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View From Proskauer: 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

By Robert Rachal

ERISA, as the Supreme Court has often noted, reflects a ''careful balancing'' between the interests of plan sponsors and plan participants.[1] Uniformity and predictability are critical protections that ERISA affords plan sponsors, and these goals have been used to justify important aspects of ERISA, such as the need for judicial deference to plan administrators. *See Conkright v. Frommert*, 130 S. Ct. 1640, 1649-51, 48 EBC 2569 (2010). This need for uniformity and predictability applies with added force to pension plan administration, in which the IRS plays a critical role in determining whether these plans are tax-qualified, and thus eligible for the tax benefits (*e.g.*, deferral of income for participants until received) that justify their existence. Indeed, the need for predictability has been deemed so important to pension plan administration that the Supreme Court has protected plans and plan sponsors from retroactive liability caused by any ''marked departure from past practice.''[2]

In light of this need for uniformity and predictability, deference to the IRS's guidance on pension law should be uncontroversial, at least when it is long-standing and consistent guidance. Yet, as the recent rulings in the ''church plan'' cases aptly illustrate, federal judges have sometimes become quick to second-guess the IRS and to develop their own unique pension rules, even when these new rules are a ''marked departure from past practice.''[3] Given the complexity of ERISA and the large number of federal judges (*e.g.*, 677 district judges are currently authorized[4]) this lack of judicial deference can, unfortunately, create balkanized and unexpected legal rules, defeating some of the very protections ERISA is supposed to provide plan sponsors.

Background on the 'Church Plan' Exemption

The ''church plan'' cases arise out of Congress's expansion of the ''church plan'' exemption in 1980. As originally enacted in 1974 with ERISA, the ''church plan'' exemption only exempted from ERISA plans established by ''churches'' for the church and a church agency. The IRS applied this original exemption nar-

[1] *Conkright v. Frommert*, 130 S. Ct. 1640, 1649, 48 EBC 2569 (2010) (quoting *Aetna Health Inc. v. Davila*, 542 U.S. 200 215, 32 EBC 2569 (2004)).

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[2] *City of Los Angeles Dept. of Water & Power v. Manhart*, 435 U.S. 702, 722, 1 EBC 1813 (1978) (refusing to impose retroactive liability based on Court's ruling that sex-based pension contribution tables violated Title VII).

[3] *Manhart*, 435 U.S. at 722.

[4] See http://www.uscourts.gov/JudgesAndJudgeships/FederalJudgeships.aspx (last visited April 1, 2015).

rowly, focusing on whether the activity of the organization seeking the exemption was, in the IRS's view, sufficiently ''religious'' to deem that organization to be part of a ''church.'' Thus, the IRS concluded a Catholic religious order was not part of the church, as the order's operation of health facilities was not, per the IRS, deemed sufficiently ''religious,'' that is, focused on worshipful or sacerdotal functions.[5]

This and other aspects of the original exemption led to complaints from churches that this exemption as originally enacted was too narrow. The churches proposed to Congress an expansion that would, among other things, include within the ''church plan'' exemption the churches' ''good works'' ministries, such as their schools, hospitals and charitable organizations.[6] Notably, Treasury objected to this very expansion, but was overruled by the Senate Finance Committee.[7]

As amended and reenacted, subsection (A) of the ''church plan'' exemption remains unchanged substantively from its original enactment. Subsection (A) provides that a ''church plan'' is a plan established and maintained by a church. Subsection (C), however, was added by the 1980 amendment, and extends ''church plan'' status to include plans administered by organizations controlled by or associated with a church: ''A [church plan] ***includes*** a plan maintained by an organization . . . if such organization is controlled by or associated with a church or a convention or association of churches.'' ERISA § 3(33)(C)(i) (emphasis added). Congress also deemed the church to be the employer of the employees of these church-affiliated organizations. ERISA § 3(33)(C)(ii)(II), (C)(iii).

