STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MCKINSEY MASTER RETIREMENT PLAN TRUST	:	DECISION DTA NO. 817551
for Redetermination of a Deficiency or for Refund of Unrelated Business Income Tax under Article 13 of the Tax Law for the Years 1994, 1995 and 1996.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on November 29, 2001 with respect to the petition of McKinsey Master Retirement Plan Trust, 55 East 52nd Street, New York, New York 10022. Petitioner appeared by Phillips, Lytle, Hitchcock, Blaine and Huber, LLP (Edward M. Griffith, Jr., Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Nicholas A. Behuniak, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception, petitioner filed a brief in opposition and the Division of Taxation filed a reply brief. Oral argument, at the Division of Taxation's request, was heard on November 13, 2002 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether New York State's Unrelated Business Income Tax ("UBIT") imposed by Tax Law Article 13, § 290 against petitioner, a trust which holds and administers the assets of certain retirement plans subject to the tax, is preempted under the Federal Employment Retirement Income Security Act of 1974 ("ERISA") either because: (i) it is imposed on petitioner's ERISA covered stock bonus, pension or profit sharing plans by reference to Internal Revenue Code ("IRC") § 401(a); or (ii) is "connected with" petitioner's ERISA covered plan such that its impact thereon is more than tenuous, remote or peripheral.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

McKinsey & Company, Inc., is an international management consultant company. It has approximately 80 offices that operate in 42 countries. Its consultants number about 6,000, and they are citizens of over 90 countries.

Petitioner, McKinsey Master Retirement Plan Trust has, since its establishment on December 14, 1994, held the assets of the McKinsey & Company, Inc. Profit-Sharing Retirement Plan and the McKinsey & Company, Inc. Money Purchase Pension Plan ("the Plans").

Both of the Plans are subject to the provisions of ERISA. They are exempt from Federal income taxes, except for Federal unrelated business income tax, and New York franchise taxes.[1]

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[1]It is the petitioner Trust which is specifically exempt from taxation pursuant to IRC § 401(a).

McKinsey & Company employees receive an annual firm contribution under each plan based upon a percentage of qualifying compensation paid during the calendar year.[2] At year end, participants are offered the opportunity to elect how their contributions shall be allocated, or reallocated, among the investment options offered under each plan.

Petitioner has an investment office which creates and puts together funds through which participants in the Plans may invest. The investment office consists of approximately four or five highly trained individuals who can, and do, seek additional help from outside third-party investment advisors, attorneys and accountants in running the funds and making investment decisions. During the years in question, various investments were offered to Plan participants in the form of separate funds, each of which encompassed a specific asset type or strategy. Participants selected from among the funds and, in effect, constructed their own investment portfolios. The funds were specifically designed by petitioner to allow participants to diversify their investments into various asset classes and risk levels.

The funds are created to offer very attractive benefits and unique investment opportunities for participants, and the investment managers' primary focus in selecting investments for the funds is on the final return to investors. To this end, investment managers go through an elaborate process of finding investment opportunities and screening them by various criteria to estimate what their return will be and whether to invest.

During the years in question there were approximately 15 different funds available to participants in the Plans. Some of the funds had investments which incurred unrelated business

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[2]McKinsey's employees who are foreign nationals receive a 12 percent contribution to the Profit Sharing Retirement Plan, while McKinsey's United States employees receive a 7 percent contribution to the Profit Sharing Retirement Plan plus a 5 percent contribution to the Money Purchase Pension Plan (together equaling a 12 percent total contribution).

income tax ("UBIT"). Those funds were the Hedging Strategies Fund, the Real Estate and Related Securities Fund, the Special Situations Fund, and the International Equities Fund. These funds, from time to time, invested in limited partnerships. The limited partnerships, in turn, incurred debt at various times in an effort to increase earnings. Income earned from such debt (debt-financed income) constituted unrelated business taxable income subject to UBIT at the Federal level and (unless preempted) under Article 13 of the Tax Law.

