General Board
Pension and Health Benefits

Caring For Those Who Serve

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Legislative Update—Clarifications to Church Plan Provisions: Retirement, Health and Welfare

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"). One particular section of the new PATH Act, Section 336, contains important new rules and clarifications that impact church retirement plans and health and welfare benefit plans. The provisions of Section 336 are identical to the Church Plan Clarification Act of 2015 (CPCA)—legislation authored by the Church Alliance (of which the General Board is a member) and that the General Board has been supporting for many years. Section 336 includes five topics that are important to church benefit plans:

1. "Controlled group" rules for determining when separate entities must be treated as one employer for various purposes
2. Pre-emption of state laws that would restrict automatic enrollment in church retirement plans
3. Easing of the rules regarding transfers and mergers of assets between church retirement plans
4. Modification of the "Section 415" contribution and benefit limitations that apply to grandfathered 403(b) defined benefit plans
5. Easing of the rules regarding church plans investing in group trusts

The PATH Act also delayed the Affordable Care Act (ACA)'s "Cadillac" Plan Tax (the excise tax on high-cost health plans) by two years to 2020 (as described in the **February 25, 2016 *On Board Express***).

Highlights of these five church plan clarification provisions and the Cadillac plan tax delay are described below.

1. Controlled Group Rules for Church Plans

Section 336 of the PATH Act includes "Controlled Group" rules that clarify when churches and church-controlled organizations must be grouped together and treated as a single employer for purposes of certain laws, including the ACA. For example, a Controlled Group might include a local church and an affiliated day care, camp or ministry facility operated by that church.

General Rule—Section 336 provides a General Rule for the application of Controlled Group provisions to church organizations. An organization that is eligible to participate in a church plan will generally not be treated as a single employer (i.e., a Controlled Group) with another such organization unless:

- One of the organizations provides, directly or indirectly, at least 80% of the operating funds for the other organization; *and*
- There is common management or supervision, such that the organization providing the operating funds is directly involved in the day-to-day operations of the other organization.

Because this General Rule is considered a clarification, it should be applied to historical questions as well as future events.

The General Rule provides greater clarity and guidance for churches and church-controlled organizations, which are generally eligible to participate in church plans. Thus, the two-part test above is applied to determine whether a church and a church-controlled organization are in the same Controlled Group.

Rule for Two or More Non-Qualified Church-Controlled Organizations (Exception)—For two or more non-qualified church-controlled organizations[1], the legislation provides a special rule to determine Controlled Group (single employer) status. For one non-qualified church-controlled organization to be considered one employer with another such organization (or one that is not exempt from tax at all), at least 80% of the directors or trustees of the second organization must be either representatives of, or controlled by, the first organization.

It is possible, then, for two non-qualified church-controlled organizations to be treated as one employer, even though the church that controls both organizations is not aggregated with either of the two non-qualified church-controlled organizations[2].

Provisions that Provide Additional Flexibility to Churches—The new provisions also give churches more flexibility in some respects. While the General Rule may not *require* a church-controlled organization to be treated as one employer with the church, *the church may elect* to treat the organization as one employer with the church. Conversely, even if the church would be aggregated with one or more other organizations under the General Rule, an election is available for the church to be treated as a separate employer.

A cautionary note: In cases where the IRS Commissioner determines that the structure of a church or positions taken by church-controlled organizations may have the effect of evading or avoiding any of the Controlled Group Rule provisions, the IRS may treat the church-affiliated entities as a Controlled Group/single employer.

Clarification of these rules may help churches determine whether they should be treated as a single employer with other church organizations for purposes of the ACA's Employer Shared Responsibility Rule (i.e., employer mandate).

Read more about Controlled Groups for **local churches** and **annual conferences and other church-affiliated employers**.

[1] A *non-qualified* church-controlled organization is one that offers goods or services to the public, and receives more than 25% of its support from governmental sources or from the sale of goods or services.

[2] For example, this might occur if eight of the 10 directors of one non-qualified church-controlled organization are also directors of the other non-qualified church-controlled organization.

2. Pre-Emption of State Laws that Would Restrict Automatic Enrollment in Church Retirement Plans

Plans such as the United Methodist Personal Investment Plan (UMPIP) and the Horizon 401(k) Plan (Horizon) include a salary reduction feature under which employees may elect between receiving taxable cash compensation and making "elective deferral" contributions to an individual account in the defined contribution retirement plan. Many plans that are subject to the federal law known as ERISA (Employee Retirement Income Security Act) include an automatic enrollment feature, under which elective deferrals are deemed to have been elected by employees at a certain percentage of compensation, unless the employees affirmatively make a different election or choose to make no elective deferral contributions (i.e., opt out of contributions). In such ERISA-covered plans, ERISA pre-empts any state wage withholding laws that could prevent or restrict the ability to implement an automatic enrollment feature within the retirement plan.

However, church plans—*not being subject to ERISA*—did not have such pre-emption protection from state wage withholding laws. As a result, whether such an automatic enrollment feature could be added to a church retirement plan was a matter that had to be determined state-by-state.

The PATH Act now provides church retirement plans that implement an "automatic contribution arrangement" the same pre-emption protection that is offered to ERISA plans, effective as of the date of enactment (December 18, 2015). An automatic contribution arrangement is defined by the new law as an arrangement under which:

- A participant may elect to have the plan sponsor or employer make payments as contributions under the plan on behalf of the participant, or to the participant as part of his or her taxable compensation;
- A participant is treated as having elected to have the plan sponsor or employer make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects to have such contributions made at a different percentage or stopped; *and*
- Certain notice, election and investment requirements are satisfied.

