that was established by a church or a church-related organization and in effect on September 3, 1982) is subject to the limit on benefits under a defined benefit plan but is not subject to the limit on contributions to a defined contribution plan. This law applies for years beginning before, on or after December 18, 2015.[538]

d. Contributions by Self-Employed Ministers and Chaplains to §403(b)(9) Plan

A minister described in §414(e)(5) (generally, chaplains and self-employed ministers; see discussion at II.B.3., above) can contribute to a retirement income account described in §403(b)(9). In that event, the contribution is treated as made to a tax-exempt trust that is part of a plan described in §401(a) and is deductible by the minister.[539] Contributions by a minister to a §403(b)(9) account are subject to the limit on elective deferrals under §402(g) and the limit on annual additions under §415.[540] Thus, to the extent that such a minister contributes directly to his or her denominational church plan, he or she can deduct the contribution on his or her individual tax return subject to the §402(g) and §415 limits.

e. Mergers and Transfers Between Church Plans and Annuity Contracts

A transfer occurring after December 18, 2015, of any of the accrued benefit of a participant or beneficiary from a church plan that is either a §401(a) plan or a §403(b) annuity contract to a §403(b) annuity contract, or from a §403(b) annuity contract to a church plan that is a §401(a) plan, or a merger of a §403(b) annuity contract with the plan or annuity contract, is not includible in gross income if the church plan and annuity contract are both maintained by the same church or convention or association of churches.[541] For discussion of the additional requirements that must be satisfied to avoid inclusion in income, see III.F.14., above.

I. Governmental and Church §457(b) Plans

Section 457(b) applies to governmental plans and plans of tax-exempt organizations. Notably, only governmental plans, and not plans of tax-exempt organizations, have the special retroactive correction period afforded by the flush language of §457(b). Governmental §457(b) plans also must hold their assets and income in trust.[542]

Nonqualified deferred compensation plans adopted by state and local governments are subject to §457, and may be eligible or ineligible.[543] Nonqualified plans of churches and qualified church-controlled organizations (often referred to as "QCCOs") are exempt from §457.[544] Note that the definition of QCCO excludes many church-controlled hospitals, colleges, universities and nursing homes, as well as some charities offering goods and services for sale which heavily rely on governmental funding.[545] Nevertheless, because §457(b) and §457(f) plans of such nonqualified church-controlled organizations (non-QCCOs) are not subject to Title I of ERISA, they may allow broad-based participation and need not be limited to a top hat group.

The maximum annual contribution that may be deferred under a §457(b) plan is the lesser of the applicable dollar amount or 100% of the participant's includible compensation.[546] This applies to §457(b) plans of both governmental and tax-exempt employers.

The following generally only apply to §457(b) governmental plans and not to tax-exempt organizations:

- Special catch-up contributions for participants who reach age 50 by the end of the taxable year.[547]

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[538] Pub. L. No. 114-113, Div. Q, §336(b)(1), effective for years beginning before, on or after December 18, 2015. Reg. §1.403(b)-10(f)(2), which predates this law, provides that §403(b)(9) defined benefit plans are subject to both the defined benefit limitation of §415(b) and the defined contribution limitation of §415(c).

[539] §404(a)(10).

[540] §404(a)(10).

[541] §414(z), added by Pub. L. No. 114-113, Div. Q, §336(d)(1), effective for transfers or mergers occurring after December 18, 2015.

[542] §457(g). Note that the right of participants to choose among various investment options under the plan will not adversely affect the status of the plan as an eligible deferred compensation plan under §457(b). PLR 200330033. See also Rev. Rul. 2004-67, which permits the assets of §457(b) governmental plan trusts to be pooled with the assets of group trusts described in Rev. Rul. 81-100, without adversely affecting the tax status of any of the separate trusts or the group trust if certain conditions are satisfied. Rev. Rul. 2004-67 also provides model language for §457(b) plans to use for this purpose. Rev. Rul. 81-100 has been further modified by Rev. Rul. 2011-1. See discussion at III.J., below.

[543] *See, e.g.*, PLR 201930009 (State's restated deferred compensation plan constituted an eligible deferred compensation plan as defined in §457(b); PLR 201636018 (nonqualified deferred compensation plan that provides for acceptance of transfers from other eligible deferred compensation plans, and is sponsored by state school district is an eligible §457(b) plan).

[544] §457(e)(13), cross-referencing §3121(w)(3)(A) and §3121(w)(3)(B).

[545] Compare §403(b)(12)(B) and §457(e)(13), both of which define "church" by reference to the definition set out in §3121(w)(3). For these purposes, a church includes a convention or association of churches, or an elementary or secondary school that is controlled, operated or principally supported by a church or by a convention or association of churches. §3121(w)(3)(A). A QCCO is defined as a church-controlled tax-exempt organization described in §501(c)(3), other than one which: (1) offers goods, services or facilities for sale, except on an incidental basis, to the general public, unless such sale is at a nominal charge substantially less than costs; and (2) normally receives more than 25% of its support from either governmental sources and/or from receipts from admissions or sales of goods, services or facilities. §3121(w)(3)(B).

[546] §457(b)(2). The applicable dollar amount under §457(b)(2)(A) periodically is adjusted for inflation. §457(e)(15)(B). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments.*

[547] §414(v). The catch-up contribution amount periodically is adjusted for inflation. §414(v)(2)(C). Effective for taxable years beginning in 2025, the SECURE 2.0 Act of 2022 makes available a higher limit for individuals who attain ages 60, 61, 62, and 63 in the taxable year. §414(v)(2)(B)(i), as amended by Pub. L. No. 117-328, Div. T, §109(a). *See* Prop. Reg. §1.414(v)-1(c)(2)(i)(B), REG-101268-24, 90 Fed. Reg. 2645 (Jan. 13, 2025). However, the SECURE 2.0 Act limits catch-up contributions by requiring participants with wages in excess of $145,000 (indexed for inflation) in the prior calendar year to designate the catch-up contributions as Roth contributions. §414(v)(7), as added by Pub. L. No. 117-328, Div. T, §603(a), effective for taxable years beginning after December 31, 2023. In Notice 2023-62, the IRS provided significant relief for this rule requiring Roth catch-up contributions and effectively delayed its effective date until taxable years beginning after December 31, 2025, and indicated that certain church and governmental plans covering individuals not subject to FICA may not be subject to this requirement. Prop. Reg. §1.414(v)-2(a)(2), REG-101268-24, would incorporate this guidance and would not apply the Roth catch-up requirement in the current year to participants with FICA wages (defined to include the Social Security portion but not the Medicare portion) not exceeding $145,000 (as adjusted) from the employer sponsoring the plan in the preceding calendar year. Thus, for example, Roth catch-up would not be required for state or local government employees whose services are excluded

ISBN 978-1-63359-446-3

• The inclusion of deemed IRAs.[548]

• Nonrefundable credit of up to $2,000 (as adjusted for inflation) for elective deferrals made before 2026 by participants with modified adjusted gross income (MAGI) below certain limits.[549]

• Rollovers of distributions from §401(a) and §403(b) plans and IRAs to governmental §457(b) plans so long as the §457(b) plan separately accounts for the rollover amounts.[550]

• Eligible rollover distributions from §457(b) governmental plans are subject to the mandatory 20% withholding tax and plan-to-plan transfer rules of §401(a)(31) and §3405,[551] as well as the withholding and reporting rules applicable to §401(a) and §403(b) plans.[552]

• Governmental §457(b) plans may make automatic rollover distributions of accounts in excess of $1,000 but not more than $7,000 ($5,000 before 2024) to an IRA when the participant does not elect otherwise.[553]

• For distributions beginning after December 31, 2007, distributions from qualified retirement plans, §403(b) tax-sheltered annuities and governmental §457 plans may be directly rolled over into a Roth IRA, subject to the pre-2006 PPA rules that apply to rollovers from a traditional IRA into a Roth IRA.[554]

• Designated Roth contributions can be made under a governmental §457(b) plan for taxable years beginning after December 31, 2010.[555] After September 27, 2010, governmental §457(b) plans may allow participants and surviving spouses to roll distributions from non-Roth plan accounts into a designated Roth account under the same plan.[556] After December 31, 2012, plans also may allow in-plan transfers of amounts that are not otherwise distributable from non-Roth plan accounts into a designated Roth account.[557] Transferred amounts are taxable. Note that §403(b) plans also may be amended to permit designated Roth accounts and rollovers of non-Roth contributions into those accounts.

• Effective for plan years beginning after December 31, 2023, a governmental §457(b) plan may include a linked emergency savings account with contributions up to $2,500.[558]

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from employment under §3121(b)(7), without regard to §3121(u), or for individuals whose compensation was taxed under FICA in an earlier year because of the deferred compensation rules under §3121(v)(2). For the current and prior dollar amounts, see Tables, Charts & Lists, *Pension and Retirement Plans — IRC Cost of Living Adjustments*. Note that the catch-up rule of §457(b)(3) applies to both governmental and tax-exempt plans, which a participant may elect to use for one or more of the last three taxable years ending before the taxable year in which the participant reaches normal retirement age under the plan. If the §457(b)(3) catch-up rule applies, the maximum deferral limitation for each affected taxable year is the lesser of: (1) an amount equal to twice the dollar amount in effect under §457(b)(2)(A) determined under §457(e)(15); or (2) the underutilized limitation. §457(b)(3)(A), §457(b)(3)(B). However, a participant can apply the age 50 catch-up contribution in any year in which the §457(b)(3) catch-up rule is applied if the age 50 rule produces a higher catch-up contribution. §414(v)(6)(C). Further, a §457 plan participant can make catch-up contributions in an amount equal to the greater of the amount permitted under §414(v) and the amount allowed under §457(b)(3) or §457(c). §457(e)(18).

[548] *See* §408(q). For a discussion of deemed IRAs, see 368 T.M., *SEPs and SIMPLEs*.

[549] §25B. The MAGI limit for joint returns is adjusted for inflation. The MAGI limit for head of household filers is 75% of this indexed dollar amount, and the MAGI limit for any other return filing status is 50% of the indexed dollar amount. §25B(b), as amended by Pub. L. No. 109-280, §833. For the current and prior MAGI limits for joint returns, see Tables, Charts & Lists, *Qualified Retirement Savings Contributions Credit (Saver's Credit) Table*. For taxable years beginning in 2027, this "saver's credit" is replaced with the saver's match under §6433, as enacted in the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §103(a). The saver's match is a direct federal matching contribution to the applicable retirement savings vehicle of an individual. Subject to phase outs for incomes above a threshold, the match is 50% of the individual's contribution to the savings vehicle, up to a maximum of $2,000 per individual.

[550] §402(c)(8)(B), §457(e)(16). See PLR 200719014, in which the IRS, citing Reg. §1.457-7(b)(2), ruled that a direct trustee-to-trustee transfer pursuant to §401(a)(31) or an eligible rollover distribution pursuant to §402(c)(4) from a city's §457 plan to its defined benefit plan for the purchase of additional benefits was a permissible transfer under §457(e)(16) and did not result in ordinary income to the employees. The IRS also ruled that, pursuant to Reg. §1.415(b)-1(b)(1)(ii) and §1.415(c)-1(b)(3)(i), such transfers are not treated as either an annual benefit for purposes of determining limitations for defined benefit plans or an annual addition for purposes of determining the limitations for defined contribution plans. For distributions made after December 31, 2001, but before tax years beginning in 2007, employee after-tax contributions could be rolled over into another qualified plan (under certain conditions) or a traditional IRA, but could not be rolled over into a tax-sheltered annuity or §457 plan, and only if: (i) the rollover was made in a direct trustee-to-trustee transfer; (ii) the transferee plan was a defined contribution plan; and (iii) the transferee plan agreed to separately account for amounts so transferred, including separately accounting for the portion of such distribution that was includible in gross income and the portion of such distribution that is not so includible. Former §402(c)(2)(A). For taxable years beginning after 2006, 2006 PPA §822(a) amended §402(c)(2)(A) to allow for the rollover of after-tax contributions from a qualified retirement plan to a defined benefit plan or a §403(b) tax-sheltered annuity (but not a §457 plan) in addition to a defined contribution plan or IRA. The rollover must be a direct rollover and the receiving plan must separately account for the after-tax contributions (and any earnings thereon).

[551] §457(d)(1)(C) and §3405(c)(3), respectively.

[552] §3401(a)(12)(E).

[553] §401(a)(31)(B) (increasing amount from $5,000 to $7,000), as amended by Pub. L. No. 117-328, Div. T, §304, effective for distributions made after December 31, 2023, §457(d)(1)(C); Notice 2005-5, Q&A-6.

[554] §408A(e), as amended by Pub. L. No. 109-280, §824(a), and redesignated as §408A(e)(1) by §109 of Pub. L. No. 110-245. *See* Notice 2010-15, §VI.

[555] §402A(f)(1) and §402A(f)(2), as amended by Pub. L. No. 111-240, §2111, and redesignated by Pub. L. No. 117-328, Div. T, §127(e)(1), effective for taxable years beginning after December 31, 2023 (redesignating subsection (e) as (f)). *See, e.g.*, PLR 201908014 PLR 201908014 (state retirement plan with a qualified Roth contribution program is an eligible deferred compensation program as defined under §457(b); while amounts distributed from the Roth contribution program will not be includible in gross income under §402A(d)(1); PLR 201731009 (municipal retirement plan with a qualified Roth contribution program is an eligible deferred compensation plan under §457(b)).

[556] §402A(c)(4), as amended by Pub. L. No. 111-240, §2112. *See* Prop. Reg. §1.457-4(b)(2), REG-147196-07, 81 Fed. Reg. 40,548 (June 22, 2016); Notice 2010-84, *modified by* Notice 2013-74.

[557] §402A(c)(4)(E), added by the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, §902, and amended by Pub. L. No. 113-295, Div. A, §220(k) (clerical correction). A plan amendment that provides for in-plan Roth rollovers of otherwise nondistributable amounts is a discretionary amendment that is generally not permitted to be adopted later than the last day of the first plan year in which the amendment is effective. However, to give plan sponsors sufficient time to adopt such an amendment and thereby enable plan participants to make in-plan Roth rollovers of otherwise nondistributable amounts before the end of the 2013 plan year, the IRS extended the deadline for adopting such a plan amendment to the later of the last day of the first plan year in which the amendment is effective or December 31, 2014, provided the amendment is effective as of the date the plan first operates in accordance with the amendment. *See* Notice 2013-74, Q&A-5.

[558] §402A(e), added by Pub. L. No. 117-328, Div. T, §127(e). *See Frequently Asked Questions: Pension-Linked Emergency Savings Accounts*,

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• Effective for plan years beginning after December 31, 2023, a governmental §457(b) plan may provide matching contributions based on qualified student loan payments.[559]

Restrictions on early distributions apply to §457(b) plans of state and local governments and other tax-exempt organizations. Generally, the §457(b) plan cannot provide for distribution until the earliest of the calendar year in which the participant attains a certain age (for plan years beginning before 2020, that certain age was age 70½ for both groups of employers, and for plan years beginning after 2019, the age is 59½ for governmental plans),[560] when the participant has a severance from employment, when the participant is faced with an unforeseeable emergency, the deauthorization of the plan to hold lifetime income investments,[561] or, for distributions made after December 29, 2025, the provision of qualified long-term care distributions.[562]

From time to time, Congress and the IRS provide relief related to distributions from eligible retirement plans, including governmental and church §457 plans, to individuals who were adversely affected by disasters. For discussion of relief due to disaster situations or Armed Forces service, see 370 T.M., *Distributions from Qualified Plans — Taxation and Qualification.*

J. Governmental and Church Plans and Group Trusts

Rev. Rul. 2011-1[563] provides that the assets of a custodial account under §403(b)(7) generally may be commingled in a group trust provided that the group trust otherwise meets the requirements of that revenue ruling, including that if assets of a custodial account under §403(b)(7) are invested in the group trust, all assets of the group trust must be solely permitted to invest in stock of regulated investment companies. Further, the ruling also states that retirement income accounts under §403(b)(9) may participate in the group trust, as well as governmental plans pursuant to §401(a)(24).[564] As that section applies to governmental plans that provide not only pension benefits but other employee benefits for retirees such as retiree welfare benefits, a governmental plan providing retiree welfare benefits may invest in a group trust as well.