It is not necessary or required that the funds make or offer investments which will generate unrelated business income and incur the UBIT. The incurrence of UBIT is one of several factors the investment managers consider in choosing investments, but it is not necessarily the most important consideration. Investment managers invest in limited partnerships which incur the UBIT because the investment managers believe such investments may, even though they incur the tax, offer a greater total gross return than alternatives which do not incur any UBIT. The investment return of those plan participants who invested in funds that generated unrelated business taxable income was reduced, dollar for dollar, by the amount of UBIT paid by petitioner.

Every year each participant is provided a detailed description of what each fund invests in. The detailed description of each of the funds' investments expressly warns if a particular fund has potential exposure to UBIT liability. Participants do not have to select funds which have exposure to UBIT, but rather can invest as much or as little as they choose in the various funds, and may invest nothing in those funds which have exposure to UBIT. Each participant also receives a detailed personalized account statement which, among other things, discloses those funds invested in which have UBIT liability and the amount thereof. In selecting investments for

the separate funds, petitioner's investment office was largely guided by final returns to fund participants. Because UBIT decreases these returns, petitioner's investment office may elect to not invest in or may reduce investments in limited partnerships that have, or are expected to have, debt-financed income.

For the years 1994, 1995 and 1996, petitioner filed tax returns under Article 13 of the Tax Law, reporting unrelated business taxable income. In each case, petitioner was required to determine a New York State apportionment factor which related, in part, to the underlying investments of the separate funds. Petitioner paid UBIT under Article 13 of the Tax Law for the years in issue in the respective amounts of $147,412.00, $4,102.00 and $225,860.00. Payment of the tax is accounted for as an expense of the Trust, and is thereafter allocated to the specific investment funds which generated the UBIT and to such funds' participants on a dollar for dollar basis, as described hereinafter (***see***, below).

As required under Article 13, petitioner made estimated payments of UBIT for each of the years in issue. Since petitioner had no control over the debt financing of the limited partnerships in which certain of its funds were invested, the determination of estimated taxes was problematic. For calendar year 1996, petitioner paid interest and penalties of approximately $14,000.00 relating to the underpayment of estimated UBIT.

Petitioner determined the net asset value (NAV) of the separate funds on a monthly basis. In making this determination, petitioner was required to take into account any potential UBIT liability. However, information related to debt-financed income was not available from the limited partnership on a monthly basis. Such information was not supplied by the limited partnerships until several months after the end of the calendar year (via Forms K-1 detailing for

the partners of each partnership the results, including tax results, of partnership operations). Accordingly, petitioner estimated the amount of UBIT liability based on past debt-leveraged ratios of the limited partnerships in arriving at its monthly calculation of NAV.

Petitioner's determination of NAV of the separate funds on a monthly basis is required under the plans and is used for purposes of calculating the amount of the participant's benefits upon their termination of employment, death or retirement. In such case, if the participant was invested in funds that generated unrelated business taxable income, the participant would be paid out using the NAV at the end of the month in which his services terminated, which would include an estimate of UBIT liability.

At the end of each calendar year, participants are given the opportunity to reallocate their retirement funds among the various investment alternatives. For this purpose, month-end NAV's are used, which in the case of certain funds contain estimates of UBIT. After information relating to the debt-financed income is received from the limited partnerships several months later, the NAV's of the affected funds are readjusted. Thus, the participants in an affected fund at that time will either benefit from an overestimate of UBIT or be charged in the case of an underestimate. Those participants who eliminated their investment in one of the affected funds at the end of the year would likely have been credited with a higher or lower NAV at the time of "cash-out" than the later-determined actual NAV of the fund.