Treasury, which had participated in this legislative process, and its bureau the IRS, revisited its guidance in *I.R.S. General Counsel Memo* 39,007 (Nov. 2, 1982). The IRS examined in detail the text of the expanded ''church plan'' exemption and reversed its earlier ruling, concluding that plans of organizations controlled by or associated with churches, in this instance plans for employees of hospitals run by religious orders, could be ''church plans.'' *Id.* . The IRS based its contemporaneous guidance on the newly added exemption in subsection (C)(i), which ''includes'' within the definition of ''church plan,'' plans of church-affiliated organizations that are administered by an organization with a principal purpose to administer or fund the plan.[8]

Since the IRS issued its guidance, for the last 30-plus years there has been a settled understanding among the federal agencies (the IRS, DOL and PBGC), the federal courts, and religiously affiliated plan sponsors that this expanded exemption included plans established by the ''good works'' ministries of churches, such as their religiously-affiliated schools and hospitals.[9] As part of this settled understanding, the IRS and DOL have issued over 500 rulings to church-affiliated organizations exempting their plans from ERISA. Also, after the IRS issued its guidance, Congress has repeatedly expanded the ''church plan'' exemption to exempt these ''church plans'' from various health care, insurance, and securities laws.[10]

The 'Church Plan' Cases

In the last two years, 12 class actions have been filed across the country against religiously-affiliated healthcare institutions (principally Catholic institutions), challenging whether their pension plans are exempt ''church plans.''[11] Although there are some variations in the complaints, a core issue common to all is whether the ''church plan'' exemption includes plans established by church-affiliated organizations (the prior settled understanding), or instead should be limited to only plans established by ''churches''—presumably as previously construed by the IRS to be institutions focused on worshipful activities, instead of ''good works'' ministries. This later approach would resurrect the troubling constitutional issues engendered by the original exemption, since many religious faiths and traditions include good works as part of ***how*** they practice their faith. In any event, the statutory construction issue can be distilled to whether ''include'' in ERISA § 3(33)(C) is read as illustrative or additive—does it only illustrate a ''subset'' of the ''plans established by churches'' set forth in subsection (A) of the exemption, or does it add a category of plans, *i.e.*, of plans maintained by church-affiliated organizations, to the exemption?

There are powerful arguments why ''include'' should be read in its normal sense to add something to a group or category, including that this is how ''include'' is used throughout ERISA's ''governmental plan'' and ''church plan'' exemptions.[12] There are also 30-plus years of settled understandings between the federal agencies, courts and plan sponsors that this is what the exemption meant. Nonetheless, recently three district court judges have held that only ''churches'' can establish ''church plans.'' To do so, each district judge concluded that no deference was due the IRS, reasoning that only his construction of the statute made sense.

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[5] *See* I.R.S. Gen. Couns. Mem. 37,266 (Sept. 22, 1977). The IRS noted that its rule defining religious mission applied even when it was contrary to the religious doctrine of the applicable church. *Id.*

[6] *See* 125 Cong. Rec. 10,054-58 (1979) (Sen. Talmadge, publishing letters of the religious organizations).

[7] *See* Exec. Sess. of S. Comm. on Fin., 96th Cong. 41-42 (June 12, 1980).

[8] *Id.*. The IRS also cited Senator Javits' floor statement to note that, as amended, the ''church plan'' exemption is no longer limited to plans of churches. *Id.* .

[9] *See, e.g.*, *Lown v. Continental Cas. Co.*, 238 F.3d 543, 547, 25 EBC 1838 (4th Cir. 2001) (''church plans'' include plans established by church-affiliated organizations); *Hall v. USAble Life*, 774 F. Supp. 2d 953, 958-61, 51 EBC 1074, 2011 BL 81738 (E.D. Ark. 2011) (rejecting argument that ''church plan'' exemption could not extend to a hospital).

[10] For some examples, (i) in 1988 Congress excluded ''church plans'' from the requirement to provide health continuation coverage under Code § 4980B. *See* 26 U.S.C. § 4980B(d)(3); (ii) in 1996 Congress added § 3(c)(14) to the Investment Company Act of 1940 to exclude ''church plans'' from the definition of ''investment companies'' under that Act. *See* 15 U.S.C. § 80a-3(c)(14); and (iii) in 2000 Congress enacted the ''Church Plan Parity and Entanglement Prevention Act'' to amend ERISA to preempt certain state insurance requirements from applying to ''church plans.'' *See* 29 U.S.C. § 1144(a).

[11] *See* Jacklyn Willie, *Firms File 12th Church Plan Lawsuit; Illinois-Based Presence Health Targeted*, BNA Pension & Benefits Daily (65 PBD, 4/6/15)(April 6, 2015).

[12] *See, e.g.*, ERISA § 3(32) (''including'' plans of Indian tribes, international organizations, and railroads within ''governmental plan'' exemption); § 3(33)(C)(ii)(II) (''including'' as employees of a church the employees of church-affiliated organizations).