Rev. Rul. 2011-1 does not appear to allow investment in the group trust by §403(b)(1) annuity contracts or other tax-favored accounts held by plans described in §401(a) or §403(b), and the IRS asked for comments as to whether that should be permitted.

In the case of investments made after December 18, 2015, the Protecting Americans From Tax Hikes Act of 2015[565] permits the investment in a group trust[566] of the assets of a church plan under §414(e), including a §401(a) plan and a retirement income account under §403(b)(9), and an organization controlled by or associated with a church or a convention or association of churches that administers the church plan or retirement income account as its principal purpose or function.[567] The investment does not adversely affect the tax status of the group trust, the church plan, the retirement income account, or the administrator, or any other plan or trust that invests in the group trust.[568]

Securities laws may affect the application of the IRS's group trust guidance. Section 3(a)(2) of the Securities Act of 1933 provides (among other exemptions) relief from registration for offers and sales of interests in collective trust funds maintained by a bank, so long as the interests are issued in connection with:

• plans that are tax-qualified under I.R.C. §401(a),

• annuity plans that permit the deduction of employer contributions under I.R.C. §404(a)(2),

available on the DOL website at www.dol.gov. For further discussion of pension-linked emergency savings accounts (PLESAs), see 358 T.M., *Section 401(k) Cash or Deferred Arrangements.*

[559] §401(m)(13) and §457(b) ("flush language", added by Pub. L. No. 117-328, Div. T, §110(c) and §110(f), respectively. In calculating the employee's maximum qualified student loan payment (QSLP) for a year for the §457(b) plan, the amount of the employee's salary deferrals under that plan for the year is the amount that is subtracted from the dollar limit under §457(e)(15)(A) – $15,000 (or, if less, the employee's compensation under §415(c)(3)). Notice 2024-63, Q&A-A-3. Employers also are permitted to make matching contributions based on QSLPs to §401(k) plans, §403(b) plans, and SIMPLE IRAs. *See* Notice 2024-63, Q&A-A-2. For further discussion of matching contributions for QSLPs, see 358 T.M., *Section 401(k) Cash or Deferred Arrangements.*

[560] §457(d)(1)(A)(i), as amended by Pub. L. No. 116-94, Div. M, §104(b), effective for plan years beginning after December 31, 2019.

[561] Lifetime income investments are qualified distributions to the extent they are either distributed in a direct trustee-to-trustee transfer, or in the form of a qualified annuity contract, during the 90-day period prior to the last day upon which the plan may hold lifetime income investments. §457(d)(1), as amended by Pub. L. No. 116-94, Div. O, §109(d) (adding §457(d)(1)(A)(iv) and §457(d)(1)(D)), applicable to plan years beginning after December 31, 2019. For further discussion, see 358 T.M., *Section 401(k) Cash and Deferred Arrangements.*

[562] Qualified long-term care distributions, if permitted by a defined contribution plan, may be no more than the least of the amount the employee pays or is assessed for certified long-term care insurance, 10% of the present value of the employee's accrued benefit, or $2,500 (as adjusted for inflation) in a taxable year. §457(d)(1)(A)(v), cross-referencing §401(a)(39), as added by Pub. L. No. 117-328, Div. T, §334(b)(5) and §334(a), respectively.

[563] *Modifying* Rev. Rul. 81-100 and Rev. Rul. 2004-67, generally effective on or after January 10, 2011. Rev. Rul. 2011-1 also provided related model language for group trusts. Rev. Rul. 2014-24, modified Rev. Rul. 2011-1 to include ERISA §1022(i)(1) plans on the list of group trust retiree benefit plans eligible to participate in a group trust, and to permit separate accounts to invest in group trusts as long as (1) all of the assets in the separate account consist solely of assets of group trust retiree benefit plans as defined in Rev. Rul. 2011-1 and as modified Rev. Rul. 2014-24, (2) the insurance company maintaining the separate account enters into a written arrangement with the trustee of the group trust consistent with the requirements of Rev. Rul. 2011-1 (including the requirement that no part of the corpus or income of any of the group trust retiree benefit plans be used for, or diverted to, any purpose other than for the exclusive benefit of the plan participants and their beneficiaries), and (3) the assets of the separate account are insulated from the claims of the insurance company's general creditors. For further discussion, see 373 T.M., *Employee Benefits for Tax-Exempt Organizations.*

[564] Section 401(a)(24) allows qualified plans to participate in group trust arrangements that include the assets of plans or governmental units described in §818(a)(6). Notice 2012-6, §III.B., modified Rev. Rul. 2011-1 to provide that, in the case of a §401(a)(24) governmental plan for which the authority to amend the plan is held by a legislative body that meets in legislative session, the plan will not fail to satisfy the requirements of Rev. Rul. 2011-1 if the governing document is modified to satisfy the applicable requirements of Rev. Rul. 2011-1 by the earlier of: (1) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2012; or (2) January 1, 2015.

[565] Pub. L. No. 114-113, Div. Q.

[566] As otherwise described in Rev. Rul. 81-100, as modified, or its successor.

[567] Pub. L. No. 114-113, Div. Q, §336(e)(1). The assets permitted to be invested include any assets otherwise permitted to be commingled for investment purposes with the assets of the plan, account, or organization.

[568] Pub. L. No. 114-113, Div. Q, §336(e)(1).

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• certain governmental plans as defined by I.R.C. §414(d), or

• certain church plans that are excluded from the definition of investment company under §3(c)(14) of the Investment Company Act.

However, Securities Act §3(a)(2) further provides that the collective trust fund exemption is not available with respect to offers and sales of interests in a collective trust fund to any plan that is funded by an annuity contract described in I.R.C. §403(b). Although not entirely clear, some practitioners believe that this language precludes I.R.C. §403(b)(7) plans, unless governmental, and I.R.C. §403(b)(9) plans from participating in a collective investment fund relying on the Securities Act §3(a)(2) exemption. Other practitioners argue that the exception does not apply to I.R.C. §403(b)(7) and §403(b)(9) plans because these plans are not literally funded by an annuity contract. Although the SECURE 2.0 Act of 2022 added additional language clarifying that I.R.C. §403(b)(7) plans may invest in group trusts,[569] further guidance is needed to resolve the Securities Act question.

K. Governmental Excess Benefit and Excessive Compensation Arrangements

1. In General

Governmental employers are permitted to maintain qualified governmental excess benefit arrangements. Qualified governmental excess benefit arrangements are not subject to the compensation limits of §457(b)(2) and §457(c).[570] A qualified governmental excess benefit arrangement (also called a §415(m) plan) is a portion of a governmental plan if: (a) such portion solely is maintained for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limits of §415; (b) under such portion of a plan no election is provided at any time (directly or indirectly) to defer compensation; and (c) benefits described in (a) are not paid from a trust forming a part of such governmental plan unless such trust solely is maintained for the purpose of providing such benefits.[571]

Comment: Because of the reference to "annual benefit," some practitioners have questioned whether qualified governmental excess benefit arrangements only are for purposes of providing benefits in excess of the defined benefit limitations.

A rabbi trust may be used to hold qualified excess benefit plan assets.[572] Income accruing to a governmental plan or to a trust described in (c) above in respect of a qualified governmental excess benefit plan will constitute income derived from the exercise of an essential government function upon which such governmental plan (or trust) will be exempt from tax under §115.[573] The taxable year or years in which amounts under a qualified governmental excess benefit arrangement are includible in the gross income of the participant, and the treatment of such amounts when so includible by the participant, are to be determined as if the arrangement were treated as a plan for the deferral of compensation maintained by a corporation that is not exempt from income tax and does not meet the requirements for qualification under §401.[574]

2. Section 415(m) Plans and FICA

Some state laws permit, but do not require, the state and its political subdivisions to elect Social Security coverage by entering into an agreement with the Social Security Administration pursuant to §218 of the Social Security Act.[575] For those public employers subject to FICA pursuant to state law, there is an open question as to whether contributions and benefits under §415(m) excess arrangements should be subject to Social Security tax withholding. On one hand, §3121(a)(5)(E) excludes from wages (and therefore FICA) payments made to an employee under an exempt governmental deferred compensation plan as defined in §3121(v)(3). Section 3121(v)(3) generally defines an exempt governmental deferred compensation plan as any plan maintained by a governmental entity providing for deferred compensation, but excluding certain nonqualified plans to which §83, §402(b), §403(c), §457(a) or §457(f)(1) apply. The issue arises because §457(f)(2)(E) excludes plans described in §415(m) from the reach of §457(f)(1).

The contrary argument is based on §415(m)(2)(B), which indicates that a §415(m) plan distribution is taxed the same as one from a nonqualified plan of a private sector for-profit employer. In that event, the benefits would be subject to FICA when no longer subject to a substantial risk of forfeiture, subject to special rules for calculating when that is the case depending upon the type of plan.[576] State §415(m) plans have requested a ruling on this issue, but the IRS has refused to rule because the matter "cannot readily be resolved before published guidance is issued."[577] The IRS has not indicated when such guidance may be forthcoming.

3. Excessive Compensation Arrangements

Section 4960 imposes an excise tax equal to the corporate tax rate on total compensation in excess of $1 million paid to one of an applicable tax-exempt organization's (ATEO) covered employees.[578] The excise tax also applies to any excess

[569] *See* §403(b)(7), as amended by Pub. L. No. 117-328, Div. T, §128(a), effective for amounts invested after December 29, 2022.

[570] §457(e)(14).

[571] §415(m)(3). *See, e.g.*, PLR 201643014 (state employers' excess benefits plans, collectively administered and provided to employees covered by a statewide governmental defined benefit plan system, constitute a qualified governmental excess benefit arrangement under §415(m)), PLR 201546012, PLR 201539030, PLR 201441032–PLR 201441034, PLR 201132029 (same).

[572] PLR 201031043, PLR 200835034, PLR 200148054, PLR 199923056.

[573] §415(m)(1). The IRS will not issue a ruling on whether some, but not all, income of an entity is from the exercise of an essential government function in order to be excluded from gross income under §115. Rev. Proc. 2025-3, §3.01(26).

[574] §415(m)(2). *See, e.g.*, PLR 201441032–PLR 201441034, PLR 201132029. Note, however, that the rules governing nonqualified deferred compensation plans under §409A do not apply to any plan described in §415(m). §409A(d)(2)(C); Reg. §1.409A-1(a)(2)(viii).

[575] See the discussion at V.A.1., below.

[576] Reg. §31.3121(v)(2)-1.

[577] *See* PLR 200411048, PLR 199923056. *Compare* PLR 200247040 (treatment of governmental nonqualified plan that is not described in §415(m)).

[578] Added by Pub. L. No. 115-97, §13602, effective for taxable years beginning after December 31, 2017. *See* Reg. §53.4960-1 through §53.4960-4, added by T.D. 9938, 86 Fed. Reg. 6196 (Jan. 19, 2021), generally applicable to taxable years beginning after December 31, 2021, but may be applied to taxable years beginning after December 31, 2017, see Reg. §53.4960-6. This provision

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parachute payment made to a covered employee.[579] The tax on excess parachute payments does not apply to payments (1) from plans qualified under §401(a) that include a trust exempt from tax under §501(a), an annuity plan described in §403(a), a simplified employee pension pursuant to §408(k) or a simple retirement account described in §408(p); (2) made under or to an annuity contract described in §403(b) or a plan described in §457(b); (3) made to licensed medical professionals (including veterinarians) to the extent that such payment is for the performance of medical or veterinary services by such professional; or (4) made to employees who are not "highly compensated," as that term is defined in §414(q). This does not include any payment made under or to a §403(b) annuity contract or a §457(b) plan, however.[580] For further discussion of §4960, see 390 T.M., *Reasonable Compensation*, and 373 T.M., *Employee Benefits for Tax-Exempt Organizations*.

L. Religious Order Charitable Trusts

It is not uncommon for members of religious orders to take vows of poverty, and members of such orders typically are not treated as employees. Nevertheless, such religious orders may desire to provide financially for members in their later years. In addition, in many religious orders, the members may not be considered to be ministers within the meaning of §414(e). As a consequence, the use of a §401(a) or §403(b)(9) plan to provide retirement benefits for members of religious orders may raise issues of compliance with compensation-based limits on benefits under §415, as well as issues concerning the coverage of individuals who are neither employees nor ministers under a §403(b) plan.[581] As a result, some religious orders provide retirement-type benefits through a charitable trust controlled by the order.[582] Such trusts typically are structured so that payments of such benefits entirely are at the discretion of the order and are not vested. The IRS does not appear to have issued any rulings on the tax consequences of such an arrangement to the trust or to the participants. Arguably, the trust is tax-exempt because it is performing essential services to the order and is thus an integral part of its activities are in furtherance of the order's exempt purposes.[583]

M. Governmental DROP Plans

The manner in which many governmental defined benefit plans are designed may have the effect of encouraging valuable senior employees to retire. This is because, as a general rule, benefits to an employer under a retirement plan may not commence prior to normal retirement age, but an employee with a significant number of years of service may be eligible for a subsidized early retirement benefit if he or she were to retire. As a result, that employee may consider switching to a job in the private sector in order to earn both a salary and a pension. Employers may, however, wish to encourage those experienced employees to stay. To compensate those employees for the pension benefits not paid during those years, many governmental employers have adopted what is known as a "deferred retirement option program" or DROP plan.

DROP plans can be designed in a number of ways, but the underlying concept is that the employee ceases to accrue additional compensation and years of service under the defined benefit plan, and in return, amounts, typically based upon the value of the forgone early retirement pension payments, accumulate in an account under the defined benefit plan and are credited with actual earnings[584] or a stated rate of interest. The method chosen must satisfy the "definitely determinable" benefit requirements of the I.R.C.[585] The account may be paid out in any number of ways: the actuarial equivalent of the account may be added to the defined benefit pension otherwise paid, or it may be paid out in a lump sum or paid out periodically in addition to the basic pension.

Comment: Whether §415(b), the defined benefit limit, or §415(c), the defined contribution limit, will apply to the DROP plan presumably depends upon whether the account for DROP contributions is structured as a separate defined contribution plan; for example, if actual earnings are attributed to the account.[586] Note that a defined contribution DROP plan would appear not to be eligible for the $3,000 annual exclusion for retiree health or long-term care.[587]

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is intended to cover federal instrumentalities and public universities exempt from taxation under §501(c)(3), but while the definition of an applicable tax-exempt organization refers to organizations that have income excluded from taxation under §115(1), not all state schools (including those with large athletic departments and highly paid coaches) are considered to be tax-exempt entities due to §115(1), but instead are tax-exempt under a doctrine of implied immunity that is respected by the federal government. The IRS addressed this issue in its proposed regulations, stating that state universities that have relied on the doctrine of implied immunity and do not seek an exemption under §501(c)(3) or §115 are not subject to the excise tax. *See* REG-122345-18, 85 Fed. Reg. 35,746, 35,747 (June 11, 2020); Notice 2019-09, Q&A-5. The IRS did not address this issue in its final regulations, however, and additional definitive guidance is needed.

[579] §4960(a)(2). *See* Reg. §53.4960-4(b)(2), added by T.D. 9938, 86 Fed. Reg. 6196 (Jan. 19, 2021).

[580] §4960(c)(5)(C). *See* Reg. §53.4960-3(a)(2) (exclusions) and §53.4960-3(a)(3) (highly compensated employees for purposes of exclusion).

[581] §403(b)(1)(A).

[582] *See, e.g.*, Campbell, *Charitable Trusts Reviewed* and *More on Charitable Trusts*, 68 The Legal Bulletin (Winter 1997).

[583] *See, e.g.*, Letters from the IRS to the Yale University Retiree Health Benefits Coverage Trust (July 29, 1997) and the Georgetown University Retirees Welfare Benefit Trust (July 29, 1997). *See also YMCA Ret. Fund, Inc. v. Commissioner*, 18 B.T.A. 139 (1929), *acq.*, C.B. IX-1, p. 60 (1930).

[584] *See, e.g.*, PLR 9645031.