Regardless of the existence of any New York State UBIT, petitioner will incur Federal UBIT if the limited partner debt-financed investments are made. Petitioner is required to file a Federal tax return with the Internal Revenue Service ("IRS") disclosing its unrelated business income and paying appropriate Federal UBIT thereon. Petitioner, the Trust, is the party who

files the UBIT returns with the IRS and with the Division of Taxation ("Division"), and is the party liable for the payment of any UBIT due or assessed. The tax is accounted for by petitioner as an administrative expense. The Trust's exposures to Federal and New York State (and other states') UBIT is accounted for by reducing the assets available in a particular fund. The income left in the fund after payment of all fund expenses, including any UBIT, is then apportioned to the participants who allocated their pension interests to that fund.

In addition to filing a UBIT return with the IRS and with New York State, petitioner also files UBIT returns and pays UBIT with Illinois, Connecticut, Maryland and California.

New York State's UBIT is calculated based on the Federal unrelated business income numbers reported to the IRS by petitioner. New York applies an apportionment adjustment to the Federal amount to arrive at a taxpayer's New York State unrelated business income subject to State UBIT. The Division has applied Tax Law § 290 against many other types of tax-exempt entities in addition to tax exempt trusts such as petitioner.

On October 14, 1998, the Division received from petitioner three Forms CT-8 ("Claim for Credit or Refund of Corporation Tax Paid"), seeking refunds of the unrelated business income tax and any attendant penalties and interest paid by petitioner for the years 1994, 1995 and 1996. The Division responded to these claims by letters dated October 30, 1998 (pertaining to petitioner's claim for 1994) and November 5, 1998 (pertaining to petitioner's claims for 1995 and 1996). These letters denied petitioner's claims for refund on the basis that the UBIT imposed under Article 13 of the Tax Law was not preempted by the provisions of ERISA.

Petitioner challenged these denials, ultimately commencing the subject proceeding via the filing of a timely petition with the Division of Tax Appeals.[3]

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge noted that the New York UBIT mirrors the Federal UBIT imposed under IRC § 511. Specifically, IRC § 511(a)(2) and (b)(2) provide that the UBIT is imposed on every IRC § 501(a) tax exempt organization described in IRC § 501(c) and IRC § 401(a). The IRC, in turn, specifies several organizations which, while generally exempt from taxation, are subject to both the Federal and New York State UBIT (IRC § 501[c][1] through [27]). Directly relevant to this matter, IRC § 401(a) provides a tax exemption for trusts "created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer . . . ." There is no dispute that the trust, holding the assets of the McKinsey plans, complies with the statutory requirements set forth in IRC § 401(a). Thus, the Administrative Law Judge explained, while petitioner enjoys both Federal and New York State tax exempt status in general, it nonetheless is specifically subject to the Federal UBIT and, unless its imposition is otherwise preempted, to the New York State UBIT.

The Administrative Law Judge stated that the sole issue presented by petitioner here was whether New York State UBIT section 290, is preempted under Federal statute. The potential for preemption arises in this case under the provisions of ERISA. Specifically, the Administrative Law Judge noted, section 514(a) of ERISA (29 USCS § 1144[a]) provides, in

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[3]The November 5, 1998 refund denial letter references the year 1997 (as well as the years 1995 and 1996). However, the balance of documents in the record makes clear that the years at issue in this proceeding are 1994, 1995 and 1996.

relevant part, that "the provisions of [ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan . . . ."

Section 514(c) of ERISA defines "State law" and "State" as follows:

> (1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State . . . .
>
> (2) The term "State" includes a State, any political subdivisions thereof, or any agency or instrumentality of either, which *purports to regulate, directly or indirectly, the terms and conditions of employee benefit plans covered by [ERISA]* (29 USCS § 1144[c][1], [2], emphasis added).

The Administrative Law Judge noted that the Courts that have addressed the issue of ERISA preemption have recognized that the statutory preemption clause, and specifically, the phrase "relate to," provide little guidance.

