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Supreme Court rules that pension plans of church-related hospitals may be church plans exempt from ERISA

In recent years, hospitals have been sued by their employees and former employees challenging the hospitals' long-taken position that their the pension plans are exempt from ERISA as "church plans." Each of the pension plans was established by the hospital and maintained by an internal employee benefits committee. Because many of these pension plans are significantly underfunded, losing exempt church plan status would result in billions of dollars in funding costs for the hospitals.

ERISA's definition of the term "church plan" requires that a church plan be established and maintained by a church for the benefit of its employees. ERISA's church plan definition was amended in 1980 to add (i) that a plan established and maintained by a church includes a plan maintained by a church-related organization whose principal purpose or function is the administration and funding of the plan (a "principal-purpose organization") and (ii) that an employee of a church includes an employee of a church-affiliated organization.

In 2015 and 2016, decisions by three federal Courts of Appeals agreed with the suing employees that the hospitals' pension plans were not church plans because they were not established by a church, even though each plan was arguably maintained by a principal-purpose organization (the internal employee benefits committee).

The three Courts of Appeals decisions focused on the part of ERISA's church plan definition that says a church plan includes a plan maintained by a principal-purpose organization. All three Courts of Appeals understood the language of the statute as requiring the plan to be established by a church, *even if* the plan is maintained by a principal-purpose organization.

Because the cases were decided on this part of ERISA's church plan definition, the Courts of Appeals decisions did not examine other aspects of the church plan definition as they applied to the hospitals and their pension plans, such as whether the plans covered employees of a church-affiliated organization or whether the principal-purpose organizations were associated with or controlled by a church.

The three hospitals appealed. The Supreme Court took their appeals and combined the three cases into one.

In a unanimous decision, the Supreme Court ruled in favor of the hospitals. The Court held that the plain meaning of ERISA's church plan definition means a plan maintained by a principal-purpose organization is a church plan; the statute does not require that the plan be established by a church, even if maintained by a principal-purpose organization.

However, just like the Courts of Appeals, the Supreme Court stressed that many other questions about the exempt church plan status of the hospitals' pension plans remain to be decided, including whether the hospitals are sufficiently related to a church that their pension plans cover employees of a church-affiliated organization and whether the hospitals' internal employee benefits committees are church-related organizations, as required in the church plan definition for principal-purpose organizations. These issues will now be explored further in the lower court proceedings.

It is likely that additional class action lawsuits will be brought against hospitals and other church-related entities sponsoring exempt church plans. Organizations that sponsor employee benefit plans they have treated as exempt church plans should review their plans carefully and make any changes necessary to the plan documents or to plan governance and administration to safeguard the church plan status of their plans.

Advocate Health Care Network v. Stapleton Clarifies What is a Church Plan

1. ERISA's Definition of "Church Plan"

When ERISA was enacted in 1974, “church plans” were made exempt from the law. Originally, ERISA Section 3(33)(A) (and its parallel at Code Section 414(e)) defined the term “church plan” as “a plan established and maintained . . . for its employees (or their beneficiaries) by a church or convention or association of churches. . . .”¹

This definition became problematic when the IRS ruled in 1977 that the pension plans established by two orders of Catholic sisters for their hospital employees were not church plans. The IRS reasoned that a “church” is an organization that principally engages in religious activities. The IRS further reasoned the hospitals were not churches because running the hospitals is not a religious function. Since the hospitals run by the sisters were not churches, their pension plans were not established and maintained by a church and therefore were not exempt church plans.

Religious organizations raised a hue and cry over this IRS ruling, questioning whether it was appropriate for the IRS to determine what were a church’s religious functions, and objecting that the unfavorable ruling could be extended to church pension plans governed by independent pension boards.