Notice Requirements. The plan sponsor or employer maintaining an automatic contribution arrangement must, within a reasonable period of time before the first day of each plan year, provide a notice of a participant's rights and obligations under the arrangement to each participant to whom the arrangement applies. The notice must be sufficiently accurate and comprehensive to apprise the participant of such rights and obligations, and must be written in a manner calculated to be understood by the average participant. The notice must:

- Include an explanation of the participant's right under the arrangement not to have elective contributions made on the participant's behalf (or to elect to have such contributions made at a different percentage);
- Ensure that the participant has a reasonable period of time, after receipt of such explanation and before the first elective contribution is made, to make such election; *and*
- Explain how contributions made under the arrangement will be invested in the absence of any investment election by the participant.

Default Investment. If no affirmative investment election has been made with respect to an automatic contribution arrangement, contributions to such arrangement must be invested in a default investment option selected with the care, skill, prudence and diligence that a prudent person selecting an investment option would use. Under UMPIP and the Horizon 401(k) plan, such default investments will be invested under the LifeStage Investment Management Service (LifeStage).

3. Easing of Rules Regarding Church Plan Transfers and Mergers

Prior to the PATH Act, it was not permissible for plans qualified under Section 401(a) of the Internal Revenue Code [which includes any "401(k)" plan] and plans satisfying Section 403(b) of the Internal Revenue Code to conduct trustee-to-trustee transfers or mergers between the two types of plans. Such mergers and trustee-to-trustee transfers could occur only between "like" retirement plans, e.g., involving two 401(a) plans, or two 403(b) plans.

The PATH Act adds a new Section 414(z) to the Internal Revenue Code, effective for transfers or mergers occurring after the date of enactment. New Section 414(z) provides that the following transactions will be permissible:

- Transfer of all or a portion of the accrued benefit of a participant or beneficiary (whether or not vested) from a church 401(a) plan or 403(b) annuity contract to a 403(b) annuity contract
- Transfer of all or a portion of the accrued benefit of a participant or beneficiary (whether or not vested) from a 403(b) annuity contract to a church 401(a) plan
- Merger of a church 401(a) plan or 403(b) annuity contract with a 403(b) annuity contract

These transfers and mergers may occur only if the plan and annuity contracts are both maintained by the same church or convention or association of churches. In addition, the participant's or beneficiary's total accrued benefit immediately after the transfer or merger must be equal to or greater than the participant's or beneficiary's total accrued benefit immediately before the transfer or merger. Lastly, the accrued benefits must be fully vested after the transfer or merger.

The easing of these transfer and merger rules will provide church employers with alternatives to terminating or having to maintain separate "legacy" plans, and should decrease complexity and administrative costs for church employers. The new rules will also decrease confusion for employees who are covered by more than one plan of the employer. This statutory language will also allow church-affiliated organizations with frozen 401(a) plans to move the frozen assets into a 403(b)(9) church retirement plan, such as UMPIP.

4. New "Section 415" Limits for Grandfathered Defined Benefit Plans

Under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), certain defined benefit retirement plans established by churches or church organizations that were in effect on September 3, 1982 ("grandfathered defined benefit plans") could continue to be treated as 403(b) retirement plans. These plans, which include the Clergy Retirement Security Program (CRSP), Retirement Plan for General Agencies (RPGA) and Global Episcopal Pension Program (GEPP), were intended to be treated—and continue to be operated—as defined benefit plans. Generally, Section 403(b) retirement plans are subject to the Code Section 415(c) limits on annual contributions to an individual's account, whereas defined benefit retirement plans are subject to the Code Section 415(b) limits on annual distributions from such plans. For grandfathered defined benefit plans under Section 403(b), however, current regulations subject these plans to both the 415(c) annual contribution limits and the 415(b) limits on distributions from defined benefit plans.

The PATH Act amends TEFRA for years beginning before, on, or after the date of enactment to provide that grandfathered defined benefit plans under Section 403(b) are subject only to the annual distribution limits of Code Section 415(b). This will simplify administration and make it less likely that participants' accrued benefits in plans such as CRSP, RPGA and GEPP will be subject to limitations.

5. Investing in Group Trusts

Generally, retirement plan assets must be held in trust and used exclusively for providing benefits to plan participants and beneficiaries. One exception created by the IRS is that qualified plan assets—including assets of church retirement plans and plans maintained by unrelated employers—may be pooled and held in a group trust in order to help smaller plans obtain economies of scale. Assets held in a 403(b)(9) church retirement income account (such as UMPIP) may be commingled in a common fund with other assets of the church (e.g., assets that are not for the retirement plan, but for other church purposes). However, until enactment of the PATH Act, retirement plan assets of unrelated employers held in a group trust could not be commingled with other, non-retirement plan assets.

The PATH Act eases these restrictions and now permits group trusts to receive investments of church plan retirement assets that are commingled with other non-retirement church assets. This will increase the ability of small church retirement plans to pool assets for investment and obtain economies of scale.

The General Board does not expect this provision to have any impact on our retirement plan assets, as our plans already benefit from economies of scale. In addition, the General Board's specific investing principles as outlined in *The Book of Discipline* make it impractical for us to invest assets in group trusts with unrelated organizations whose investing principles may differ.

Delay of Cadillac Tax

The PATH Act also delayed implementation of the Cadillac Tax for two years. This 40% tax on high-cost employer-sponsored plans—originally scheduled for 2018—is now delayed until 2020. Information on the Cadillac Tax was provided December 22, 2015 via ***On Board Express*** and ***HealthFlex Express***.

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