In this context, the Administrative Law Judge reasoned, the question to be answered is whether the State action impermissibly relates to petitioner's employee benefit plans in violation of the statute. The United States Supreme Court, the Administrative Law Judge observed, has held that a state law "relates to" a covered ERISA plan for purposes of preemption under section 514(a) if the state law either: (1) impermissibly "refers to" an ERISA plan or (2) has a "connection with" such a plan (***see***, ***Shaw v. Delta Air Lines***, 463 US 85, 77 L Ed 2d 490). ERISA's preemption clause is broadly worded, but will not apply unless the state law in issue affects an ERISA plan "in more than a tenuous, remote or peripheral way" (***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal***, 80 NY2d 44, 587 NYS2d 252, 255).

The Administrative Law Judge pointed out that the New York Court of Appeals in 1992 addressed the question of ERISA preemption in ***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal*** (***supra***). The Court held that New York's former real property

transfer gains tax ("gains tax"), a State tax of general application, was preempted by ERISA where the tax was imposed on the gain derived from the sale of certain real property owned by an ERISA-regulated entity. While noting that the former gains tax had no specific reference or application to ERISA-covered employee benefit plans, the Court, applying ERISA preemption principles, found that the former gains tax had "more than a tenuous, remote or peripheral connection" to employee benefit plans (***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal***, ***supra***, 587 NYS2d, at 256).

The Administrative Law Judge noted that subsequent to the decision in ***Morgan Guaranty***, the United States Supreme Court decided ***De Buono v. NYSA-ILA Medical & Clinical Servs. Fund*** (***supra***). ***De Buono*** involved New York State's imposition, under Public Health Law § 2807(d), of a tax on gross receipts from patient services at hospitals, residential health care facilities and diagnostic and treatment centers, including hospitals owned and operated by an ERISA qualified plan. The Court found no basis for preemption. The Court held that the tax, implemented to reduce the State's Medicaid deficit, was a tax of general application imposed in a field traditionally occupied by the States, i.e., health and safety, and did not impact the calculation of ERISA benefits or impact the determination of an employee's eligibility for such benefits. The Court noted that the tax provision in ***De Buono*** did not expressly refer to an ERISA plan. ***De Buono***, one of the cases upon which the Division's argument relied heavily, confirmed the United States Supreme Court's reasoning in ***New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*** (***supra***), including its rejection of a strictly literal reading and application of the phrase "relates to" in favor of the conclusion that in using that phrase Congress did not intend to alter the starting presumption against supplanting state

laws, especially state action in areas of traditional state regulation. Rather, the Administrative Law Judge noted, the preemption review must focus on the objectives of ERISA and the effect of the State law on ERISA plans.[4]

The Administrative Law Judge first addressed the issue of whether New York State's UBIT must be preempted because it impermissibly refers to ERISA-covered employee benefit plans. The Administrative Law Judge found in this case that the State law's reference to ERISA plans is clear and results in the imposition of tax directly and immediately upon ERISA-covered employee benefit plans.

The Administrative Law Judge acknowledged that the UBIT at issue here, as well as Public Health Law § 2807(d) at issue in ***De Buono***, are both revenue raising measures, i.e., taxes. However, the Administrative Law Judge observed, the United States Supreme Court noted in ***De Buono*** that Public Health Law § 2807(d) clearly operated in a field traditionally regulated by the states (health and safety), and was not a tax on ERISA plans, *per se*, but a tax on health care facilities. Moreover, the Administrative Law Judge stated, the Court concluded that the actual impact of the tax in ***De Buono*** was essentially neutral. In contrast to Public Health Law § 2807(d), and the result in ***De Buono***, the Administrative Law Judge noted that the Article 13 UBIT does not operate directly in a sphere of traditional state regulation such as health and safety. Rather, the Article 13 UBIT is a revenue raising measure, piggybacked onto a virtually identical Federal UBIT. While the State UBIT was enacted with the same intent as