In 1980, Congress amended ERISA Section 3(33) (and Code Section 414(e)) to broaden the definition of the term “church plan.” The 1980 amendment completely revised ERISA Section 3(33)(C) by adding a new section (C)(i), providing that a church plan established and maintained by a church “includes a plan maintained by an organization . . . the principal purpose or function of which is the administration and funding of a plan or program [that provides retirement or welfare benefits] for employees of a church . . . if such organization is controlled by or associated with a church. . . .” The organization described in the revised subsection has come to be known as a “principal-purpose organization.”

The 1980 amendments to the ERISA church plan definition also added ERISA Section 3(33)(C)(ii)(II), specifying that the term “employee of a church” includes an employee of a church-affiliated organization.

After the 1980 revision of ERISA's church plan definition, the IRS reversed its ruling on the pension plans for the hospitals run by the Catholic sisters. Thereafter, the IRS, the Department of Labor and the Pension Benefit Guaranty Corporation all agreed that the amended church plan definition meant that a plan maintained by a principal-purpose organization was a church plan, and consistently ruled accordingly. For instance, the IRS has opined in hundreds of private letter rulings since the 1980 revision that employee benefit plans of church-related hospitals maintained by a principal-purpose organization (including an internal employee benefits committee controlled by or associated with a church) were church plans.

2. Hospitals Are Sued Over Whether Their Pension Plans are Church Plans; Three Appeals Courts Agree They Are Not

Beginning in 2013, a total of 33 class action lawsuits have been brought against church-related hospitals², challenging the exempt church plan status of their pension plans. Each pension plan was established by the respective hospital and maintained by an internal employee benefits committee.

Losing church plan status would be a major blow to the hospitals because the pension plans would then be subject to ERISA's funding requirements. Many pension plans now regarded as church plans are underfunded according to the ERISA funding requirements; thus, success by the employees in these lawsuits could cost the hospital sponsors of these pension plans billions of dollars.

The Third, Seventh, and Ninth Circuit Courts of Appeals ruled in separate cases that the 1980 amendment to ERISA's church plan definition only clarified what type of organization can **maintain** a church plan, namely, a principal-purpose organization. But being maintained by a principal-purpose organization alone is not enough to be a church plan, these Courts of Appeals concluded. ERISA still requires the plan to be **established** by a church.

Because the three Courts of Appeals each decided the case before it based on whether being maintained by a principal-purpose organization was sufficient to meet the "established and maintained by a church" requirement, their decisions did not address many

other issues that could be raised under ERISA's definition of church plan, such as whether the internal employee benefits committees that maintained the pension plans were associated with or controlled by a church as required for principal-purpose organizations, and whether the hospitals are sufficiently affiliated with a church that their pension plans cover employees of a church.

The defendant hospital in each case appealed to the Supreme Court to overturn the respective Court of Appeals decision.

3. Supreme Court Overturns the Courts of Appeals

The Supreme Court agreed to take the combined cases to decide how ERISA Sections 3(33)(A) and (C)(i) should be understood when read together. Do these two sections together mean a church plan is a plan established by a church and maintained by a principal-purpose organization or do they mean a church plan is a plan maintained by a principal-purpose organization whether or not a church established the plan? In other words, when the church plan definition was amended to say that a church plan established and maintained by a church includes a plan maintained by a principal-purpose organization, did that change cover both "established and maintained" in or just "maintained?"

In *Advocate Health Care Network et al. v. Stapleton et al.*, in a unanimous decision issued on June 5, 2017, the Supreme Court ruled that ERISA's church plan definition allows a plan maintained by a principal-purpose organization to claim church plan status and be exempt from ERISA.

Of the eight justices participating (Justice Gorsuch had not joined the Court when the case was argued), six joined the majority opinion written by Justice Kagan. The majority opinion held that when ERISA says a plan established and maintained by a church includes a plan maintained by a principal-purpose organization, it means that if a plan is maintained by a principal-purpose organization, then that in itself is sufficient to meet the "established and maintained by a church" requirement.