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Thus, in *Rollins v. Dignity Health*, 19 F. Supp. 2d 909, 913, 57 EBC 1346, 2013 BL 343403 (N.D. Cal. 2013), the district judge focused on only a part of IRS's post-amendment guidance and held he ''declines to defer to the IRS's interpretation''; instead, he would conduct his own ''independent analysis'' of the statute. In *Kaplan v. Saint Peter's Healthcare System*, (D.N.J. March 31, 2014), the district judge at least noted that deference may be due the IRS if the statute were ambiguous, but then concluded that the exemption could be read in only one way, as making ''include'' illustrative since subsection (A) is, in his view, the ''gatekeeper'' for the exemption. Finally, in *Stapleton v. Advocate*, 2014 BL 370485 (N.D. Ill. Dec. 31, 2014), the district judge noted that deference would be due the IRS if its guidance were persuasive, but again the judge found the exemption could be read in only one way, as making ''include'' illustrative since subsection (C)(i) was, in his view, a ''subset'' of the category protected by subsection (A).

Unless the district judges properly found the statute to be unambiguous, their dismissal of the IRS guidance is doctrinally questionable. But ''gatekeeper'' and ''subset'' are nowhere in the statutory text, and instead are interpretative glosses added by these respective judges. And although each of these judges concluded that the exemption was unambiguous (and thus that reasonable minds could read the statute in only one way) each one also certified this same question for appeal pursuant to 28 U.S.C. § 1292(b) – and each case has been accepted for appeal by the respective circuit, the Ninth, Third, and Seventh Circuits. But 1292(b) certification requires that ''there is a substantial ground for difference of opinion'' over the question at issue. In sum, the ''unambiguous'' conclusion does not appear to withstand rigorous scrutiny.

Other courts have not been so dismissive of the IRS. Thus, in *Thorkelson v. Publ'g House of Evangelical Lutheran Church of Am.*, 764 F. Supp. 2d 1119, 1126-29, 50 EBC 2154 (D. Minn. 2011), the district court considered prior court decisions and agency guidance to conclude they supported reading the ''church plan'' exemption inclusively, to include plans established by church-affiliated organizations. And in *Overall v. Ascension Health*, 23 F. Supp. 3d 816, 826, 58 EBC 1885, 2014 BL 148842 (E.D. Mich. 2014), the district judge went further, noting:

> Also important is that the ''church plan'' exemption is codified in parallel form in the Internal Revenue Code (''IRC'') at § 414(e), 26 U.S.C. § 414(e). The IRS construed and applied the ''church plan'' exemption shortly after the 1980 revision. In IRS General Counsel Memo 39007, (July 1, 1983), the IRS recognized that its ''worshipful activity'' requirement had been legislatively overruled and that the ''church plan'' exemption now includes plans sponsored by non-profit organizations that are ''controlled by or associated with a church,'' which the IRS memorandum applied to include hospitals operated by Roman Catholic religious orders. *Id.* .
>
> The IRS has followed this rule for more than 30 years.

The district judge thus accorded the IRS's rulings deference in concluding the ''church plan'' exemption should be read according to the prior settled understanding, *i.e.*, inclusively to include plans established by church-affiliated organizations. *Id.* at 827-29. The IRS's involvement in the legislative process, and its long-standing consistent construction of the exemption, amply support this deference.[13]

Proskauer's Perspective

It is no surprise that ERISA and the Internal Revenue Code provisions applicable to pension plans are often dense and complex. In the instant area, the ''church plan'' exemption is a bit of a Frankenstein, cobbled together from Congressional enactments occurring years apart—part (A) from 1974; part (C) from 1980. Clever arguments can be made to find and exploit potential latent ambiguities lurking in complex statutory language, such as the different meanings that can be attributed, *post hoc*, to the word ''include'' used in the ''church plan'' exemption. Yet ERISA cannot offer plan sponsors promised uniformity and predictability if each federal judge decides these issues anew.

In these circumstances there are sound grounds to defer to the IRS, which (other than the Supreme Court or Congress) is the only entity that can provide uniform and predictable rules in this area. This should not be a blank check, and courts must review IRS guidance for consistency with the statutory language. But ignoring long-settled, consistent IRS and court' construction, by effectively deeming them all to be unreasonable, is not a sound way to administer pension law, and defeats the uniformity and predictability necessary for plan sponsors to offer and administer pension plans.

[13] For example, the IRS's General Counsel Memo 39,007 (subsequently followed by the DOL and PBGC) reflects its contemporaneous analysis of the amended exemption in light of that institutional knowledge. *Compare United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001) (noting IRS ruling reflecting agency's longstanding interpretation that is reasonable ''attracts substantial judicial deference''). Congress' expanding the ''church plan'' exemption to other contexts after this agency guidance was published provides further grounds for deference. *See Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978).