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[4]The Administrative Law Judge noted in a footnote that the Division's reliance upon ***De Buono*** and ***Travelers*** is made clear by its December 2, 1998 issuance of Technical Services Bureau Modified Advisory Opinion TSB-A-97(10.1)C concluding, based on ***De Buono*** and ***Travelers***, that the UBIT imposed under Article 13 was not preempted by ERISA. This advisory opinion reverses TSB-A-97(10)C, dated May 9, 1997, which, based specifically on ***Morgan Guaranty***, reached the opposite conclusion and held Article 13 preempted under ERISA.

its Federal counterpart to level the playing field between tax exempt organizations and for profit organizations, the Administrative Law Judge found that it does not operate in the areas of safety, health or any other area of traditional state regulation. In fact, rather than operating in a field traditionally regulated by the states, the Administrative Law Judge determined that New York State's UBIT, by its reference to IRC § 401(a), thrusts itself into a field (pension and benefit plans) of exclusive federal concern. Moreover, the Administrative Law Judge pointed out that the tax statute at issue in this case includes by direct reference, pension and benefit plans under IRC § 401(a) as among those specifically subject to the tax.

The Division urged that although Congress specified ERISA plans as among those organizations generally exempt from taxation per IRC § 501(a), it nonetheless imposed the Federal UBIT on ERISA plans. The Administrative Law Judge rejected this argument noting that while Congress enacted the Federal UBIT some 20 years prior to ERISA, and left the UBIT essentially unchanged upon enactment of ERISA, it does not follow that Congress intended the states to enact similar measures. On the contrary, the Administrative Law Judge pointed out, Congress aimed to maximize the financial well-being of ERISA plans (***see, e.g.,*** 29 USCS § 1001[a]), and to foster uniformity in plan regulation, minimizing administrative and economic burdens on ERISA plans. The Administrative Law Judge concluded that imposition of a state tax aimed at, *inter alia*, ERISA pension plans, is clearly inapposite to such aims.

The Administrative Law Judge observed that pursuant to ERISA's "savings" clause, certain state laws such as banking, securities, insurance and general criminal statutes, are exempted or saved from preemption. However, the Administrative Law Judge noted, Congress made clear that state tax laws are not exempt from preemption (***see***, 29 USCS

§ 1144[b][5][B][i]), and the courts have made clear that no higher standard applies in preemption analysis simply because a state tax law is involved (***see***, ***De Buono v. NYSA-ILA Medical & Clinical Servs. Fund***, ***supra***).

Rather, the Administrative Law Judge pointed out, the preemption standard remains that the challenged state action must either impermissibly "refer to" ERISA in a manner resulting in a legal consequence to the ERISA entity, or must be "connected with" an ERISA plan such that its impact thereon is more than tenuous, remote or peripheral. The Administrative Law Judge concluded that in this case, both of these standards are met.

The Administrative Law Judge noted that the UBIT targets exempt organizations, but in so doing specifically defines, by reference to the IRC, those particular exempt organizations subject to the tax and those that are not subject. Religious and apostolic organizations pursuant to IRC § 501(d) are specifically excluded from coverage, while stock bonus, pension and profit sharing plans, i.e., ERISA entities, are specifically defined as subject to the tax under IRC § 401(a). In sum, the Administrative Law Judge found that the UBIT is a state tax directed at ERISA entities pursuant to IRC § 401(a). Further, the Administrative Law Judge reasoned, the tax directly impacts on the plan's investment strategy, in that it is imposed directly on the investment profits from certain of the plan's investments. The Administrative Law Judge stated that every ERISA plan with investments which generates unrelated business income is subject to the tax, with the result being a reduction of funds available for plan beneficiaries, coupled with increased administrative burdens on the plans.

The Administrative Law Judge also rejected the Division's argument that any UBIT impact could be eliminated by the choice not to make investments with the potential to generate

unrelated business taxable income including debt-financed income. The Administrative Law Judge pointed out that eliminating possible investment choices would itself limit a fund's investment strategy, and be inconsistent with ERISA regulations which direct funds to offer to participants diversified investment opportunities with different asset classes and risk levels.