[585] Reg. §1.401-1(b)(1)(i); PLR 9645031. In PLR 200721022, the IRS ruled that the DROP plan met the definitely determinable requirements under the regulations, noting that the DROP benefit was based on service and compensation and upon contributions paid while participating in the plan, was not contingent upon the amount of actual employer contributions, and was not based on the amount of pension benefits funded at each member's retirement date. The IRS also noted that the employer and employee contributions could be determined actuarially by projecting service and compensation to an assumed retirement age.

[586] §414(k). In PLR 200219042, the IRS ruled that a lump-sum DROP benefit must be converted to an actuarially equivalent benefit and included in a participant's annual benefit when determining the plan's compliance with §415(b). The IRS reasoned that for §415 purposes, the lump-sum DROP benefit merely is part of a participant's accrued benefit, and because the benefit is made in the form of a lump-sum distribution, §415(b)(2)(B) requires the distribution to be converted into an actuarially equivalent straight-life annuity using the rules of §417(e)(3). Once the benefit is actuarially converted, it must be added to the annuity benefit for §415(b) limitation purposes. In PLR 200721022, the IRS ruled that the DROP program was not a separate defined contribution plan, reasoning that because the DROP benefit was based solely on the amounts contributed to the participant's DROP account, which is not adjusted for earnings or losses, the account was not an individual account under §414(i). The IRS also concluded, among other rulings, that the defined benefit plan limitation under §415(b) applied to the entire benefit under the plan with the DROP.

[587] See discussion at III.F.9.b.(2), above.

ISBN 978-1-63359-446-3

The IRS directs its EP staff who are reviewing a governmental defined benefit plan to not treat the benefit amounts credited to a DROP plan (i.e., the amounts that the participant would have received as a defined benefit retirement payment had the participant retired) as annual additions subject to the §415(c) defined contribution limit. In addition, if the governmental defined benefit plan does not allow additional employee or employer contributions to be made to the DROP plan, it will not be required to include §415(c) limitation provisions for the DROP plan. If it does allow additional contributions to be made to the DROP plan, the IRS generally will not treat these additional contributions as annual additions subject to the §415(c) limits. An exception applies when three criteria are met, however. The §415(c) limits apply, but only with respect to the additional contributions, if: (1) the DROP plan consists of segregated accounts for each participant; (2) earnings on amounts in the DROP plan are based solely on actual investment earnings (i.e., the DROP plan does not provide for a fixed or guaranteed rate of return on funds in the DROP plan); and (3) the DROP plan does not provide for cessation of the accrual of earnings at any time.[588]

N. Church Plans and Housing Allowances

Compensation is an important factor in applying the limit on annual additions for purposes of §415. Controversy has arisen over whether one of the alternative definitions of compensation for purposes of the §415 limit might include nontaxable housing allowances under §107. The safe harbor definition provides that in the case of employees (other than self-employed individuals treated as employees under §401(c)(1)), compensation for §415 purposes may be defined as wages within the meaning of §3401(a) for purposes of income tax withholding at the source, plus amounts that would be included in wages but for an election under §125(a), §132(f)(4), §402(e)(3), §402(h)(1)(B), §402(k) or §457(b), and excluding any limit based on the nature or location of the employment or the services performed.[589] The exception for services performed by a minister is found at §3401(a)(9). Accordingly, it is arguable that this definition would include amounts that otherwise are excludible by reason of service as a minister, i.e., the housing allowance. It is informally understood, however, that the IRS does not agree with this interpretation; thus, caution should be exercised in this area.[590]

Distributions from a church plan may be excluded from the income of a retired minister under §107, if it is designated by the employing church or, in the case of a denominational plan, the national governing body of the religious denomination.[591] A survivor pension payable to the spouse of the deceased minister is not eligible for such exclusion.[592]

In the case of a truly self-employed minister, it appears that a minister's compensation for purposes of §415 is inclusive of amounts treated as nontaxable under §107.[593] It should be noted, however, that whether a minister truly is self-employed can be a difficult determination.[594]

For more information on Social Security taxes and the clergy, see IRS Publication 517, *Social Security and Other Information for Members of the Clergy and Religious Workers.*

O. Church and Governmental Plan Audits by IRS

Historically, church plans and governmental plans appear to have been seldom audited by the IRS. A notable exception is the IRS audit of the Rhode Island Employees Retirement System in the early 1990s.[595] Beginning in 2008, however, the IRS began a Governmental Plans Initiative, according to a statement on the IRS web site.[596]

Churches in general are subject to stringent restrictions on audits.[597] It is not clear whether those restrictions apply to a church plan, or a church pension board that is an integrated auxiliary of a church.

P. Church Plans and Securities Laws

Church plans and the investment pools maintained by church benefit programs in connection with such plans are exempt from federal and state securities laws.[598] Church plans utilizing these exemptions are to give plan participants notice of such exemptions to inform them that they will not be afforded the protection of the securities laws. This notice is to be given to new participants as soon as practicable after beginning participation and annually to all participants.[599]

Comment: Church plans that rely on other exemptions from the securities laws presumably are not required to give these notices.

For further discussion of securities laws and employee benefit plans, see 362 T.M., *Securities Law Aspects of Employee Benefit Plans.*

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[588] *See generally* TEGE-07-1114-0029, "Applying Section 415 Limits to Governmental Defined Benefit Plans with Deferred Retirement Option Plan Features" (Dec. 8, 2014) (incorporated into IRM 4.72.7), reproduced in the Worksheets of this Portfolio. IRM 4.72.7 was obsoleted by the internal only publication of the Examination Guidelines for IRC 415(c) Employee Plans Issue Resource Guide, effective November 22, 2022. The Worksheet includes examples of plan language for non-segregated accounts and segregated accounts, and plan language providing for fixed or guaranteed rates of return and for cessation of earnings. The IRS has referred to a plan into which contributions to the DROP account are made for the years after the employee enters into the arrangement and for prior years, with the plan determining the specific years, as a "back DROP." *See* IRM 7.11.1.31.1 (06-19-17).

[589] Reg. §1.415(c)-2(d)(3).

[590] See PLR 200135045, in which the IRS ruled that, for purposes of determining the limits on contributions under §415(c), amounts paid as a tax-free housing allowance under §107 may not be treated as compensation pursuant to the general or alternative definitions of compensation under former Reg. §1.415-2(d) (now Reg. §1.415(c)-2(d)(3)).

[591] Rev. Rul. 75-22. *See* PLR 8225137 (this designation may be up to 100% of the payment).

[592] PLR 8404101.

[593] §401(c)(2), §1402(a)(8).

[594] *See, e.g.*, *Robert A. Shelley v. Commissioner*, T.C. Memo 1994-432, 18 EBC 1953; *Weber v. Commissioner*, 103 T.C. 378 (1994), aff'd, 60 F.3d 1104 (4th Cir. 1995).

[595] *See* 21 Pens. & Ben. Rep. (BNA) 505 (Mar. 7, 1994).

[596] http://www.irs.gov.

[597] §7611.

[598] National Securities Markets Improvement Act of 1996 (1996 NSMIA), Pub. L. No. 104-290, §508; Investment Company Act of 1940 §3(c)(14), 15 U.S.C. §80a-3(c)(14).

[599] Pub. L. No. 104-290, §508(g).

ISBN 978-1-63359-446-3

Q. Church Plan Automatic Contribution Arrangements

A church plan under §414(e) may have an automatic contribution arrangement (i.e., automatic enrollment) and, if certain requirements are met, that arrangement is not preempted by any state law relating to wage, salary or payroll payment, collection, deduction, garnishment, assignment, or withholding that would directly or indirectly prohibit or restrict the inclusion of the automatic contribution arrangement in the plan.[600] For the state law to be superseded, the arrangement must: (1) allow a plan participant to elect to have the employer or plan sponsor make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash; and (2) treat a plan participant as having elected to have the amount of those contributions be a uniform percentage of compensation provided under the plan until the participant specifically elects to stop the contributions or to have the contribution percentage changed.[601]

The arrangement also must satisfy annual notice requirements.[602] These requirements are discussed at VI.E.3., below.

In addition, if a participant does not make an affirmative investment election for the automatic contribution arrangement, the contributions to the arrangement must be invested in a default investment selected with the care, skill, prudence, and diligence that a prudent person selecting an investment option would use.[603]

Church plans are exempt from the requirement to have automatic enrollment for plan years beginning after 2024.[604] This requirement generally applies to §401(k) plans and §403(b) annuity contracts purchased under a salary reduction agreement that are established after December 29, 2022.

[600] Protecting Americans From Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, §336(c)(1), effective December 18, 2015.

[601] Pub. L. No. 114-113, Div. Q, §336(c)(2).

[602] Pub. L. No. 114-113, Div. Q, §336(c)(3).

[603] Pub. L. No. 114-113, Div. Q, §336(c)(4).

[604] §414A(c)(3). Section 414A was added by the SECURE 2.0 Act of 2022, Pub. L. No. 117-328, Div. T, §101, effective for plan years beginning after December 31, 2024. The exemption also applies to governmental plans under §414(d). §414A(c)(3).

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IV. Church and Governmental Health Care Plans

A. Special Rules

1. Affordable Care Act

The Patient Protection and Affordable Care Act[605] and the Health Care and Education Reconciliation Act of 2010,[606] collectively referred to as the Affordable Care Act (or ACA), ushered in a series of changes to the rules for providing health care. In addition to enacting numerous non-codified provisions, Congress amended the Public Health Service Act (PHSA), the Social Security Act, the I.R.C., and ERISA. Most of the health insurance coverage provisions of the PHSA[607] that were enacted before 2010 have counterparts in ERISA or the I.R.C. (e.g., mental health and substance use disorder parity, mother and newborn hospital stays, and reconstructive surgery following a mastectomy). The Affordable Care Act added market reforms that require substantive changes to group health plans (e.g., prohibitions on lifetime or annual limits, minimum coverage requirements).[608] Qualified small employer health reimbursement arrangements, which are available for plan years beginning after 2016, are not group health plans subject to these requirements.[609]

The health insurance coverage provisions of the PHSA are applicable to church and governmental plans.[610] However, sponsors of church plans (and any other nongovernmental plan) may assert a religious exemption for certain requirements under ACA, such as the preventive care requirement to cover contraceptives without cost sharing.[611]

For further discussion of the Affordable Care Act, see 335 T.M., *Health Care Reforms — Implications for Employee Benefit Plans.*

An Individual Coverage HRA may be offered for plan years beginning on or after January 1, 2020, to individuals to whom no group health plan is available. It is an HRA that is treated as being integrated with individual health insurance coverage for purposes of ACA market reforms. Employers may set up the Individual Coverage HRA to provide for reimbursement of all or specific expenses for medical care. Regulations set out the requirements for this type of plan.[612]

An Excepted Benefit HRA (or other account-based group health plan) may be offered for plan years beginning on or after January 1, 2020, without regard to whether employees have other group or individual market coverage or without regard to whether employees have coverage that is subject to and satisfies the group market requirements. Regulations set out the requirements for this account-based plan to be treated as an excepted benefit.[613] Employers may offer an Excepted Benefit HRA to cover costs for some or all of the following: excepted benefits, such as limited-scope dental benefits and limited-scope vision benefits; and various other medical expenses such as COBRA premiums and cost sharing for individual or group health plan coverage. One condition is a notice requirement. For plan years beginning on or after January 11, 2021, a nonfederal governmental plan Excepted Benefit HRA plan sponsor must provide a notice that (1) describes conditions pertaining to eligibility to receive benefits, annual or lifetime caps or other limits on benefits, and (2) contains a description or summary the benefits available under the Excepted Benefit HRA. The notice must be provided no later than 90 days after the employee becomes a participant in the Excepted Benefit HRA, then annually, and in a manner reasonably calculated to ensure actual receipt.[614]

For discussion of Individual Coverage HRAs and Excepted Benefit HRAs, see 330 T.M., *Tax and ERISA Implications of Employer-Provided Medical and Disability Benefits.*

2. COBRA Exemption

Church and governmental health care plans are exempt from the I.R.C. provisions imposing an excise tax upon failure to provide continuation coverage under a group health plan under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).[615] Many states have continuation coverage rules similar to COBRA under their insurance law, and many such provisions do not exempt employers with fewer than 20 employees as under the federal provision,[616] so that medical in-

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[605] Pub. L. No. 111-148.

[606] Pub. L. No. 111-152.

[607] Part A of title XXVII, 42 U.S.C. §300gg *et seq.*

[608] Pub. L. No. 111-148, §1001 and §10101; Pub. L. No. 111-152, §2301. *See, e.g.*, PHSA §2711, §2713. Title XXVII of the PHSA is incorporated into ERISA and the I.R.C. Pub. L. No. 111-148, §1562(e), §1562(f), and §10107.

[609] *See* §9831(d), added by Pub. L. No. 114-255, Div. C, §18001(a)(1); ERISA §733(a)(1) and PHSA §2791(a)(1), as amended by Pub. L. No. 114-255, Div. C, §18001(b)(1) and §18001(c)(1), respectively, effective for years beginning after December 31, 2016. An employer is eligible to offer the arrangement if the employer did not average 50 or more full-time and full-time-equivalent employees on business days during the preceding calendar and does not offer a group health plan to any of its employees. §9831(d)(3)(B).

[610] PHSA §2722, as amended by Pub. L. No. 111-148, §1563(a)(2) and §1562(c)(12), as redesignated by Pub. L. No. 111-148, §10107(b)(1). It is unclear how this provision of the PHSA affects the exemptions for church and governmental plans in ERISA and the I.R.C. Provisions of the I.R.C. and ERISA indicate that, if there is a conflict with a HIPAA provision in the I.R.C. or ERISA, the PHSA provision controls. ERISA §715 and I.R.C. §9815, as added by Pub. L. No. 111-148, §1562(e) and §1562(f) (as redesignated by Pub. L. No. 111-148, §10107(b)(1)).

[611] Reg. §54.9815-2713A, added by T.D. 9840, 83 Fed. Reg. 57,536 (Nov. 15, 2018) (final rule expanding availability of exemption for objection based on sincerely held religious beliefs; also allows objection by individuals), effective January 14, 2019; and amended by T.D. 9841, 83 Fed. Reg. 57,592 (Nov. 15, 2018) (final rule allowing exemption of nongovernmental plan sponsors objecting based on sincerely held moral convictions; also allows objection by individuals); 29 C.F.R. §2590.715-2713A; 45 C.F.R. §147.132. *See* T.D. 9827, 82 Fed. Reg. 47,792 (Oct. 13, 2017) and T.D. 9828, 82 Fed. Reg. 47,838 (Oct. 13, 2017) (interim final rules), effective October 6, 2017. Challenges to the expanded contraceptive coverage exemptions initially resulted in a nationwide preliminary injunction barring their enforcement, but the U.S. Supreme Court concluded that the IRS, DOL, and HHS had the authority under the Affordable Care Act to promulgate the religious and moral exemptions in the contraceptive coverage regulations. *Little Sisters of the Poor Saints Peter & Paul Home v. Pennsylvania*, 140 S. Ct. 2367 (2020), rev'g and rem'g *Pennsylvania v. President*, 930 F.3d 543 (3d Cir. 2019). *See California v. HHS*, 941 F.3d 410 (9th Cir. 2019), vac'd and rem'd, 141 S. Ct. 192 (2020).

[612] Reg. §54.9802-4, 29 C.F.R. §2590.702-2, and 45 C.F.R. §146.123, added by T.D. 9867, RIN 1210-AB87, CMS-9918-F, 84 Fed. Reg. 28,888 (June 20, 2019).

[613] Reg. §54.9831-1(c)(3)(viii), 29 C.F.R. §2590.732(c)(3)(viii), and 45 C.F.R. §146.145(b)(3)(viii), added by T.D. 9867, RIN 1210-AB87, CMS-9918-F, 84 Fed. Reg. 28,888 (June 20, 2019).

[614] 45 C.F.R. §146.145(b)(3)(viii)(E), added by CMS-9916-F, 85 Fed. Reg. 29,164 (May 14, 2020).

[615] Pub. L. No. 99-272; I.R.C. §4980B(d)(2), §4980B(d)(3).