Justice Kagan outlined her understanding of the issue as a succinct logic problem:

Premise 1: A plan established and maintained by a church is an exempt church plan. [ERISA Section 3(33)(A).]

Premise 2: A plan established and maintained by a church includes a plan maintained by a principal-purpose organization. [ERISA Section 3(33)(C)(i).]

Deduction: A plan maintained by a principal-purpose organization is a church plan.

Justice Sotomayor wrote a concurring opinion to express her concern with the outcome of the cases. She agreed with the majority opinion on how ERISA Sections 3(33)(A) and (C)(i) must be read, but wrote separately to make the point that the health care landscape in the United States has changed so much since 1980 that Congress might take a different path were it considering an amendment to the ERISA church plan definition today. Justice Sotomayor pointed out that the hospitals involved in the cases the Court was presented with are very different organizations than the hospitals run by Catholic sisters in 1977. Rather, these large health care providers look more like secular organizations. Justice Sotomayor was concerned that ERISA's protections might be denied to a much greater number of employees than Congress originally intended, due to the logic of ERISA's church plan definition.

4. Questions Remain for Church Plans

The Court was careful to say that the *only* question they considered was whether a plan maintained by a principal-purpose organization, but not initially established by a church, can be an exempt church plan.

Both the majority and concurring opinions expressly state that other important questions are not before the Court and, as the majority opinion puts it in a footnote, "nothing we say in this opinion expresses a view of how [the other issues] should be resolved." The Court's opinion does not address whether the hospitals' pension plans cover employees of a church because the hospitals are affiliated with a church. Rather, the Court made clear that it was simply assuming for purposes of its decision that the hospitals' church ties were as the hospitals themselves described them, namely, that they are church-affiliated hospitals. Likewise, the

Court's opinion did not determine whether the internal employee benefits committees maintaining the pension plans are associated with or controlled by a church as required for principal-purpose organizations. This requirement was also assumed to be met for purposes of the Court's decision.

For hospitals and other church-related organizations that sponsor an employee benefit plan they regard as an ERISA-exempt church plan, the possibility remains that a lawsuit will be brought on the basis of one of the other parts of the church plan definition, such as whether the plan sponsor is affiliated with a church or whether the organization maintaining the plan is associated with or controlled by a church.

In this climate, church plan sponsors would be wise to review their employee benefit plans and, if necessary, make changes to cement their church plan status. Some questions to be considered are the following:

- Is the plan's administration handled by and funding decisions made by a principal-purpose organization and is this clearly spelled out in the plan documents?
- Does the plan document or charter of the organization that maintains the plan clearly describe how the organization falls within the definition of a principal-purpose organization?
- Is the principal-purpose organization in fact controlled by or associated with a church?
- Is the plan sponsor affiliated with a church to such an extent that its employee benefit plans can be regarded as being for the benefit of the employees of a church-affiliated organization?
- Are the plan documents consistent with church plan status? Do they incorporate ERISA requirements by reference or purport to comply with ERISA even though the church plan exemption from ERISA is claimed?

Church plan status aside, any review of an employee benefit plan should make sure that the fundamentals of plan sponsorship and administration are observed. For instance, have the plan sponsor and principal-purpose organization consistently kept written

descriptions of the decision-making processes that led to their actions with respect to the plan?

For more information, please contact [Jeffries M. Hamilton](#) or any attorney in Frost Brown Todd's [Employee Benefits Law](#) practice.

¹ The phrase "convention or association of churches" is intended to account for church organizations organized as a voluntary association of independent local churches. Note also that the term "church" is meant to be a generic term, even though the everyday use of the word "church" refers to a Christian organization. In ERISA's church plan definition, the term "church" is not intended to refer to organizations of any particular religion but should be understood more broadly to cover all religious organizations. For simplicity, we will follow the statute and use the term "church" to cover all relevant religious organizations.

² In this context, the term "hospitals" refers to church-affiliated nonprofit organizations that run hospitals, hospital systems and networks, and other healthcare facilities.

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