The Administrative Law Judge agreed with petitioner's claim that the State's UBIT impacts plan structure, administration and economics in more than a remote, tenuous or peripheral manner. In this context, the Administrative Law Judge pointed out, the issue of nexus or connection between the state, the plan and the investment vehicle must be examined and determined. Furthermore, assuming the plan is subject to UBIT, the question of how much unrelated business income must be apportioned to each state, including New York, becomes relevant, involving therein examination of each state's apportionment formula, as well as potentially varying definitions of unrelated business income and apportionable income on a state-by-state basis. The Administrative Law Judge found that subjecting ERISA plans to a state's UBIT immediately gives rise to reporting and compliance requirements on a state-by-state basis, as well as filing and payment duties which involve estimation and timing issues. The Administrative Law Judge determined that all of these requirements are contrary to the congressional aim of achieving a uniform body of pension law with minimal financial and administrative burdens and conflicts among and between the different states and between the states and the Federal government. The Administrative Law Judge concluded that Article 13 is connected with petitioner's plans so as to impact them in more than a remote, tenuous or peripheral manner and, as such, must be held preempted.

ARGUMENTS ON EXCEPTION

In its exception, the Division continues to argue that the State's UBIT is a tax of general application and its impact on petitioner is not unduly burdensome. After all, the Division urges, the Federal government also imposes a UBIT.

The Division asserts that since taxation is an area of traditional state government authority, the proponent of preempting such action bears a considerable burden to overcome the starting presumption that the state act is not to be superceded.

Furthermore, the Division reasons that since the State UBIT operates in a manner consistent with the Federal UBIT, in that it serves to further the Federal aim of leveling the playing field with for-profit entities and, for that reason, the State law should be seen as in furtherance of Congress's purpose and intent.

The Division also maintains that the State UBIT is just one of many factors for petitioner's investment managers to consider in determining each fund's investment choices, and that it is not a consideration so onerous or burdensome so as to limit petitioner to only one course of action or eliminate most other alternative courses of action (e.g., other attractive investments). The Division also claims that the State UBIT burden is less significant than other impositions on ERISA plans in that the UBIT applies to only a part of petitioner's total income, and that it is only part of petitioner's overall potential UBIT liability (a "layer" of UBIT in addition to petitioner's Federal UBIT).

The Division also claims that the State's UBIT does not act exclusively on ERISA plans, but also impacts many other types of exempt organizations, and notes that the tax does not

require the existence of an ERISA plan to operate, but only requires that an exempt organization earn unrelated business income.

Finally, the Division asserts that since the State UBIT follows the Federal UBIT and, since petitioner is already subject to the latter tax, any timing, estimation or other compliance difficulties will exist in any event even without those imposed by the State. The Division urges that the Administrative Law Judge lacked jurisdiction to determine the constitutionality of the statute on its face citing ***Matter of Unger*** (Tax Appeals Tribunal, March 24, 1994).

OPINION

We begin by addressing the Division's argument that the Administrative Law Judge lacked jurisdiction to determine the constitutionality of a statute on its face. We reject the Division's argument since the determination of the Administrative Law Judge was based on ERISA § 514(a) (29 USCS § 1144[a]). This case does not involve the constitutionality of the UBIT on its face.

The ERISA preemption clause broadly provides that all State laws are superseded "insofar as they may now or hereafter relate to any employee benefit plan" (29 USCS § 1144[a]). Our analysis begins with the presumption that State law has not been preempted by ERISA "in the absence of persuasive evidence to the contrary. The focus is on congressional intent" (***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal***, ***supra***, 587 NYS2d, at 254, ***citing Sasso v. Vachris,*** 66 NY2d 28, 494 NYS2d 856). In analyzing the issue of ERISA preemption, the Courts look to "the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive" preemption (***New York***

State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., ***supra***, 131 L Ed 2d, at 705).