[616] §4980B(d)(1).

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surance contracts purchased by churches or governmental entities may nevertheless include such provisions.[617] See the discussion of state insurance laws applicable to church health care plans at IV.A.4., below.

Comment: Many church and governmental plans voluntarily follow the federal or state COBRA rules.

The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA)[618] also imposes continuation coverage requirements for participants serving in the uniformed services. USERRA does not exempt church plans or governmental plans from its rules.[619]

3. HIPAA

The Health Insurance Portability and Accountability Act of 1996 (HIPAA)[620] imposes a number of requirements upon group health plans. HIPAA imposes its requirements through ERISA, from which both church and governmental plans are exempt, the I.R.C., in a manner that does not apply to governmental plans but does apply to church plans,[621] and the Public Health Service Act (PHSA).[622] The PHSA provisions do not include an exemption for church and governmental plans, and it is unclear the extent to which the Centers for Medicare & Medicaid Services (CMS) and state regulations will impose the PHSA provisions against church and governmental plans.[623] However, for plan years beginning on or after September 23, 2010, self-funded, non-federal governmental plans that are group health plans are subject to limitations on preexisting condition exclusions, requirements for special enrollment periods and prohibitions against discrimination based on health status (including genetic information requirements).[624]

The I.R.C. provisions of HIPAA contain certain special church plan rules. This includes an exemption from the $2,500 minimum excise tax for failure to comply with HIPAA.[625] In addition, a church plan has a longer correction period before the $100 per day excise tax for failure to comply with HIPAA is imposed. This longer correction period is the same as the correction period for correction of church plan status failures under §414(e)(4)(C), discussed above at II.B.4.[626] For further discussion of HIPAA, see 389 T.M., *Medical Plans — COBRA, HIPAA, HRAs, HSAs and Disability.*

4. State Insurance Laws

The imposition of state insurance laws is unclear in the case of church and governmental plans that are not preempted from such laws by operation of ERISA's deemer clause.[627] The issue is important due to the enactment by most states of laws severely restricting the activities of multiple-employer welfare arrangements (MEWAs). In many cases, whether a denominational church welfare plan is a single-employer plan or a multiple-employer plan is unclear. Under the Church Plan Parity and Entanglement Prevention Act of 1999,[628] a church plan that is a welfare plan (and any trust under such plan) is deemed to be a plan sponsored by a single employer that reimburses costs from general church assets or purchases insurance coverage with general church assets, or both.[629] Thus, such church plans are not treated as MEWAs. Such church plans also are exempt from state licensing, solvency and insolvency requirements.[630] The exemption does not extend to insurers doing business with the church plan. In addition, the act provides that for purposes of enforcing provisions of state insurance laws that apply to a church welfare plan, the plan will be subject to state enforcement as if the church plan were an insurer licensed by the state.[631]

Comment: The consequences of this last provision remain unclear, inasmuch as it is unclear what state insurance laws would apply to a single-employer, self-insured church welfare plan.

B. Church and Governmental Welfare and Fringe Benefit Plans — Special Rules

1. Church Group Term Life Insurance

Church group term life insurance plans are not subject to the nondiscrimination requirements of §79(d).[632] For purposes of this exemption, a plan is a church plan if it meets the

[617] To the extent they are subject to state laws requiring continuation coverage, churches and governmental entities may be subject to the temporary COBRA premium subsidy requirement under the American Rescue Plan Act of 2021, Pub. L. No. 117-2, §9501(a), or may have been subject to the COBRA subsidy under American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, Div. B, §3001, as amended. *See* Notice 2021-31, Q&A-15 (a self-insured church plan may not be subject to either federal COBRA or state mini-COBRA). For discussion of the temporary premium subsidy, see 338 T.M., *COBRA — Consolidated Omnibus Budget Reconciliation Act of 1985.*

[618] Pub. L. No. 103-353, 38 U.S.C. §4301.

[619] *See* 38 U.S.C. §4303(7).

[620] Pub. L. No. 104-191.

[621] §9831(a), §9832(d)(2).

[622] PHSA §2701 *et seq.* (42 U.S.C. §300gg *et seq.*). Unlike its pre-ACA counterpart and §9831(a)(2), PHSA §2722, does not contain the HIPAA exemption for group health plans with fewer than two participants who are current employees. PHSA §2722, as amended and redesignated by Pub. L. No. 111-148, §1001(4) and §1562(a) and §1562(c)(12) (as redesignated by Pub. L. No. 111-148, §10107(b)(1)), effective for plan years beginning on or after September 23, 2010. Nonetheless, HHS does not intend to use its resources to enforce the requirements of HIPAA or ACA for non-federal governmental retiree-only plans. Preamble to T.D. 9489, 75 Fed. Reg. 34,538, 34,540 (June 17, 2010).

[623] See the discussion of state insurance regulation and church plans, at IV.A.4., below.

[624] PHSA §2722(a)(2). For plan years beginning before September 23, 2010, those plans could opt out of these requirements (other than the genetic information requirements) for each plan year. Pre-ACA PHSA §2721(b). A plan maintained pursuant to a collective bargaining agreement that was ratified before March 23, 2010, and that elected to opt out of these requirements must comply with the requirements at the start of the first plan year following the last plan year governed by the agreements. HHS Memorandum, "Amendments to the HIPAA opt-out provisions (formerly section 2721(b)(2) of the Public Health Service Act) made by the Affordable Care Act" (Sept. 21, 2010). A self-funded, non-federal governmental plan that violates these requirements is subject to enforcement action by CMS under 45 C.F.R. §150.301 *et seq.*

[625] §4980D(b)(3)(C).

[626] §4980D(c)(2)(B)(ii).

[627] ERISA §514(b)(2)(B).

[628] Pub. L. No. 106-244, §2(a). Prior to the enactment of this act, several states enacted legislation exempting certain church plans from state insurance and other laws. *See, e.g.,* Florida Statutes §624.4031; Oregon Insurance Code §731.036; Minnesota Statutes Annotated §64B.38; Michigan Insurance Code §24.18199; Massachusetts Insurance Law ch. 175, §118.

[629] Pub. L. No. 106-244, §2(b).

[630] Pub. L. No. 106-244, §2(b)(3)(B).

[631] Pub. L. No. 106-244, §2(d).

[632] §79(d)(7).

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requirements of §414(e)[633] but excludes employees of certain church-related universities and colleges, hospitals and medical nonprofit organizations.[634] For this purpose and for purposes of treatment as life insurance for the purpose of the death benefit exclusion of §101, self-funded church death benefit plans are treated as life insurance.[635] The provision of such a death benefit under a church plan does not, however, cause the sponsor to be taxed as an insurance company.[636]

2. Church and Governmental Cafeteria Plans

The cafeteria plan rules apply to governmental and church employers in the same manner as they apply to other employers. However, it should be noted that the general exemption from filing Form 5500 in the case of governmental and church plans only applies to pension plans.[637] Although nonelecting church and governmental plans are not subject to the annual reporting requirements of Title I of ERISA, the requirement that Form 5500 be filed by certain fringe benefit plans under §6039D does not include an exemption for nonelecting church plans and governmental plans. However, the IRS suspended the requirement for church cafeteria plans under §125, educational assistance programs under §127 and adoption assistance programs under §137 to file Schedule F of Form 5500.[638] Effectively, this grants them an exception to filing the Form 5500.

For information on changes to cafeteria plans and health accounts made by the Affordable Care Act, see 397 T.M., *Cafeteria Plans.*

3. Governmental Severance Pay Plans

Bona fide severance pay plans are exempt from the limitations of §457 for deferred compensation plans.[639] One of the central criteria applied by the IRS suggesting that a plan is not a bona fide severance pay plan has been whether amounts are vested and payable on termination of employment whether voluntary or involuntary. Historically, many governmental severance pay plans paid severance benefits to employees who met specific criteria without regard to whether the employee terminated voluntarily or involuntarily. In TAM 199903032, the IRS advised that such an arrangement by a school district was deferred compensation and not severance pay, with the result that the present value of the benefit became taxable upon vesting. In response to concerns by many school districts with similar plans, the IRS issued an announcement that state or local government employers need not report such amounts as taxable to the participant prior to the year in which the participants actually received such amounts if:

(1) the plan was in existence in December 22, 1999;

(2) the plan was a broad-based plan maintained by a state or local government employer primarily for nonhighly compensated employees;

(3) the plan was nonelective;

(4) payments under the plan were designed to provide supplemental income rather than to provide retirement income;

(5) payments under the plan were made only after separation from service with the employer, including retirement; and

(6) payments were completed within a short period of time, not to exceed five years, after separation from service.[640]

Pending the issuance of further guidance, the IRS considers an arrangement to be a bona fide severance pay plan under §457(e)(11) if:

(1) the benefit is payable only upon involuntary severance from employment;[641]

(2) the amount payable does not exceed twice the employee's annual rate of pay (taking into account only pay that does not exceed the maximum amount that may be taken into account under a qualified plan pursuant to §401(a)(17) for the year in which the employee has a severance from employment); and

(3) the plan provides that the payments must be completed by the end of the employee's second tax year following the year in which the employee separates from service.[642]

Because governmental plans are not exempt from the deferred compensation limitations of §409A, consideration also has to be given to whether the severance plan either complies with §409A or meets any regulatory exemptions from §409A for severance plans.[643]

4. Special Church Plan Exception for Health Plan Nondiscrimination

Section 9802 provides a rule that a group health plan may not discriminate against individuals who enroll in the plan on

[633] Compare §403(b)(12)(B) and §457(e)(13), both of which define "church" by reference to the definition set out in §3121(w)(3). For these purposes, a church includes a convention or association of churches, or an elementary or secondary school that is controlled, operated or principally supported by a church or by a convention or association of churches. §3121(w)(3)(A). A "qualified church-controlled organization" is defined as a church-controlled tax-exempt organization described in §501(c)(3), other than one which: (1) offers goods, services or facilities for sale, except on an incidental basis, to the general public, unless such sale is at a nominal charge substantially less than costs; and (2) normally receives more than 25% of its support from either governmental sources and/or from receipts from admissions or sales of goods, services or facilities. *See* §3121(w)(3)(B).

[634] §79(d)(7)(B).

[635] §7702(a) and §7702(j).

[636] §501(m)(3).

[637] Announcement 82-146. Church pension plans that elect coverage under §410(d) are not exempt.

[638] Notice 2002-24, *modifying and superseding* Notice 90-24; Instructions to Form 5500.

[639] §457(e)(11). *See* Prop. Reg. §1.457-11(c)(1) and §1.457-11(d), REG-147196-07, 81 Fed. Reg. 40,548 (June 22, 2016) (generally proposed to apply to compensation deferred under a plan for calendar years beginning (or, if legislation is required to amend the plan, compensation deferred in calendar years beginning on or after the close of the second regular legislative session of the legislative body with the authority to amend the plan that begins) after publication of final regulations, but taxpayers may rely on them in interim).

[640] Announcement 2000-1.

[641] The IRS anticipates that future proposed regulations will include exceptions for window programs, collectively bargained separation pay plans and certain reimbursement or in-kind benefit arrangements similar to the exceptions in Reg. §1.409A-1(b)(9)(ii), §1.409A-1(b)(9)(iv), and §1.409A-1(b)(9)(v). Notice 2007-62.

[642] Notice 2007-62, §III.

[643] *See* Reg. §1.409A-1(b)(9)(ii), §1.409A-1(b)(9)(iv), and §1.409A-1(b)(9)(v); Notice 2007-62.

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the basis of health status and certain other factors. A special rule permits a church plan to be treated as not failing to meet these requirements for a year solely because the plan requires evidence of good health for coverage of: (1) both any employee of an employer with 10 or less employees (determined without regard to the rule under §414(e)(3)(C) that the church or convention or association of churches is deemed to be the employer of any individual included as an employee under §414(e)(3)(B)) and any self-employed individual; or (2) any individual who enrolls after the first 90 days of initial eligibility under the plan, provided that the plan included such a provision on July 15, 1997, and at all times thereafter before the beginning of the year.[644]

Comment: This rule was intended to "grandfather" this type of provision for certain church plans of denominations that did not have the authority to mandate coverage by employees and ministers of local churches, and were concerned with the effects of possible adverse selection.

[644] §9802(f); Reg. §54.9802-2. Former §9802(c) was redesignated §9802(f), effective for plan years beginning after May 21, 2009. Pub. L. No. 110-233, §103(b). Reg. §54.9802-2 does not reflect the redesignation and contain references to former §9802(c). Effective for plan years beginning on or after July 1, 2007, the grandfathered plan provisions must exactly state the 10 employees rule and the 90-day period, and may not apply to a lesser or greater number of employees or state a longer period. Reg. §54.9802-2(b). The rule may be used only if the plan is self-insured because there is no comparable exception for health insurance issuers under the PHSA provisions. *See* Reg. §54.9802-2(a)(2), §54.9802-2(c) *Ex.* 2. See also the discussion of the HIPAA provisions at IV.A.3., above.

ISBN 978-1-63359-446-3

V. Governmental Plans, Church Plans, and Social Security

A. *Social Security Coverage*

1. *State and Local Governments*

Under §3121(b)(7)(F), employees of state and local governments (other than for the District of Columbia, Guam, or American Samoa), or of a wholly owned instrumentality thereof, who are *not* covered by a state voluntary agreement or a retirement system in conjunction with such employment, are automatically included in Social Security, and their wages are subject to FICA taxes.[645] Exceptions from FICA taxes apply to service performed: (1) by an individual who is employed to relieve that individual from unemployment; (2) by a patient or inmate of a hospital, home or other institution; (3) by a temporary employee serving on account of fire, storm, snow, earthquake, flood or similar emergency; (4) by an election official or worker if paid less than a certain dollar amount in a calendar year for such service;[646] and (5) by an employee in a position compensated solely on a fee basis that is treated as a trade or business under §1402(c)(2)(E).[647]

The determination under §3121(b)(7)(F) generally is made at the entity level, rather than on a position-by-position basis.[648]

a. *Retirement System*

For purposes of §3121(b)(7)(F), a retirement system includes any pension, annuity, retirement or similar fund or system under §218 of the Social Security Act maintained by a state or a political subdivision or instrumentality to provide retirement benefits to employee participants.[649] The retirement system must provide at least a minimum level of retirement benefits to an employee for the employee to qualify for an exception from FICA taxes.[650]

A defined benefit retirement system generally satisfies the minimum retirement benefit requirement if the employee has a total accrued benefit comparable to the basic retirement benefit the employee would have under Social Security, based on his or total compensation and periods of service with the entity.[651] A defined contribution plan satisfies the minimum retirement benefit requirement if an allocation equal to at least 7.5% of an employee's compensation[652] for the period is made to his or her account.[653]

Comment: Though the regulations do not specifically address the question, it appears to be permissible for such plans to provide for participant-directed investment accounts.

The minimum benefit requirement may be satisfied even if the retirement system is not a tax-qualified plan, and benefits funded by employee contributions are considered to the same extent as benefits provided through employer contributions. Thus, under some circumstances, a plan may be treated as a retirement system even if it is completely funded through elective or after-tax employee contributions. Furthermore, §457(b) and §457(f) plans satisfy the minimum retirement benefit requirement.[654] Note that an employee's total system-wide benefit may be considered if all service under the system is considered in

[645] Service by an employee that is treated as employment by reason of §3121(b)(7)(F) is treated as employment for purposes of both the Social Security and the Medicare portion of FICA taxes, regardless of when the employee was hired. If an employee becomes subject to the Medicare portion solely because he or she was hired before April 1, 1986, but not a member of a retirement system, and subsequently becomes covered by a retirement system, the employee no longer is subject to the Medicare portion. 56 Fed. Reg. 29,570 (June 28, 1991). Service performed as an employee of a state and/or local government generally is not treated as covered employment for Social Security purposes unless the state elects coverage. §3121(b)(7)(E). Employees of a state or political subdivision may be covered in one of two coverage groups: (1) groups composed of employees whose positions are not covered by a governmental plan; and (2) groups of employees who are covered by a retirement program. Social Security Act §218(b) and §218(c)(4). The act also provides for certain specific groupings of employees for inclusion and exclusion, and for special rules for police and firefighters. *See* 20 C.F.R. §404.1205–§404.1212.

[646] The threshold amount under §3121(b)(7)(F)(iv) is $2,400 for 2025, $2,300 for 2024, and $2,200 for 2023. SSA Notice, 89 Fed. Reg. 85,276 (Oct. 25, 2024) (2025 amount); SSA Notice, 88 Fed. Reg. 72,803 (Oct. 23, 2023) (2024 amount); and SSA Notice, 87 Fed. Reg. 64,296 (Oct. 24, 2022) (2023 amount).

[647] §3121(b)(7)(F)(i) through §3121(b)(7)(F)(iv).

[648] In CCA 201519027, the IRS Chief Counsel's Office concluded that a charter school was not an instrumentality of the state under §3121(b)(7)(F) because, although its employees participated in government retirement plans, the state exercised no meaningful control over the school's day-to-day operations or budget, state laws permitted the school to operate independently from the local school district, no governmental entity had the power to appoint the school's governing board and the organization's bylaws permitted management to be delegated to a private management company. The IRS relied on the six-factor test set forth in Rev. Rul. 57-128 for determining whether an organization is an instrumentality of state or political subdivision for purposes of §3121). *See also* PLR 200346002 (relying on six-factor test of Rev. Rul. 57-128, IRS ruled that state corporation formed to provide management, technical and other services to entity created by participating state counties was instrumentality of state under §3121(b)(7)(F) and not required to withhold FICA taxes for its employees who were qualified participants in retirement system). For more discussion of what constitutes an instrumentality of the state for the purposes of the §3121(b)(7)(F) FICA tax exemption, see 392 T.M., *Withholding, Social Security, and Unemployment Taxes on Compensation.*

[649] Reg. §31.3121(b)(7)-2(e)(1).

[650] Reg. §31.3121(b)(7)-2(e)(2)(i). The minimum benefit requirement does not apply to defined benefit retirement systems in existence on November 5, 1990, for plan years that began before January 1, 1993, with respect to individuals who were actually covered under the system on November 5, 1990, unless benefit levels were materially reduced pursuant to an amendment adopted after November 5, 1990. Reg. §31.3121(b)(7)-2(f)(2)(i)(A). A special "fresh-start" testing method applies for such defined benefit retirement systems for plan years beginning after 1992. Reg. §31.3121(b)(7)-2(f)(2)(i)(B). Similar relief was available for defined contribution systems through 1992. Reg. §31.3121(b)(7)-2(f)(2)(ii). The minimum benefit requirement must be met on an individual-by-individual basis. Reg. §31.3121(b)(7)-2(f)(2)(ii). *See* PLR 9320043 (services performed by full-time employees of association of public housing authorities who were qualified participants in association's defined contribution plan were excluded from FICA taxes where plan is retirement system of association that is instrumentality of political subdivisions of states).

[651] Reg. §31.3121(b)(7)-2(e)(2)(ii). Early retirement benefits generally are not taken into account in determining whether this requirement is satisfied. 56 Fed. Reg. 29,568 (June 28, 1991). *See* CCA 200021001 (services performed by employee plan members were not excepted from employment because state employee retirement plan failed to meet the minimum benefit requirement; benefits were much less than Social Security primary insurance amount and not based upon average compensation and benefit formula included factor for years of service but did not have factor for amount of compensation).

[652] The definition of compensation must be at least as inclusive as the employee's base pay and the employee's account must be credited with earnings at a reasonable rate or such accounts must be held in a separate trust that is subject to general fiduciary standards and credited with actual earnings on the trust fund. Reg. §31.3121(b)(7)-2(e)(2)(iii)(B).

[653] Reg. §31.3121(b)(7)-2(e)(2)(iii)(A).

[654] *See* Reg. §31.3121(b)(7)-2(e)(1).

ISBN 978-1-63359-446-3

determining the employee's retirement benefit.[655] Also, a plan may be a retirement system with respect to some but not all employees.[656] Therefore, a failure to provide minimum retirement benefits to a participant in the retirement plan only affects that participant and has no effect on the status of any other participants as members of the retirement system.

A defined benefit retirement system that uses one of the safe harbor formulas set forth in Rev. Proc. 91-40[657] is deemed to satisfy the minimum retirement benefit requirement with respect to all employees whose benefits are computed under the formula.

A system that calculates benefits by reference to a participant's average compensation for a period of no more than 36 months meets the minimum benefit requirement for any employee if it makes available a single-life annuity, payable beginning no later than age 65, that is at least 1.5% of average compensation for each year (or fraction thereof) of credited service. If average compensation is calculated over a period of more than 36 months, different percentage factors apply. A system that uses a pro rata accrual toward a projected normal retirement benefit may use the 36-month safe harbor, provided such projected benefit under the plan formula is greater than or equal to that benefit. Additional requirements regarding calculation of compensation, credited service, and treatment of prior distributions are set forth in Rev. Proc. 91-40.[658]

With respect to the safe harbors, for plan years beginning after July 1, 1991, a retirement system must calculate benefits based on the definition of compensation in the regulations.[659] An employer may use any less inclusive definition of compensation, provided that the benefit percentage is adjusted to reflect aggregate differences between the definition under the regulations and that under the retirement system.[660] Service and compensation not related to an employee's full-time employment may, in some cases, be disregarded in determining the employee's required benefit level.

b. Qualified Participant

An employee generally is treated as a member of a retirement system only if he or she actually participates in the system and actually has an accrued benefit or actually receives an allocation sufficient to satisfy the minimum retirement benefit requirement.[661] Allocations or accruals conditioned on the satisfaction of service, employee election or other requirements (other than vesting) generally are not taken into account for this purpose unless and until the employee actually has satisfied those requirements. In order to provide certainty at the beginning of a calendar year regarding whether an employee will be treated as a member of a retirement system for that year, and to minimize administrative burdens on employees, an alternative lookback rule applies for determining whether an employee is a member of a retirement system,[662] in addition to the general rule described above. Under the alternative lookback rule, an employee may be treated as a member of a retirement system for a calendar year if he or she was a member of the retirement system on the last day of the plan year ending in the previous calendar year. If the alternative lookback rule is used, it must be used consistently from year to year with respect to all employees of the entity who are covered under a particular retirement system.[663]

Part-time, seasonal, and temporary employees typically make up a large number of state and local government employees who are not currently covered in either a public retirement system or a voluntary coverage agreement with the Commissioner of Social Security. These employees generally have higher turnover rates than comparable permanent and full-time employees. Typically, public retirement systems do not provide the full portability feature of Social Security. As a result, part-time and seasonal employees face a significant risk that they may never vest in the benefits they accrue.

Because retirement systems maintained by state and local government entities generally lack the full portability feature of Social Security, and in order to provide retirement income protection that is comparable to the protection provided under the Social Security system, the rules require that part-time, seasonal, and temporary employees be vested in any retirement benefits relied on to meet the minimum retirement benefit requirement. Thus, part-time, seasonal, and temporary employees must be 100% vested in the retirement benefit used to satisfy the minimum retirement benefit requirement in order to be qualified participants.[664] However, a part-time, seasonal or temporary employee's benefit is considered nonforfeitable if, on account of separation from service or death, the employee is unconditionally entitled to a single-sum distribution from the retirement system equal to 7.5% of the employee's compensation over the period of covered service, plus interest.[665] In these situations, the distribution does not have to occur at the time the employee separates from service, and the special service credit-

[655] Reg. §31.3121(b)(7)-2(e)(2)(iv), §31.3121(b)(7)-2(e)(2)(v).

[656] Reg. §31.3121(b)(7)-2(e)(2)(i).

[657] These safe harbor formulas were designed to produce a retirement benefit equivalent to the primary insurance amount under Social Security for the average wage-earner, but certain valuable ancillary benefits provided under the Social Security system were disregarded, including disability and survivor benefits and post-retirement cost-of-living increases.

[658] *See, e.g.,* CCA 200021001.

[659] Rev. Proc. 91-40, §3.03(1)(a). *See* Reg. §31.3121(b)(7)-2(e)(2)(iii)(B). In PLR 201138006, the IRS ruled that a plan maintained by state political subdivision satisfied the minimum benefit requirements of Reg. §31.3121(b)(7)-2 using safe harbor formulas set forth in Rev. Proc. 91-40, and thus qualified as retirement system under §3121(b)(7)(F). The plan defined compensation as "all wages within the meaning of I.R.C. §3401(a), and all other compensation" for which the employer was required to furnish a Form W-2. The plan also provided that benefits would be calculated by reference to a member's highest average monthly pay, defined as the member's average monthly compensation based on the 60 consecutive months of service with the employer that yielded the highest monthly average. The plan made available, in the form of a single life annuity at age 65, a monthly payment equal to the product of a member's credited service multiplied by the member's highest average monthly pay multiplied by 1.67%.

[660] In CCA 200330018, the IRS concluded that regardless of whether the definition of compensation under a government's defined benefit plan was reasonable under the regulations, the plan met the safe harbor minimum benefit standards because the applicable benefit percentage in the safe harbor formula was increased to offset the effect of the lower compensation base.

[661] Reg. §31.3121(b)(7)-2(d)(1). *See* PLR 201138006 (plan provided that eligible employees participate as of the day their employment commences and as long as employed by state political subdivision employer).

[662] Reg. §31.3121(b)(7)-2(d)(3).

[663] Reg. §31.3121(b)(7)-2(d)(3)(v).

[664] Reg. §31.3121(b)(7)-2(d)(2)(i).

[665] Reg. §31.3121(b)(7)-2(d)(2)(ii).

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ing rules in Rev. Proc. 91-40 do not apply. In addition, the rules allow cash-outs for part-time, seasonal or temporary employees under rules similar to those under §411(a)(11).[666]

A part-time employee is any employee who normally works 20 hours or less per week.[667] A seasonal employee is defined as any employee who normally works on a full-time basis fewer than five months in a year.[668] A temporary employee is any employee performing services under a contractual arrangement with the employer of two years or less duration, but not solely because the employee is covered by a collective bargaining agreement of that duration.[669]

Rehired annuitants may be treated as members of a retirement system even if they do not actually receive any additional accruals or allocation to their account during a year and even if they do not have a total accrued benefit under the system sufficient to satisfy the minimum retirement benefit requirement.[670]

2. Church and Church-Controlled Organizations

Service performed for a church or qualified church-controlled organization constitutes "employment" for Social Security purposes.[671] Except for service in an unrelated trade or business, however, a church or qualified church-controlled organization may elect not to withhold FICA taxes from employees' wages or pay the employer's share of the tax if it opposes payment of Social Security taxes for religious reasons.[672] For this purpose, the term "church" means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated or principally supported by a church or by a convention or association of churches.[673] The term "qualified church-controlled organization" means any church-controlled tax-exempt organization described in §501(c)(3) other than an organization that: (1) offers goods, services or facilities for sale to the general public (i.e., to non-church members) other than on an incidental basis and at a nominal charge; 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 that are not unrelated trades or business.[674]

Organizations must file an application for exemption before the first date on which a quarterly employment tax return is due, or would be due, but for the election.[675] The election is made by filing IRS Form 8274.[676]

The election may be revoked by the IRS if the church or organization fails to furnish the information required under §6051 for a period of two years or more.[677] The revocation is effective from the first year of such period. The church or organization may also revoke the election by filing a Form 941, "Employer's Quarterly Tax Return," on or before the due date (without regard to extensions) for the first quarter for which the revocation is to be effective.[678] Full payment of the taxes due for that quarter had there been no prior election must accompany the form.[679] Once an election is revoked, no subsequent election is permitted.[680]

3. Ministers and Religious Orders

Services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order are not treated as covered employment for Social Security purposes.[681] However, a religious order or an autonomous subdivision of such order may elect coverage for those members who are required to take vows of poverty and who perform tasks usually required of active members of the order.[682]

Rev. Proc. 91-20 provides guidelines for determining whether an organization qualifies as a religious order for employment tax purposes. At a minimum, an organization must be a §501(c)(3) organization. Six other characteristics that are considered are: (1) the members vow to live under a strict set of rules requiring moral and spiritual self-sacrifice and dedication to the goals of the organization at the expense of their material well-being; (2) the members, after training and probation, make a long-term commitment to the organization; (3) the organiza-

[666] Reg. §31.3121(b)(7)-2(d)(2)(i).

[667] Reg. §31.3121(b)(7)-2(d)(2)(iii)(A). Teachers employed by post-secondary schools are not considered part-time if they normally work at least half of the number of classroom hours defined by the educational institution as constituting full-time employment, provided that designation is reasonable under a facts and circumstances test. Reg. §31.3121(b)(7)-2(d)(2)(iii)(A).

[668] Reg. §31.3121(b)(7)-2(d)(2)(iii)(B).

[669] Reg. §31.3121(b)(7)-2(d)(2)(iii)(C). Possible contract extensions may be considered in determining the duration of a contractual arrangement (and thus remove the employee from the temporary employee category and from the nonforfeitability requirement) only if either: (1) approximately 80% of those employees in the same or similar job classification with expiring employment contracts have had bona fide offers to renew in the immediately preceding two academic or calendar years; or (2) the employee in question has a history of contract extensions with respect to his or her current position. Elected officials (and election officials/workers paid more than $100 annually) are not considered part-time, seasonal or temporary employees under these rules.

[670] Reg. §31.3121(b)(7)-2(d)(4)(ii). A rehired annuitant is any former participant of a state or local retirement system who has previously retired from service with the current employer and either is in pay status under a retirement system maintained by this employer or has reached normal retirement age under such retirement system. This definition includes an employee who previously retired from service with another employer maintaining the same retirement system as the current employer (e.g., another state, political subdivision or instrumentality thereof), provided that prior service was in a position covered under such system. Reg. §31.3121(b)(7)-2(d)(4)(ii).

[671] §3121(b)(8)(B).

[672] §3121(w)(1). Section 3121(b)(8)(B) provides that such services will not be considered employment if the election is made.

[673] §3121(w)(3)(A).

[674] §3121(w)(3)(B). *See* PLR 9307029 (§501(c)(3) membership corporation formed to manage health care system and provide health and life care services to persons of all religions was not qualified church-controlled organization as more than 25% of its support originated from amounts paid for its services by hospitals and other health care entities that are open to public). Compare §403(b)(12)(B) and §457(e)(13), both of which define "church" by reference to the definition set out in §3121(w)(3).

[675] §3121(w)(2).

[676] Reg. §301.9100-6T(b)(3).

[677] §3121(w)(2).

[678] Reg. §301.9100-7T(i)(2).

[679] Reg. §301.9100-7T(i)(2).

[680] Reg. §301.9100-7T(i)(3).

[681] §3121(b)(8)(A). *See* PLR 202043003 (subsistence provided to members of religious order for services provided does not constitute wages subject to FICA taxes), PLR 201904008 (similar).

[682] §3121(r). The election, which is irrevocable, must apply to all current and future members of the order or, if the election is made with respect to an autonomous subdivision of such order, to those members of the order who belong to such subdivision. All services performed by such individuals in the exercise of their duties must be treated as performed by such persons as employees of the order of subdivision. §3121(r). "Wages" for this purpose include the fair market value of any board, lodging, clothing, and other perquisites furnished to the member, except that the amount included as "wages" shall not be less than $100 a month. *See* §3121(i)(4).

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tion is controlled and supervised or is significantly funded by a church or convention or association of churches; (4) the members normally live together as a community and are held to a significantly stricter level of moral and religious discipline than are lay church members; (5) the members work full-time in the service of the organization's goals; and (6) the members regularly participate in such activities as prayer, religious study, teaching, care of the aging, missionary work, or church reform or renewal.

The absence of one or more of these characteristics is not necessarily determinative in a particular case, but the presence of all of them is determinative that the organization is a religious order.[683] Organizations and individuals may request a ruling from the IRS on their qualification as a religious order or member thereof, and if consideration of these characteristics does not yield a clear conclusion, the IRS will contact the appropriate authorities affiliated with the organization and consider their views.

4. Ministers and SECA

Ministers generally are not subject to FICA, whether employees or self-employed, and instead are subject to the Self-Employment Contribution Act or SECA.[684] For purposes of SECA, in the case of an individual who is a duly ordained, commissioned, or licensed minister of a church or a member of a religious order, his or her net earnings from self-employment does not include any retirement benefit received by such individual from a church plan (as defined in §414(e)) after the individual retires.[685] Thus, unlike a lay employee subject to FICA on nonqualified deferred compensation under §3121(v), a minister is not subject to SECA on payments of nonqualified deferred compensation.

B. Church Plans — Integration with Social Security

Qualified nonelecting church plans are subject to the nondiscrimination rules of §401(a)(4). Thus, they also are subject to the rules governing the integration of qualified plans with Social Security.[686] Plans that meet these rules (i.e., are properly integrated) may provide greater contributions or benefits on behalf of highly compensated employees without violating §401(a)(4).[687] Because the rationale for integration is that the employer also is providing retirement benefits through its contributions to Social Security, a plan may be integrated only if the employer is paying Social Security taxes on behalf of its employees.[688] Plans maintained by churches that have elected not to pay Social Security taxes cannot be integrated. For a full discussion of the integration rules, see 356 T.M., *Nondiscrimination Testing and Permitted Disparity in Qualified Retirement Plans.*

C. Governmental Plan Offset

In some instances, a person receiving pension benefits from a governmental plan based on service in noncovered employment also may be entitled to auxiliary or survivor Social Security benefits (i.e., benefits derived from the work record of another). If the individual also is receiving monthly Social Security benefits as a spouse, surviving spouse, mother or father of an insured worker, his or her Social Security benefits may be offset by two-thirds of the amount of governmental pension benefit received.[689] Depending on the amount of the governmental pension, the Social Security benefit could be reduced to zero.[690]

Note: The Social Security Fairness Act of 2023, enacted on January 5, 2025, repealed the government pension offset provision, effective for monthly benefits payable for months after December 2023.[691]

The government pension offset generally does not apply if the individual: (1) is receiving a government pension based on employment for an interstate instrumentality;[692] (2) received, or was eligible to receive, a government pension for at least one month between December 1977 and June 1983 and met all the requirements for Social Security benefits in effect in January 1977;[693] or (3) received a government pension and the final 60 months of government work were covered by both Social Security and the pension plan that provides the government pension.[694] The offset is made only after reduction for age and for simultaneous entitlement to other Social Security benefits.[695]

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[683] In PLR 9418012, the IRS noted that merely because various churches independently contributed to a nonprofit corporation and exercised some influence over the selection of its members, it did not satisfy the church control requirement. However, on the basis of all the facts and circumstances, the evangelical organization at issue qualified as religious order under Rev. Proc. 91-20. *See* TAM 9434001, PLR 9630011.

[684] *See generally* IRS Pub. 517, *Social Security and Other Information for Members of the Clergy and Religious Workers.*

[685] §1402(a)(8).

[686] Integration is authorized by §401(a)(5) and §401(l). Qualified church plans are not exempted from these sections.

[687] §401(a)(5)(C).

[688] *See* Reg. §1.401(l)-1(a)(4)(i).

[689] 20 C.F.R. §404.408a(d)(1). The offset also applies to a divorced spouse or divorced surviving spouse. 20 C.F.R. §404.408a(a)(1)(iii) (defining "spouse's benefits"). Noncovered employment is work for which the person did not pay Social Security taxes. 20 C.F.R. §404.408a(a)(1)(ii).

[690] 20 C.F.R. §404.408a(d)(1).

[691] Pub. L. No. 118-273, §2, repealing Social Security Act §202(k) (42 U.S.C. §402(k)). It also repealed the Social Security Act windfall elimination provisions. *See* Social Security Act §215 (42 U.S.C. §415), as amended by Pub. L. No. 118-273, §3.

[692] 20 C.F.R. §404.408a(b)(1).

[693] 20 C.F.R. §404.408a(b)(2) and §404.408a(b)(3). The January 1977 requirements were: (1) for a man, a one-half support test; and (2) for a woman claiming benefits as a divorced spouse, marriage for at least 20 years to the insured worker. Both men and women who became eligible for a government pension between December 1982 and July 1983 must have met the one-half support test. *See* 20 C.F.R. §404.408a(b)(3). Generally, the one-half support test requires that the claimant had been dependent on the insured worker for at least one-half of his or her support. The test is set out at 20 C.F.R. §404.366.

[694] 20 C.F.R. §404.408a(b)(6) (also applying a transition rule for employment ending after June 30, 2004 and on or before March 2, 2009). For additional exceptions, see 20 C.F.R. §404.408a(b).

[695] 20 C.F.R. §404.408a(d)(3).

ISBN 978-1-63359-446-3

VI. Reporting and Disclosure Requirements

A. In General

Although governmental plans and nonelecting church plans are not subject to the reporting and disclosure requirements of Title I of ERISA,[696] they are nevertheless required to file some documents with the IRS and to provide certain types of information to plan participants. The following is a summary of these requirements. Churches that elect to be subject to the participation, vesting, funding, and other rules of the I.R.C. and ERISA must meet the reporting and disclosure requirements for qualified plans in general. For a more detailed discussion of these requirements, see 361 T.M., *Reporting and Disclosure Under ERISA*.

B. IRS and Social Security Administration

Governmental retirement plans and nonelecting church retirement plans are not required to file the Form 5500 series.[697] This exemption includes Form 8955-SSA, which reports participants who have separated from service with vested deferred benefits,[698] and actuarial information Schedules SB and MB.[699]

Churches also are not required to file an annual information return (generally Form 990)[700] pursuant to §6033.[701]

1. Request for Determination Letter — Forms 5300, 5303, 5307, 6406

A qualified §401(a) governmental plan, a §403(b) plan, or a nonelecting church plan may request a determination letter from the IRS, if it is eligible to do so (i.e., initial plan determination, plan determination upon termination, or other circumstances identified by the IRS). If a determination letter is sought by a §403(b) plan or a church plan, notice must be provided to interested parties.[702] Governmental plans are not subject to the notice requirement.[703]

2. Termination, Merger, Consolidation, or Transfer of Plan Assets or Liabilities — Form 5310

a. Plan Termination

A qualified §401(a) and §403(b) governmental plan or church plan may file Form 5310 in order to obtain a determination from the IRS regarding a plan termination. However, it is not required to submit the form as notice to the Pension Benefit Guaranty Corporation (PBGC) of intent to terminate the plan. A plan that seeks an advance determination from the IRS with respect to whether a plan termination affects the continuing qualification of the plan must provide notice to all present employees with accrued benefits under the plan, all former employees with vested benefits under the plan and all beneficiaries of deceased former employees currently receiving benefits under the plan as interested parties.[704] Plan qualification through the time of distribution of plan assets should be sought to secure favorable tax treatment for distributions.

b. Plan Merger

Government and nonelecting church plans are not subject to the merger rules of §401(a)(12) and §414(l).[705] As a result, they also are exempt from the Form 5310 filing requirement established by §6058(b).

3. Request for Change in Plan/Trust Year — Form 5308

A qualified governmental or nonelecting church plan does not need prior approval to change its plan year. However, a qualified governmental plan or nonelecting church plan that seeks to change its trust year and does not meet the require-

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[696] Governmental plans may be subject to state and local reporting and disclosure requirements.

[697] Announcement 82-146.

[698] Section 6057, which requires the plan administrator to provide the information sought in Form 8955-SSA, applies only to plans that are subject to the vesting standards of §411(d). Governmental and nonelecting church plans are exempt from these standards. Reg. §301.6057-1(a)(3). However, governmental and nonelecting church plans may voluntarily file Form 8955-SSA. §6057(c); Prop. Reg. §301.6057-1(c), REG-153627-08, 77 Fed. Reg. 37,352 (May 21, 2012) (permitting taxpayer reliance pending issuance of final regulations).

[699] Section 6059 requires a periodic actuarial report for defined benefit plans subject to §412. Governmental plans and church retirement plans are not subject to §412.

[700] Form 990 has undergone several revisions. The filing thresholds are set at $200,000 gross receipts and $500,000 total assets beginning with the 2010 tax year. *See* IRS News Release IR-2007-204 (Dec. 20, 2007). Oganizations with gross receipts less than $200,000 and total assets at the end of the year less than $50,000 can file Form 990-EZ instead. Form 990 was revised to require more reporting for the exempt organizations that must fill it out, beginning in tax year 2008 (to be filed in 2009 and later years), with a transition period for smaller organizations. For the 2008 tax year, only those organizations that had more than $1 million in gross receipts and more than $2.5 million in total assets were required to file Form 990; all others could file Form 990-EZ. For the 2009 tax year (returns filed in 2010), organizations with gross receipts over $500,000 or total assets over $1.25 million were required to file the Form 990.

[701] *See* §6033(a)(3) (mandatory exception from filing requirement for "churches, their integrated auxiliaries, and conventions or associations of churches"); Rev. Proc. 96-10 (discretionary exemption from §6033 filing requirement for church-controlled organization that manages church funds or church retirement program). Reg. §1.6033-2(g)(1) and §1.6033-2(h) do not provide an exemption to certain church-related pension programs within the definition of church auxiliary; rather, such exemption is provided in Rev. Proc. 96-10. However, the Treasury and IRS "expect that few, if any, organizations meeting the requirements of Rev. Proc. 96-10 may still rely on" the guidance. Treasury has stated that the 2006 Pension Protection Act, Pub. L. No. 109-280, modified the authority for discretionary exceptions under §6033(a)(3)(B) to forbid filing relief for a supporting organization under §509(a)(3), and that organizations operated, supervised, or controlled by, or in connection with churches, conventions or associations of churches, and some integrated auxiliaries of churches are likely supporting organizations. Treasury has not withdrawn Rev. Proc. 96-10 and continues to study its applicability; however, it stated that organizations for which public charity status is dependent on being described in §509(a)(3) are not eligible to rely on the filing relief in Rev. Proc. 96-10. T.D. 9898, 85 Fed. Reg. 31,959, 31,966 (May 28, 2020) (preamble to §6033 final regulations); REG-102508-16, 84 Fed. Reg. 47,447, 47,450 (Sept. 10, 2019) (proposal requesting comments). Rev. Proc. 96-10 rendered obsolete Rev. Proc. 86-23 which superseded Notice 84-2. Governmental plans and nonelecting church plans may have to file a Form 990-T if they have more than $1,000 of unrelated business income.

[702] *See* Reg. §1.7476-1 and §1.7476-2; Rev. Proc. 2022-40, §13. For more information on the determination letter program, including eligibility to apply and the notice requirements, see 360 T.M., *Qualified Plans — IRS Determination Letter Procedures*.

[703] Reg. §1.7476-1(b)(7) limits the applicability of the notice requirement to plans that are subject to §410, and governmental plans established and maintained by a state or local government or political subdivision thereof are not subject to §410. *See* T.D. 9006, 67 Fed. Reg. 47,454, 47,455 (July 19, 2002) (preamble).

[704] Reg. §1.7476-1(b)(5).

[705] Reg. §1.414(l)-1(a)(1).

ISBN 978-1-63359-446-3

ments for obtaining automatic approval must file Form 5308.[706] A trust year may be changed without prior approval only if the following requirements are met:

- No plan year is more than 12 months long.
- The change will not delay the time when the plan would otherwise have been required to conform to the requirements of any statute, regulation or published position of the IRS.
- The trust retains its exempt status for the short period required to effect the change as well as for the taxable year immediately preceding the short period.
- The trust has no unrelated business taxable income under §511 for the short period.
- All actions necessary to implement the change have been taken on or before the last day of the short period.
- No change of plan year has been made for any of the four preceding plan years.[707]

For purposes of meeting these requirements, the term "plan year" refers to a plan, calendar, policy or fiscal year on which records of the plan are kept, and the term "trust year" refers to any 12-month consecutive period corresponding to the trust's taxable year. The term "short period" is the period that begins on the day after the close of the present trust year and ends at the close of the day before the day designated as the first day of the new trust year.[708]

4. Notice of Distribution and Withholding — Forms 1099-R, W-2, 945

Qualified §401(a) and §403(b) governmental and nonelecting church plans are subject to certain withholding, deposit, and information reporting requirements. For example, these plans must report lump sum or total distributions to participants on Form 1099-R.[709] Such plans also must make periodic deposits of withheld taxes electronically through the Electronic Federal Tax Payment System (EFTPS). Nonpayroll taxes must be reported annually on Form 945.

Filers and transmitters of Form 1099 (except forms reporting nonemployee compensation) may obtain one automatic 30-day extension of time to file with the government (but not with recipients) by submitting Form 8809 to the IRS on or before the due date for filing the information return. One additional non-automatic 30-day extension of time to file may be requested before expiration of the automatic extension. However, this request must be submitted on a signed Form 8809 with a specific indication of why the additional time is needed.[710] An extension of time to file Forms W-2 (other than Form W-2G and expedited forms) may be requested, but there is no automatic extension available. The request must explain in detail why additional time is needed and must be signed under penalties of perjury.[711] For more information on withholding and reporting requirements, see 392 T.M., *Withholding, Social Security, and Unemployment Taxes on Compensation.*

5. Active Participant Status

Governmental and nonelecting church plans must indicate on Forms 1099 and W-2 whether an employee was an active participant[712] in a pension plan for the calendar year being reported.[713]

6. Unrelated Business Income Tax — Form 990-T

The fiduciary of a trust or other funding organization forming part of a trust under a plan that has gross income used in computing unrelated business taxable income of at least $1,000 must file Form 990-T, "Exempt Organization Business Income Tax Return," no later than the 15th day of the fourth month following the close of the trust's taxable year.[714] Exempt organizations required to file Form 990-T are allowed an automatic six-month extension of time to file, however, if: (1) an application is submitted on Form 8868; (2) the application is filed with the appropriate IRS office on or before the due date of the return; (3) the application shows the full amount properly estimated as tax; and (4) payment of the full amount properly estimated as tax that is unpaid as of the date prescribed for the filing of the return accompanies the application.[715] The IRS may terminate the automatic extension by notice mailed at least 10 days before the designated termination date.[716] If an exempt organization needs more time to file a return after receiving the automatic extension, it may file a signed Form 8868 that ex-

[706] *See* Rev. Proc. 87-27. The procedure for changing the trust year applies to all qualified plans. The procedure for changing the plan year applies only to plans subject to the minimum funding requirements of §412.

[707] Rev. Proc. 87-27.

[708] Rev. Proc. 87-27.

[709] Distributions from a governmental §457(b) plan also are reported on Form 1099-R. *See* §457(e)(16), §3401(a)(12)(E), and §3405(d)(2)(B)(iv); Notice 2003-20, *superseding* Notice 2000-38.

[710] Reg. §1.6081-8(a), as amended by T.D. 9838, 83 Fed. Reg. 38,023 (Aug. 3, 2018), Reg. §31.6081(a)-1(a)(2)(i).

[711] Reg. §1.6081-8(b) and §1.6081-8(c)(2), amended by T.D. 9838, applicable to extension requests for information returns required to be filed after December 31, 2018. For extension requests for information returns required to be filed before January 1, 2019, see former Reg. §1.6081-8T. Reg. §1.6081-8(g).

[712] *See* §219(g)(5); Notice 87-16. Section 219(g) limits the amount of deduction an active participant in certain qualified plans may take for contributions to an IRA. Governmental plans are included in the list of plans to which this limitation applies, without regard to whether they are §401(a) or §403(b) plans. Church plans apparently are subject to this rule only if they are one of the types of plans listed. §219(g)(5)(A).

[713] Instructions to Form W-2.

[714] *See* Reg. §1.6012-3(a)(5). *But see* Notice 2020-23 (Coronavirus Disease 2019 (COVID-19) emergency relief automatically postpones to July 15, 2020, the due date for filings and payments due on or after April 1, 2020, and before July 15, 2020; any additional extension requested may not go beyond the original statutory or regulatory extension date); Notice 2024-7 (waives for eligible Form 990-T filers additions to tax for failure to pay taxes owed for 2020 and 2021 for the period starting on the later of the date the IRS issued an initial balance due notice or February 5, 2022, and ending March 31, 2024). Form 990-T must be filed electronically for taxable years beginning after July 1, 2019. §6011(h), added by Pub. L. No. 116-25, §3101(a), enacted July 1, 2019; Reg. §301.6011-10, added by T.D. 9972, 88 Fed. Reg. 11,754 (Feb. 23, 2023) (applying to returns required to be filed during calendar years beginning after February 23, 2023).

[715] Reg. §1.6081-9(a) and §1.6081-9(b), as amended by T.D. 9892, 85 Fed. Reg. 5323 (Jan. 30, 2020), applying to requests for extensions of time to file on or after January 30, 2020. For requests for extensions before January 30, 2020, see former Reg. §1.6081-9T, added by T.D. 9821, 82 Fed. Reg. 33,441 (July 20, 2017) (reflecting Pub. L. No. 114-41 changes), and removed by T.D. 9892. Before the amendments by Pub. L. No. 114-41, §2006(b)(4), and to coinciding regulations, the regulation in effect for requests for extensions before July 20, 2017, provided for a three-month automatic extension.

[716] Reg. §1.6081-9(c), as amended by T.D. 9892.

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plains in detail why the extra time is needed, and the IRS may grant an additional six months for the entity to file.[717]

A trust or organization with unrelated business income also must pay the unrelated business income tax no later than the 15th day of the fourth month following the close of the trust's taxable year. No extension is permitted. Penalties may be imposed both for failure to pay the tax when due and, if tax is due, for failure to file the Form 990-T.[718]

"Unrelated business taxable income" (UBTI) is the gross income (less any deductions) derived by any organization from any trade or business that although regularly carried on by it, is not substantially related to the performance of its function that constitutes the basis for its exemption from tax under §501.[719] The tax applies to a trust described in §401(a) or an organization exempt from tax under §501(c). As applied to a trust described in §401(a), the tax is computed in the same manner and at the same rate as that imposed on the taxable income of estates and trusts under §1(e).[720] While the tax would apply to church plans so described, many practitioners believe that governmental plans are not subject to the tax by reason of §115.[721] The IRS indicated, in one notice, that the tax does apply to a trust of a governmental eligible deferred compensation plan under §457(g).[722] However, earlier, the IRS informally indicated it was reconsidering whether UBTI applies to trusts relating to plans covering various elected and appointed officials of state and local governments, and "[p]ending completion of the review, the IRS will resolve these issues in favor of the taxpayer or governmental unit."[723]

Qualified §401(a) trusts have long had an exemption from §514's UBTI rules on unrelated debt-financed income. Under §514(c)(9), a §401(a) trust is a "qualified organization" whose use of leverage to acquire real property is not treated as "acquisition indebtedness."[724] Because church §403(b)(9) retirement income accounts also may have such investments (unlike other §403(b) plans, which generally are required to be invested in mutual funds and insurance annuity contracts), §514(c)(9)(C)(iv)[725] exempts them from the UBTI rules.

Estimated payments of UBTI liability must be made in the same manner as corporations make estimated income tax payments; thus, payments are due on the 15th day of the first month in each calendar quarter.[726] Unlike corporations that are charged interest on any underpayment for the period running from the due date of the installment until the earlier of the payment date or the 15th day of the fourth month following the close of the taxable year,[727] the "underpayment period" for trusts forming part of a qualified plan runs from the due date to the earlier of the payment date or the 15th day of the fifth month after the close of the taxable year.[728]

7. Excise Tax on Reversions — Form 5330

The employer maintaining a church plan may be liable for a 20% nondeductible excise tax on the amount of any reversion it receives if it has not been exempt from tax at all times.[729] An employer will not be considered to have been tax exempt at all times if at any time it had been subject to UBTI liability or had otherwise derived tax benefit from the plan.[730] According to Reg. §54.6011-1T(a), an employer must report and remit the tax on Form 5330. Governmental plans expressly are exempted from this tax.[731]

In *Research Corp. v. Commissioner*,[732] the Tax Court for the first time addressed the issue of whether a §501(c)(3) organization's employee pension plan becomes a qualified plan for purposes of §4980 if the organization pays tax on UBTI. A corporation claimed that its plan was not a qualified plan under §4980(c)(1)(A) because it had been exempt from income taxes at all times during its existence, and thus, it was not liable under §4980 for the 20% excise tax on the reversion it received upon termination of a pension plan that terminated in 2002.[733] The IRS claimed that the plan was a qualified plan because the corporation had paid taxes on UBTI for 1952, 1953, 1954, 2000 and 2001, and thus, the plan had not, at all times, been exempt from tax.

The Tax Court found that the plan was not a qualified plan for purposes of §4980 and that the corporation was not liable for the excise tax. The court relied on §501(b), which provides that a §501(c)(3) organization is subject to tax to the extent it has UBTI but, notwithstanding any taxes on UBTI paid, the organization "is considered an organization exempt from income taxes for the purpose of any law that refers to organizations exempt from income taxes," and noted that §4980(c)(1)(A) is a law that refers to organizations exempt from tax under Subtitle A (i.e., income taxes) of the I.R.C. The court rejected the IRS's argument that §501(b) deals only with whether an organization will maintain its tax-exempt status for purposes of

[717] Reg. §1.6081-9(e), as amended by T.D. 9892. *See* Reg. §1.6081-1(a), as amended by T.D. 9892.

[718] §6651, §6662.

[719] Section 512 and §513 contain, respectively, the definitions of "unrelated business taxable income" and "unrelated trade or business."

[720] §511(b). The estates and trust tax rate also applies to the UBTI of charitable trusts. Generally, however, the UBTI of exempt organizations described in §501(c) is taxed at the rate applicable to corporations under §11. *See* §511(a)(1) and §511(a)(2).

[721] *See* §3121(v)(3); PLR 9024069, PLR 9025067.

[722] Notice 2003-20.

[723] IRS News Release IR-1869 (Aug. 10, 1977).

[724] *See* §514(c)(9)(C)(ii).

[725] Added by Pub. L. No. 109-280, §866, effective for tax years beginning on or after August 17, 2006.

[726] §6655(c), §6655(g), as amended by Pub. L. No. 115-97, §14401(d)(4)(A), effective for tax years beginning after December 31, 2017. *But see* Notice 2020-23 (Coronavirus Disease 2019 (COVID-19) emergency relief automatically postpones to July 15, 2020, the due date for quarterly estimated tax filings and payments due on or after April 1, 2020, and before July 15, 2020).

[727] §6655(b)(2), as amended by Pub. L. No. 114-41, §2006(a)(2)(F) (substituting fourth month for third month), effective for returns for taxable years beginning after December 31, 2015. For C corporations with a taxable year ending on June 30, however, the change to the period of underpayment (i.e., from the third to the fourth month following the taxable year) applies to returns for taxable years beginning after December 31, 2025. Pub. L. No. 114-41, §2006(a)(3)(B). *See* Reg. §1.6072-2(a), as amended by T.D. 9892, applying to returns filed on or after January 30, 2020. For returns filed before this date, see former Reg. §1.6072-2T, added by T.D. 9821 (reflecting Pub. L. No. 114-41 changes), and removed by T.D. 9892.

[728] §6655(g)(3), as amended by Pub. L. No. 114-41, §2006(a)(2)(F).

[729] *See* §4980(c)(1)(A).

[730] Conf. Rep. No. 841, Vol. 2, 99th Cong., 2d Sess., Vol. 4 at 483. *But see Research Corp. v. Commissioner*, 138 T.C. 192 (2012) (discussed below).

[731] §4980(c)(1)(B).

[732] 138 T.C. 192 (2012).

[733] At the time of its termination, the plan made a direct transfer of 25% of the gross reversion to a qualified replacement plan and transferred the remainder of the assets making up the reversion to the taxpayer corporation.

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Subchapter F of the I.R.C., finding that §501(b) refers to "any law," which includes the entire I.R.C. The court also disagreed with the IRS's argument that §4980(c)(1)(A) requires a finding of whether a taxpayer has ever not been exempt from tax under Subtitle A, noting that the statute is worded in the positive, not in the negative. Moreover, the court held, the statute does not require a determination of whether the employer has ever paid a tax under Subtitle A, but rather, requires a determination of whether the employer has always been considered exempt from tax under Subtitle A.

With respect to the legislative history discussed above, the Tax Court concluded that the legislative history addressed a set of facts where the tax-exempt organization, whether it incurred taxes on UBTI or not, derived a tax benefit from the qualified plan, noting that was not the case in *Research Corp. v. Commissioner*.

8. Group Health Plan Coverage — Form W-2

I.R.C. §6051(a)(14)[734] requires employers to include on the Form W-2 the aggregate cost of employer-sponsored health coverage under any group health plan made available to the employee that is or would be excludible from the employee's gross income, except for amounts contributed to an Archer MSA, health savings account, or health flexible spending account. There are no exceptions to this rule for church or governmental plans. The cost of coverage is determined under rules similar to COBRA. The requirement was waived for 2011 in order to provide employers with additional time to make any necessary changes to their payroll systems or procedures.[735]

For further discussion, see 335 T.M., *Health Care Reforms — Implications for Employee Benefit Plans*.

C. Department of Labor

With a limited exception for certain plans maintained by the federal government, governmental plans and nonelecting church plans are exempt from the reporting and disclosure requirements of ERISA and, therefore, are not required to file a summary plan description, annual reporting forms and other reports specified in ERISA with the Department of Labor.[736]

D. Pension Benefit Guaranty Corporation

Governmental plan and nonelecting church plans are exempt from the PBGC reporting requirements and, therefore, need not file PBGC Form 10 or any other reports with the agency.[737]

E. Disclosures to Participants and Beneficiaries

1. ERISA Disclosures

Governmental or nonelecting church plans generally are not subject to the participant disclosure requirements under ERISA.[738] Thus, they are not required to furnish participants with summary plan descriptions, although many such plans do so voluntarily.

2. Plan Terms

The terms of a §401(a) governmental plan or nonelecting church plan must be communicated to employees for the plan to be qualified.[739]

Acceptable methods of apprising employees of the key provisions of the plan include: (1) furnishing each employee with a copy of the plan; (2) providing each employee with a booklet summarizing the essential features of the plan; or (3) posting a notice in a conspicuous place on a company bulletin board.[740] Such notice must state that a plan has been established, describe the type of plan, specify the eligibility and vesting requirements, contain a synopsis of the types of benefits provided, indicate the rate of employee contributions, if any, and if the plan is a money purchase pension plan, profit-sharing plan or stock bonus plan, set out the formula for employer contributions, if any. Any booklet or notice given to employees in lieu of the actual plan must clearly state that a copy of the complete plan may be inspected at a designated place on the company's premises at certain specified times.

3. Automatic Contribution Arrangements

The plan sponsor of, plan administrator for, or employer maintaining a church plan under §414(e) that has an automatic contribution arrangement (i.e., automatic enrollment) must provide a notice annually within a reasonable period before the first day of the plan year to each participant to whom the arrangement applies for that arrangement to supersede state law. That notice must be sufficiently accurate and comprehensive to apprise the participant of the participant's rights and obligations under the automatic contribution arrangement and must be written in a manner calculated to be understood by the average participant to whom the arrangement applies.[741]

The notice must explain the participant's right under the arrangement not to have elective contributions made on the participant's behalf, or to elect to have contributions made at a different percentage. The notice requirement is not satisfied unless the participant has a reasonable period of time, after receipt of the explanation of these options to elect out of the arrangement or choose an alternate percentage and before the first contribution is made, to make the election.[742] The notice also must ex-

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[734] Added by the Patient Protection and Affordable Care Act (PPACA), Pub. L. No. 111-148, §9002, effective for tax years beginning after December 31, 2010.

[735] Notice 2010-69. Pending further guidance, reporting is not required by certain employers, including an employer required to file fewer than 250 Forms W-2 for the preceding calendar year. *See* Notice 2012-9, *superseding* Notice 2011-28 (interim guidance on informational reporting of cost of employer-sponsored group health plan coverage). The reporting exclusion is based upon the §6011(e) exemption from electronic filing for employers that file fewer than 250 returns. For returns due after 2020, §6011(e), as amended by Pub. L. No. 116-25, §2301 and Reg. §301.6011-2(c)(1), as amended by T.D. 9972, 88 Fed. Reg. 11,754 (Feb. 23, 2023), provide that the minimum number of returns that trigger mandatory electronic filing is 10 for filings due on or after January 1, 2024. For calendar years beginning before January 1, 2024, the mandatory electronic filing threshold number remains 250.

[736] ERISA §4(b)(1), §4(b)(2), §101(b).

[737] ERISA §4021(b). This includes plans established and maintained by Indian tribal governments. ERISA §4021(b)(2).

[738] ERISA §4(b)(1), §4(b)(2), §101(a).

[739] Reg. §1.401-1(a)(2).

[740] Rev. Rul. 71-90.

[741] Protecting Americans From Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, §336(c)(3)(A), effective December 18, 2015. For further discussion of the requirements for an automatic enrollment provision to supersede certain state laws, see III.Q., above.

[742] Pub. L. No. 114-113, Div. Q, §336(c)(3)(B)(i)–(ii).

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plain how the contributions made will be invested if the participant does not make an investment election.[743]

4. Information Related to Plan Distributions

Governmental or nonelecting church plans that are §401(a) or §403(b) plans and governmental §457(b) plans, must provide plan participants or beneficiaries who receive certain plan distributions with notice of their right to elect not to have federal income tax withheld.[744]

Such plans also must provide recipients of certain distributions with rollover eligibility information.[745] If such notice is not provided, the plan administrator may be subject to a penalty of $100 for each such failure, up to a maximum $50,000 in a calendar year.[746]

Finally, such a governmental or nonelecting church plan must provide copies of Form 1099-R to persons receiving distributions.[747]

5. Church Plan Status Ruling Requests

Nonelecting church plans (including §401(a) plans, §403(a) insurance annuity plans, and §403(b) plans) submitting ruling requests for church plan status under §414(e) must furnish notice of such a request to plan participants and other interested persons and provide a copy of the notice to the IRS as part of the ruling request. They also must provide procedures for the IRS to receive and consider comments relating to the ruling request from interested persons.[748] The notice must include the information set forth in the Model Notice provided by the IRS.[749] Under certain conditions, posting of the notice on a bulletin board may satisfy this notice requirement.

6. Dependent Care Reimbursement Plans

Dependent care reimbursement plans also have certain notice requirements that apply, without exception, to governmental or church plans.[750]

[743] Pub. L. No. 114-113, Div. Q, §336(c)(3)(B)(iii).
[744] §3405(e)(10)(B).
[745] §402(f); Reg. §1.402(f)-1, §1.403(b)-7(b)(3).
[746] §6652(i).
[747] Reg. §1.6041-2. *See* discussion at VI.B.4., above.
[748] Rev. Proc. 2011-44, effective for all ruling requests received after September 26, 2011, and ruling requests pending with the IRS as of September 26, 2011. *See* Rev. Proc. 2025-1, apps. E and F.
[749] Attached as an appendix to Rev. Proc. 2011-44.
[750] §129(d)(6). For discussion of these notice requirements, see 397 T.M., *Cafeteria Plans.*

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VII. Sex and Age Discrimination Issues

A. Sex Discrimination

1. Governmental Plans

Retirement plans maintained by state and local governments are subject to Title VII of the Civil Rights Act of 1964 (Title VII),[751] which prohibits employment discrimination on the basis of sex. Indeed, many of the major cases involving sexual discrimination with respect to retirement plans have involved public plans. For example, in the landmark case of *City of Los Angeles Department of Water and Power v. Manhart*,[752] the U.S. Supreme Court held that the City of Los Angeles violated Title VII when it required female employees to make larger pension fund contributions than male employees in order to receive the same monthly benefit. In *Ariz. Governing Comm. for Tax Deferred Annuity and Deferred Compensation Plans v. Norris*,[753] the U.S. Supreme Court held that the State of Arizona had violated Title VII by paying unequal retirement benefits for equal contributions purely on the basis of sex-distinct annuity values.

Both *Manhart* and *Norris* involved instances in which the assumption that women as a class live longer than men affected the amount of contributions or benefits of individual female employees. The Court held that because Title VII prohibits differences in the treatment of individuals solely on the basis of their sex, this use of generalities was improper. At least one court has held that this proscription on disparate treatment applies even when such treatment is beneficial to the individual.[754]

The remedy for a violation of Title VII may include retroactive relief in the form of return of contributions or adjustments to previously accrued benefits. However, the availability of this relief is limited. In *Florida v. Long*,[755] the U.S. Supreme Court reversed an award of retroactive benefits to certain male retirees who retired after *Manhart* and before *Norris*. The male retirees had elected a payment option which, due to the use of sex-based tables, paid them lower benefits than those received by similarly situated female employees. The state used unisex tables to determine benefits of employees who retired after *Norris* but continued to pay lower benefits to the pre-*Norris* retirees. The Court held that Florida was not on notice until *Norris* that its benefit options violated Title VII and, therefore, should not be liable for retroactive relief with respect to benefits paid before *Norris*. It also concluded that benefits that became payable to pre-*Norris* retirees after *Norris* should not be increased because such an increase would adversely affect the fund's ability to meet its accrued obligations. The Court rejected an attempt to characterize such an increase as prospective relief, noting the effect of an order that increases pension benefits to employees who have already retired is retroactive if it corrects a fixed calculation based on assumptions held by both the state and retiree when the retirement occurred. However, the *Long* Court noted that a different assessment of retroactive relief might result under pension plan structures that do not provide retirees with a contractual right to a fixed level of benefits or rate of return on contributions. In those instances, an increase in benefits might not require additional funding by the state.[756]

2. Church Plans

The applicability of Title VII to churches and other religious organizations has been the subject of litigation. Courts have generally found Title VII to be applicable, citing the Civil Rights Act's legislative history and the specific exemption of churches from certain of its requirements.[757] The courts have also rejected First Amendment challenges to the application of the statute when fringe benefits had been provided on a sexually discriminatory basis as a result of certain religious beliefs concerning the proper roles of males and females.[758] In light of these cases, it seems likely that a court would find that Title VII also applied to benefits provided under a retirement plan maintained by a church. An exception may exist in the case of benefits provided to clergy under the First Amendment.[759]

B. Age Discrimination

1. Application of ADEA to Governmental Plans and Church Plans

State and local governments specifically are subject to the Age Discrimination in Employment Act of 1967 (ADEA).[760] The status of churches and other religious organizations under ADEA is not as clear, and has been the subject of litigation.

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[751] 42 U.S.C. §2000e.

[752] 435 U.S. 702, 1 EBC 1813 (1978).

[753] 463 U.S. 1073, 4 EBC 1633 (1983).

[754] *Cabell v. New York*, No. 84 Civ. 1062 (S.D.N.Y. Apr. 15, 1988), aff'd, 872 F.2d 1021 (2d Cir. 1989) (determination of retirement benefits using the higher of sex-based or sex-neutral calculations violated Title VII).

[755] 487 U.S. 223, 9 EBC 2169 (1988).

[756] *See Spirt v. Teachers Ins. and Annuity Ass'n*, 735 F.2d 23, 5 EBC 1469 (2d Cir. 1984) (no expectation of specified benefit because monthly benefits were based on investment return).

[757] *See, e.g., EEOC v. Fremont Christian Sch.*, 781 F.2d 1362, 7 EBC 1073 (9th Cir. 1986). The original act passed by the House totally excluded religious employers from coverage. H.R. Rep. No. 914, 88th Cong., 1st Sess. (1963). The final version excluded religious employers only with respect to discrimination based on religion, and then only with respect to persons hired to carry out the employer's "religious activities." Pub. L. No. 88-352, Title VII §702. In 1972, the word "religious" preceding the word "activity" was deleted from the statute by Pub. L. No. 92-261, §3, but Congress specifically rejected proposals to extend the scope of the exemption. Subcommittee on Labor of the Committee on Labor and Public Welfare of the United States Senate, "Legislative History of the Equal Employment Opportunity Act of 1972," at 1229, 1230, 1258–1260. In *Corp. of Presiding Bishop of Church of Jesus Christ of Latter Day Saints v. Amos*, 483 U.S. 327 (1987), however, the U.S. Supreme Court held that the Title VII exemption did permit the termination of a non-Mormon custodian working at a church-run gymnasium.

[758] *See, e.g., Fremont Christian School* (religious school violated Title VII when it provided health insurance to married male employees but not to married female employees on basis of religious belief that men are heads of their households responsible for providing for their families). Similarly, see *EEOC v. Pac. Press Publ'g Ass'n*, 676 F.2d 1272 (9th Cir. 1982).

[759] *See* discussion at III.F.4.e., above.

[760] Pub. L. No. 90-202, as amended in 29 U.S.C. §621–§634. The ADEA prohibits an employer from discriminating against an employee on the basis of age. Section 11(b) of ADEA, 29 U.S.C. §630(b), includes in its definition of employer "a State or political subdivision of a State and any agency or instrumentality of a State or political subdivision of a State." However, ADEA § 11(f), 29 U.S.C. §630(f), excludes from the term "employee" "any person elected to public office in any State or political subdivision of any State. . ., or any person chosen by such officer to be on such officer's personal staff, or an appointee on the policy-making level or an immediate adviser with respect to the exercise of the constitutional or legal powers of the office." The exclusion does not apply to civil service employees.

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Courts have generally held, however, that a church or church-related organization is an employer subject to ADEA provided the church has at least 20 employees.[761] Again, with respect to clergy, discrimination in benefits based on age may be permissible under the First Amendment.[762]

2. Cash Balance Plans

ADEA has a number of provisions that apply to pension plans.[763] Special rules apply to cash balance plans.[764] Generally, in order to satisfy age discrimination requirements, such plans must provide an interest rate no more than a market rate of return,[765] and are subject to special rules on conversions to, and terminations of, such plans. These rules apply to a defined benefit plan under which the accrued benefit (or any portion thereof) is calculated as the balance of a hypothetical account maintained for the participant or as an accumulated percentage of the participant's final average compensation.[766] These provisions apply to church and governmental cash balance plans.[767] However, the application of the rules to an arrangement that may resemble cash balance plans by the use of hypothetical accounts, such as traditional church §403(b)(9) church retirement income accounts, and governmental plan provisions for refunds of contributions with statutory interest in the event of termination of employment prior to retirement age, as well as DROP plans, is unclear.

3. Mandatory Retirement or Refusal to Hire

Although ADEA was amended to cover state and local governmental employers, there remained some question concerning the constitutionality of this amendment until the U.S. Supreme Court upheld its constitutionality in *EEOC v. Wyoming*.[768] In that case, the Court held that the ADEA's prohibition on mandatory retirement applied to the state and, therefore, its requirement that game wardens retire at age 55 was improper in the absence of evidence that age was a bona fide occupational qualification. Following the decision, many government bodies either repealed or chose not to enforce provisions that used age as a basis for refusing to hire or for compulsory retirement.

The amendments of 1986[769] removed the maximum age limitation on the application of ADEA, thereby making mandatory retirement after age 40 illegal. However, the amendments contained several exceptions to this general prohibition that are relevant to public employers.

An exception applies to the general prohibition on mandatory retirement or on using age as a basis for refusing to hire with respect to individuals who seek positions as, or who are employed as, firefighters or law enforcement officers. Under this exception, a state, political subdivision, agency or instrumentality is permitted to discharge or to refuse to hire individuals who have attained the age of employment or retirement in effect under applicable state or local law on March 3, 1983, provided that the action is taken pursuant to a bona fide hiring or retirement plan that is not a subterfuge to evade the purposes of the ADEA.[770]

At least one court held that this exception applies only to supervisory law enforcement officers and firefighters who are not directly and primarily involved in law enforcement and firefighting.[771] The court based its decision on the definitions of "firefighter" and "law enforcement officer" contained in the statute, both of which included "*an employee engaged in the activity who is transferred to a supervisory or administrative position*" (emphasis added). It also cited the legislative history of the 1986 amendments that indicated that Congress contemplated that the exception applies to police officers and firefighters holding administrative jobs.[772]

4. Denial of Disability Benefits

Some states have limited the availability of disability retirement benefits to persons who become disabled before age 60 or some other age prior to normal retirement. The U.S.

[761] *See, e.g., Usery v. Manchester E. Catholic Reg'l Sch. Bd.*, 430 F. Supp. 188 (D.N.H. 1977). Section 11(b) of ADEA defines an employer as "a person engaged in an industry affecting commerce who has 20 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year."

[762] *See* discussion at III.F.4.e., above.

[763] ADEA §4, 29 U.S.C. 623.

[764] ADEA §4(i)(10). Other age discrimination rules, such as accelerated vesting, do not apply to a governmental or nonelecting church plan not subject to those provisions of the I.R.C. or ERISA. *See* I.R.C. §411(b)(5); ERISA §204(b)(5).

[765] Section 123 of Pub. L. No. 110-458 amended ADEA §4(i)(10)(B)(i)(III) to provide that, for governmental plans (as defined in I.R.C. §414(d)), a rate of return or a method of crediting interest established pursuant to any provision of federal, state or local law (including any administrative rule or policy) is treated as a market rate of return and a permissible method of crediting interest, but only if the rate or method does not violate any other requirement of ADEA. The provision is effective as if included in Pub. L. No. 109-280. Pub. L. No. 110-458, §701(c).

[766] ADEA §4(i)(10)(B)(v)(IV), cross-referencing ERISA §203(f)(3).

[767] The IRS issued regulations providing guidance on plan conversion amendments and a market rate of return in Reg. §1.411(b)(5)-1(c) and §1.411(b)(5)-1(d), respectively. *See* T.D. 9505, 75 Fed. Reg. 64,123 (Oct. 19, 2010), corrected at 75 Fed. Reg. 81,456 (Dec. 28, 2010) (2010 final hybrid plan regulations), T.D. 9693, 79 Fed. Reg. 56,442 (Sept. 19, 2014) (2014 final hybrid plan regulations), T.D. 9743, 80 Fed. Reg. 70,680 (Nov. 16, 2015) (transitional plan amendments for changing interest crediting rate). The hybrid plan regulations generally apply to plan years that begin on or after January 1, 2011. Transitional amendment provisions regarding the exclusive list of interest crediting rates and combinations of interest crediting rates that satisfy the market rate of return requirement apply to plan years that begin on or after September 18, 2014 (or an earlier date as elected by the taxpayer) but, with an exception for collectively bargained plans, do not apply for amendments made on or after the first day of the first plan year that begins on or after January 1, 2017. Amendments made by the 2014 regulations generally apply to plan years that begin on or after January 1, 2017 (or an earlier date as elected by the taxpayer). Reg. §1.411(b)(5)-1(f)(2). For periods after June 29, 2005, and before the effective date of final regulations, statutory hybrid plans may rely on the final regulations, the 2010 proposed regulations (REG-132554-08, 75 Fed. Reg. 64,197 (Oct. 19, 2010), corrected at 75 Fed. Reg. 81,543 (Dec. 28, 2010)), the 2007 proposed regulations (REG-104946-07, 72 Fed. Reg. 73,680 (Dec. 28, 2007)), and Notice 2007-6, for satisfying the requirements of §411(b)(5). T.D. 9693, 79 Fed. Reg. 56,442 at 56,456– 57 (preamble), T.D. 9505, 75 Fed. Reg. 64,123 at 64,134–35 (preamble). *See* Notice 2011-85, §III, Notice 2012-61, Q&A H-1. Transition guidance was issued in Notice 2007-7; Announcement 2009-82; Notice 2009-97, §IV.B, and Notice 2010-77, §IV.B. T.D. 9743 permits defined benefit plans that use a lump sum-based benefit formula but do not comply with the requirement to not provide for interest credits at an effective rate that is greater than a market rate of return to change, without violating the anti-cutback rules, to an interest crediting rate that is permitted under the final hybrid plan regulations.

[768] 460 U.S. 226, 4 EBC 1033 (1983).

[769] Pub. L. No. 99-592.

[770] 29 U.S.C. §623(j).

[771] *Boylan v. State*, 561 A.2d 552, 11 EBC 1481 (N.J. 1989).

[772] *Boylan* at 557–59.

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Supreme Court upheld this type of restriction in *Public Employees' Retirement System of Ohio v. Betts*,[773] in which it ruled that the bona fide plan exception of the ADEA exempts all provisions of a bona fide employee benefit plan from the purview of the ADEA unless the plan is a subterfuge for discrimination in the nonfringe benefit aspects of the employment relationship. The burden is on the employee to present such proof. Prior to *Betts*, some courts and the EEOC took the position that employers were required to show a cost-based justification for age-related reductions to fall under the bona fide plan exception.[774]

5. Benefit Accruals Beyond Normal Retirement Age

ERISA §204, I.R.C. §411(b) and ADEA §4 prohibit a plan from reducing or discontinuing benefit accruals or contributions upon attainment of the plan's normal retirement age.[775] Because the provisions of ERISA and the Code imposing the requirement do not apply to governmental and church plans, ADEA is the only basis for requiring additional benefit accruals.[776] Thus, church plans established by an employer with at least 20 employees and governmental plans cannot cease benefit accruals at normal retirement age, except, perhaps, in the case of clergy under a nonelecting church plan.[777]

Prefatory material to proposed regulations issued by the EEOC indicates that a plan that does not meet the requirements for additional benefit accruals cannot rely on the "bona fide plan exception" to avoid ADEA liability.[778]

6. Standing

Individuals do not have standing to sue a state for age discrimination under ADEA without the state's consent. In *Kimel v. Florida Board of Regents*,[779] the U.S. Supreme Court concluded that ADEA does not provide a private right of action against governmental plans. The Second Circuit interpreted *Kimel* to mean that, based on the state's claim of sovereign immunity under the 11th Amendment, an individual could not sue the New York State Retirement System for age discrimination by the state's death benefit plan.[780] Although an individual may not have standing under ADEA to sue a state entity, ADEA nonetheless may apply to states. Other litigants, notably the EEOC, may sue a state for noncompliance with ADEA. For example, the Sixth Circuit upheld an ADEA action brought by the EEOC against the Kentucky Retirement System regarding payments of disability benefits.[781] The U.S. Supreme Court in *Kimel* did not reverse its earlier decision allowing the EEOC to sue the state of Wyoming for violating ADEA's provisions regarding mandatory retirement age.[782] Thus, while *Kimel* may be interpreted to mean that states need not fear being sued by individuals for violating ADEA, states continue to be subject to ADEA enforcement actions brought by the EEOC.

[773] 492 U.S. 158, 11 EBC 1049 (1989).

[774] Section 4(f) of ADEA, 29 U.S.C. §623(f)(2), sets out the bona fide plan exception to ADEA. It provides that it is not unlawful for an employer to observe the terms of a bona fide employee benefit plan such as a retirement pension or insurance plan that is not a subterfuge to evade the purposes of ADEA.

[775] However, a plan will not be considered to have violated this prohibition solely because it reduces or discontinues benefit accruals or allocations upon completion of a specified number of years of service, even though there may be a positive correlation between age and completed years of service. For example, a plan may provide that benefits will accrue over a period not to exceed 35 years of service.

[776] However, governmental plans and church plans are subject to the same rules governing benefit accruals after normal retirement age as are other qualified plans. The Omnibus Budget Reconciliation Act of 1986, Pub. L. No. 99-509, §9201, provides that IRS regulations on post-retirement benefit accruals apply for the purposes of applying comparable provisions under §4(i)(7) of ADEA.

[777] *See* EEOC Prop. Reg. §1625.21, 52 Fed. Reg. 45,360 (Nov. 27, 1987). The proposed regulations also stated that the rules do not address the validity of vesting requirements in plans that meet pre-ERISA requirements instead of complying with §411(a).

[778] 52 Fed. Reg. 45,361 (Nov. 27, 1987).

[779] 528 U.S. 62 (2000).

[780] *McGinty v. New York*, 251 F.3d 84 (2d Cir. 2001).

[781] *See EEOC v. Ky. Ret. Sys.*, 16 Fed. App'x 443, 26 EBC 2260 (6th Cir. 2001).

[782] *See EEOC v. Wyoming*, 460 U.S. 226 (1983).

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