The Court in ***Morgan Guaranty*** noted that the preemption clause was designed to establish pension plan regulation as exclusively a Federal concern. "Broad preemptive authority was intended to facilitate the 'emergence of a comprehensive and pervasive Federal interest and the interests of uniformity with respect to interstate plans'" (***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal, supra,*** 587 NYS2d, at 254, ***citing Statement of Senator Javits,*** 120 Cong Rec 29942 [1974]).

A state law specifically designed to affect employee benefit plans is preempted by ERISA. However, if the state law is not specifically designed to affect employee benefit plans, i.e., it "is a law of general application–the next step is to determine whether the law 'relate[s] to' employee benefit plans" (***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal***, ***supra,*** 587 NYS2d, at 255, ***citing Mackey v. Lanier Collection Agency & Serv.***, 486 US 825, 100 L Ed 2d 836).

A state law "relates to" a covered benefit plan for section 514(a) purposes if it *refers to* or has a *connection with* such a plan. "ERISA pre-empts any state law that refers to or has connection with covered benefit plans" (***District of Columbia v. Greater Washington Bd. of Trade***, 506 US 125, 121 L Ed 2d 513, 520), "even if the law is not specifically designed to affect such plans, or the effect is only indirect, [citations omitted] and *even if the law is 'consistent with ERISA's substantive requirements'* [citations omitted]" (***District of Columbia v. Greater Washington Bd. of Trade***, ***supra***, 121 L Ed 2d, at 520, emphasis added). Even laws of general application representing a traditional exercise of state authority may be preempted when they

relate to ERISA-covered plans. Preemption will not occur, however, if the state law in issue affects an ERISA plan in only a tenuous, remote or peripheral way (***see***, ***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal***, ***supra***).

The Division continues to claim, as it did below, that the State's UBIT is a tax of general application whose impact is not unduly burdensome administratively, structurally or economically. In the face of this record, we view the Division's argument as untenable.

In ***Morgan Guaranty***, the State's former gains tax was preempted by ERISA where the tax was imposed *directly on the gain* derived from the sale of certain real property owned by an ERISA-regulated entity. While the former gains tax was a law of general application and made no specific reference to ERISA-covered plans, the Court found that the tax had more than a tenuous, remote or peripheral connection to employee benefit plans. Further, the Court cited the impact of the former gains tax law's record keeping and reporting requirements on the structure and administration of the ERISA-regulated plan as well as the economic impact of the former gains tax on the plans. The Court noted, in particular, that the former gains tax *directly depleted plan assets* which necessarily influenced the plan's investment strategies. Accordingly, the Court held that the former gains tax "related to" employee benefit plans within the meaning of section 514(a) of ERISA and its imposition was therefore preempted (***see***, ***Matter of Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal***, ***supra***).

We view the facts herein as even stronger than in ***Morgan Guaranty***, and they clearly are more than sufficient to overcome any presumption against preemption. In this case, as in ***Morgan Guaranty***, the State's UBIT is a tax imposed *on the income from investments of ERISA-covered plans,* and subjects ERISA-covered plans to reporting and compliance requirements on a state-by-

state basis. The State's UBIT gives rise to filing and payment duties which involve estimation and timing issues, all of which militate against the congressional aim of achieving a uniform body of pension law with minimal financial and administrative burdens and conflicts between the various state and Federal jurisdictions.

In this case, we have an additional element not present in ***Morgan Guaranty***. Here, Tax Law Article 13 refers by definition to ERISA-covered employee benefit plans. As noted earlier, mere reference to a covered plan would not necessarily result in preemption. However, a state's law impermissibly "relates to" ERISA "by reference" when it imposes requirements by reference to ERISA plans, *or* if it acts immediately and exclusively on ERISA Plans (***see***, ***Mackey v. Lanier Collection Agency & Serv***., ***supra***). It is clear from the facts in this case that the State's UBIT refers to ERISA-covered plans and results in the imposition of tax directly and immediately upon the income of ERISA-covered plans. As was noted by the Administrative Law Judge, Tax Law § 290 defines the organizations subject to New York's UBIT by reference to organizations as defined under IRC § 401(a), imposing State tax on plans such as petitioner's, i.e., stock bonus, pension or profit-sharing plans. The result of this reference is that unrelated business income earned by qualified ERISA plans are made directly subject to State taxation pursuant to Tax Law Article 13. In addition, the tax here, as in ***Morgan Guaranty***, imposes significant reporting and payment requirements, involving accounting, record keeping, and other administrative burdens impacting the structure, investment strategies and administration of petitioner's ERISA-regulated plan.

We find it telling that the investment returns of plan participants who invested in funds that generate unrelated business taxable income are reduced, dollar for dollar, by the amount of UBIT

paid by petitioner. The Division would have us ignore this issue, and instead concentrate on more recent cases involving dissimilar facts (***cf., De Buono v. NYSA-ILA Medical & Clinical Servs. Fund, supra***; ***New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.***, ***supra***).[5] We do not view the cases cited by the Division in support of its position as persuasive, since none of the cases cited are on point with the facts here.

Congress intended to maximize the financial well-being of ERISA plans (***see,*** 29 USCS § 1001[a]), and to foster uniformity in plan regulation, minimizing administrative and economic burdens on ERISA plans. The imposition of a state tax aimed at, *inter alia*, ERISA pension plans, is contrary to these congressional purposes.

State *tax laws* are not exempt from preemption (***see***, 29 USCS § 1144[b][5][B][i]), and the courts have concluded that no stricter standard applies in a preemption analysis simply because it involves a state tax law, as opposed to some other state law (***see***, ***De Buono v. NYSA-ILA Medical & Clinical Servs. Fund, supra***). The preemption standard is that the challenged state action must either impermissibly "refer to" ERISA in a manner resulting in a legal consequence to the ERISA entity, or must be "connected with" an ERISA plan such that its impact thereon is more than tenuous, remote or peripheral. In this case, we conclude that it does, on both grounds.

The State UBIT conflicts with Congress's intent, in enacting ERISA, of providing a uniform body of benefits law which fosters maximum stability and security with minimum conflict of laws and regulatory burdens between various jurisdictions (***see***, ***New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.***, ***supra***). By its express definitional reference to

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[5]The facts of these cases are exhaustively analyzed and distinguished in the determination of the Administrative Law Judge.

ERISA plans and the administrative and other burdens imposed on those plans, we find that the State's UBIT impermissibly relates to petitioner's ERISA plans.

We now address whether the State's UBIT is "connected with" an ERISA plan in more than a tenuous, remote or peripheral manner.

In this case, as has already been noted, the UBIT imposes significant requirements on plans, including reporting and payment requirements, involving accounting, record keeping, and other administrative burdens. We have already found that the State's UBIT is a tax specifically directed at ERISA entities' investment income pursuant to IRC § 401(a), and thereby directly impacts the plan's investment strategy. Every ERISA plan with investments which generate unrelated business income is subject to the tax, with the result being a reduction of funds available for plan beneficiaries, coupled with increased administrative burdens on the plans. These facts distinguish this case from those cited by the Division. Based on the above facts, we find that Article 13 is connected with petitioner's plans in more than a remote, tenuous or peripheral manner. Therefore, Article 13 is preempted by section 514(a).

Accordingly, it ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of McKinsey Master Retirement Plan Trust is granted; and

4. Petitioner's claims for refund of unrelated business income tax plus penalties and interest paid for the years 1994, 1995 and 1996 are granted.

DATED: Troy, New York
May 8, 2003

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner