STATE OF NEW YORK

DIVISION OF TAX APPEALS

---

In the Matter of the Petition :

of :

MORGAN GUARANTY TRUST COMPANY OF NEW YORK : DETERMINATION

for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law. : :

---

Petitioner, Morgan Guaranty Trust Company of New York, 23 Wall Street, New York, New York 10015, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law (File No. 803132).

Petitioner, by its duly authorized representative, Davis Polk & Wardwell, Esqs. (William Parsons, Jr., Esq., of counsel), executed a waiver of hearing (dated December 29, 1987) and submitted its case for determination based on the entire file, including a Stipulation of Facts, together with briefs to be submitted by April 15, 1988. After due consideration, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

## ISSUE

Whether petitioner's transfer of certain real property escapes taxation under Tax Law Article 31-B ("gains tax") by virtue of the preemption provisions of the Federal Employee Retirement Income Security Act of 1974 ("ERISA").

## FINDINGS OF FACT

On November 11, 1987, a Stipulation of Facts pertaining to the petition of Morgan Guaranty Trust Company of New York, duly executed by authorized representatives for petitioner (William Parsons, Jr. and Leslie J. Hoffman, Esqs.) and for the Audit Division (Paul A. Lefebvre, Esq.), was received. This Stipulation of Facts provides as follows:

## STIPULATED FACTS

1. Morgan Guaranty Trust Company of New York (the "Trustee") has served as successor trustee under American Motors Corporation Union Retirement Income Plan (the "Plan") since March 1, 1969.

2. The Plan is, and at all relevant times has been, a qualified employee benefit plan under the Federal Employee Retirement Income Security Act of 1974 ("ERISA").

3. On August 13, 1965, KMS Properties, Inc. ("KMS"), a nonprofit corporation whose

stock was wholly owned by the Plan, purchased real property located at 444 Saw Mill River Road, Greenburgh, New York (the "American Motors Facility") from American Motors Sales Corporation (the "Employer"), an affiliate of the employer of the employees covered by the Plan.

4. On the same date, KMS entered into a lease agreement (the "Lease") with the Employer, pursuant to which KMS agreed to lease the American Motors Facility to the Employer for a term of 25 years.

5. ERISA was enacted on September 2, 1974. Under section 407(a) of ERISA, the Plan was prohibited from holding the real property under the Lease with the Employer. The Plan was required under section 414(c) of ERISA to dispose of the Lease or, alternatively, tax penalties under section 4975 of the Internal Revenue Code of 1954, as amended, could have been imposed. In addition, the Trustee would have been in violation of its fiduciary responsibilities under ERISA. Section 4975 of the Internal Revenue Code imposes a penalty equal to 5% of the "amount involved" for each year, and, in addition, a penalty of 100% of the "amount involved" if the prohibited transaction is not corrected within the required period. The "amount involved" was at least $2,775,640.00 and could ultimately have been much higher if the fair market value of the American Motors Facility had increased during the time that the prohibited transaction occurred.

6. On December 15, 1983, the Employer received an opinion of counsel (the "ERISA Opinion") which advised that the Lease was a "prohibited transaction" under ERISA and that prior to June 30, 1984 the Plan or the Employer was required either to revise the Lease to provide for higher rental payments, to obtain an administrative exemption, or to dispose of its interest in the American Motors Facility. The Employer was not willing to revise the Lease to provide for higher rental payments or dispose of its interest in the Lease, and the ERISA Opinion advised that there could be no assurance that the Department of Labor would grant an administrative exemption for the Lease.

7. Pursuant to the ERISA Opinion, and in accordance with ERISA, the Trustee caused KMS to sell the American Motors Facility to the American Motors Realty Corporation for $2,775,640.20 on June 29, 1984.

8. On July 31, 1984, petitioner paid to the State real property transfer gains tax in the amount of $205,262.62.

9. On May 13, 1985, petitioner filed with the Department of Taxation and Finance a claim for refund on the ground that imposition of the real property transfer gains tax upon this transaction is preempted by ERISA § 514(a).

ADDITIONAL FACTS

10. By letter dated January 15, 1986, the Audit Division denied petitioner's claim for refund upon the following basis:

> "It is the opinion of this Department that when reference is made in the above paragraph to '...any and all State laws,' the intent is to refer to any and all State laws which are designed to regulate employee benefit plans.

Accordingly, since the Gains Tax has no regulating effect on any employee benefit plan, and such plan is not exempt under Section 1116(a)(4) of the New York State Sales and Use Tax Law or Section 501(c)(3) of the Internal Revenue Code, the refund claim of Morgan Guaranty Trust Company of New York is hereby denied in its entirety."[1]

[1]The quoted reference "...any and all State laws" relates to ERISA § 514(a) (29 USC § 1144[a]), which provides that:

11. In response to this denial, petitioner timely commenced the subject proceedings.

## CONCLUSIONS OF LAW

A. Tax Law Article 31-B, § 1441, which became effective March 28, 1983, imposes a tax at the rate of 10% upon gains derived from the transfer of real property within New York State. There is no dispute that, but for the possibility of preemption via ERISA, the subject transfer would be subject to tax under Article 31-B. Likewise, if the transfer is so subject, no dispute is raised as to the amount of tax which would be due (such tax having, in fact, been paid under protest by petitioner).

B. In Sasso v. Vachris (66 NY2d 28), the Court of Appeals provided a summary description of ERISA (29 USC § 1001 et seq.), and specifically its preemption provision (29 USC § 1144[a]), as follows:

> "ERISA was enacted in 1974 to promote the interests of participants in employee welfare and pension plans by subjecting the plans to Federal regulation. It imposes substantive requirements relating to participation, funding and vesting of pension plans and it also establishes procedural standards for reporting, disclosure and fiduciary responsibilities for both welfare benefits and pension plans. Although the statute specifies that it provides only minimum standards (see___, 29 USC § 1001[a]), it contains a preemption clause that is so broad on its face that it has been described as 'virtually unique'. Section 514(a) of ERISA (29 USC § 1144[a]) provides, with exceptions not relevant here, that it 'supersede[s] any and all State laws insofar as they may now or hereafter relate to any employee benefit plan' covered by ERISA." (Sasso v. Vachris, 66 NY2d 28, 31-32 [citations omitted].)

Since it is undisputed that the employee benefit plan in this case is covered by ERISA, the question presented is whether the gains tax imposed by Tax Law Article 31-B impermissibly "relates to" the Plan via its imposition of tax upon the Plan's gain derived from the transfer of an interest in real property.[2]

C. Section 514 of ERISA (29 USC § 1144) provides, in relevant part, as follows:

---

[2]By its brief, petitioner admits that the exemption from gains tax set forth at Tax Law § 1443(c) is inapplicable. More specifically, section 1443(c) exempts organizations described in Tax Law § 1116(a)(4), which in turn describes organizations of the type which are exempt under I.R.C. § 501(c)(3). Here, KMS, the wholly-owned subsidiary of the Plan which held legal title to the subject real property, is exempt under I.R.C. § 501(c)(2) as a "corporation organized for the exclusive purpose of holding title to real property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which is itself exempt" under I.R.C. § 501. In turn, the Plan is exempt from Federal income tax under I.R.C. § 501(a), as "[a]n organization described in...[I.R.C. §] 401(a)".

"(a) Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

* * *

Definitions

(c) For purposes of this section:

(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 this subchapter." (Emphasis added.)

D. As distilled from the above, a State law is preempted if it "relates to" an ERISA plan. In turn, a State law "relates to" a plan if it purports to regulate, directly or indirectly, the terms and conditions of an ERISA plan.

E. The U.S. Supreme Court, as well as various other courts, have held that State laws "relate to" an ERISA plan if such laws have a "connection with or reference to" a plan, whereas State laws which affect plans in a "tenuous, remote or peripheral manner" are not preempted (see___, Sasso v. Vachris, 66 NY2d 28, 32; Planned Consumer Marketing, Inc. v. Coats & Clark, Inc., 71 NY2d 442, 448). In general, those State laws held preempted have been laws which "required or prohibited the provision of specific benefits or [required or prohibited] practices relative to the calculation of benefits" (Sasso v. Vachris, supra at 33, citing Metropolitan Life Ins. Co. v. Massachusetts, 471 US 724). It has been noted that ERISA's preemption clause is not limited to "State laws specifically designed to affect employee benefit plans." (Pilot Life Insurance Co. v. Dedeaux, 107 S Ct 1549 [1987], emphasis added; see Conclusion of Law "M", infra).

F. In analyzing whether a given transaction should be preempted it is at least persuasive, if not dispositive, that ERISA'S savings clause (which excludes from ERISA'S preemption provision certain State laws) specifically saves only banking, insurance and securities laws, but not State tax laws, from preemption (ERISA § 514[b][2][A]). In this context, at the time of ERISA'S enactment, the Departments of Labor and of the Treasury submitted a proposed preemption provision specifically allowing the states to regulate the tax aspects of retirement plans. This proposal was not adopted, but rather ERISA'S current preemption provision was settled upon. In essence, ERISA's preemption clause was not drafted to specify which State laws were preempted, but was written in the broader fashion of preempting all such laws relating to a plan except those specifically saved from preemption (i.e.____, banking, securities and insurance). Further, with respect to the preemption of state tax laws, Congress amended ERISA § 514 in 1983 (Public Law No. 97-473) to except Hawaii's Prepaid Health Care Act from being preempted, and in so doing specified that ERISA'S preemption provision applied to State tax laws.[3]

---

[3]ERISA § 514, as so amended, provides:

"(a) EXEMPTION FROM PREEMPTION.-Section 514

(b) of Employee Retirement Income Security Act of

1974 (29 U.S.C. 1144(b)) is amended by adding at th e end thereof the following new paragraph:

'(5)

(A) Except as provided in subparagraph (B), subse

---

ction(a)shallnotapplytotheHawaiiPrepaidHea lth Care Act (Haw. Rev. Stat. §§ 393-1 through 393

-51).

(B) Nothing in subparagraph (A) sh

all be construed to exempt from subsection

(a) -

(i) any State tax law relating to

G. Prior case law involving ERISA preemption and state taxation has not involved state

---

_employee benefit plans_... (emphasis added).'"

statutes taxing a transaction entered into directly by an ERISA plan itself. Each of such cases, except Firestone Tire & Rubber Co. v. Neusser (810 F2d 550 [6th Cir 1987]), involved state tax laws clearly related to ERISA plans, which laws were held preempted.

H. Those cases dealing with preemption of state tax statutes as relating to ERISA plans are few in number. In General Motors v. California State Board of Equalization, (815 F2d 1305 [9th Cir 1987]), the court held a California tax imposed upon insurers based upon gross premiums received to be preempted. The court analyzed the term "relates to" in ERISA § 514(a) in its broad, common sense meaning, i.e., does the law have a "connection with or reference to" the ERISA plan (id__ at 1309, citing Metropolitan Life Ins. Co. v. Mass., 471 US 724). The court held that preemption applied because the tax was computed based upon gross premiums received including benefits paid by an ERISA plan to its employees, thus making reference to the plan unavoidable in computing the tax. However, the court went on to find such preempted tax saved via ERISA'S savings clause (ERISA § 514[b][2][A]) for insurance laws, holding that reference to the plan's benefits as a base in calculating/measuring does not vitiate the tax because "the incidence of the tax remains on the insurer, not the plans". In the instant case, the incidence of tax clearly falls on the Plan.

I. In National Carrier's Conference Committee v. Heffernan (454 F Supp 914, 915 [D Conn 1978]), the court preempted a Connecticut tax imposed upon benefits paid from ERISA plans, holding such tax was "not merely a general taxing provision that catches [ERISA] plans within its wide sweep. On the contrary, [it] is specifically directed at such plans exclusively...." By comparison, the gains tax is not aimed at ERISA plans per se although it may, and here does, catch such plans within its broad sweep. Another ERISA/tax case, Northwest Airlines, Inc. v. Roemer (603 F Supp 7 [D Minn 1984]), preempted a tax levied on plan assets in order to collect back taxes owed by a plan beneficiary.

J. In contrast to the foregoing cases, in Firestone Tire and Rubber Co. v. Neusser (810 F2d 550 [6th Cir 1987]), the court upheld a 2% municipal income tax imposed on all income of Akron, Ohio city residents and income of nonresidents earned in Akron, notwithstanding that some post-tax income was directed for contribution into ERISA plans. The court found such statute "merely taxes income without regard to employees' decisions concerning plan contribution". The court noted the tax applied to all income without regard to the ultimate disposition of the income, rejecting the argument that such tax would directly reduce the amount of money available for contribution to the plans. The court noted three factors in its analysis: (1) whether the law involves a traditional area of State authority; (2) whether the law affects relationships among principal ERISA parties; and (3) whether the possible effect of the law on an ERISA plan is purely incidental. The court essentially dismissed the first factor, noting that Congress has explicitly stated that state tax laws which relate to ERISA plans will be preempted (29 USC § 1144[b][5][B][i]). The court noted, with respect to the second factor, that:

> "[T]he courts are more likely to find that a state law relates to a benefit plan if it affects relations among the principal ERISA entities--the employer, the plan, the plan fiduciaries, and the beneficiaries--than if it affects relations between one of these entities and an outside party, or between two outside parties with only an incidental effect on the plan." (Id__. at 556, citing Sommers Drug Stores Co. v. Corrigan Enterprises, 793 F2d 1456, 1467.)

With respect to this second factor, the tax in this instance clearly impacts the principal ERISA entities, i.e. the Employer, the Plan and the Plan fiduciary.

K. With respect to the third factor, petitioner argues that, while a state statute having some economic impact upon a plan does not require invalidation (Reybaldo v. Cuomo, 749 F2d 133 [2d Cir 1984]), the imposition of a 10% tax directly on the Plan, to wit on the gain on disposition of a plan asset, represents a direct and significant economic impact neither remote, peripheral nor tenous, and requires preemption.

L. Using the foregoing Firestone reasoning, it appears that the gains tax would not be preempted in instances where an individual or entity transfers an interest in real property and directs the proceeds of such transfer for contribution to an ERISA plan (e.g., an owner sells real estate and directs the proceeds for funding a plan). However, under the subject facts, the transfer itself was of a Plan asset, was made by the Plan itself, was a course of action dictated by ERISA rules regarding investment requirements[4] and resulted in a direct tax upon the Plan. It is clear that in this limited instance, the gains tax directly relates to and affects the Plan and hence must be held preempted. The tax, in effect, imposes a penalty on the Plan when the Plan trustee acts in an attempt to avoid engaging in a prohibited transaction. Further, imposition of gains tax would serve to currently tax gains of the Plan and ultimately reduce the amount of funds available for distribution to beneficiaries. These factors, taken as a whole and viewed in light of the broad preemptive language contained in ERISA, require that this transaction be preempted from the imposition of gains tax.

M. Contrary to the position asserted in the first paragraph of the Audit Division's denial letter (see___, Finding of Fact "10", emphasis added; Pilot Life Insurance Co. v. Dedeaux, supra), ERISA's preemption is broader than prohibiting only "State laws which are designed to regulate employee benefit plans". Rather, ERISA's preemptive language speaks of overriding all State laws that "relate to" such plans (ERISA § 514[a]). On balance, it is concluded that the gains tax, on these facts, relates to the Plan in such a manner as to require preempting application of the tax to this transaction. This transaction represents more than simply an investment decision by the Plan (i.e., choice of assets). The transfer was compelled out of a need to avoid running afoul of ERISA requirements on prohibited investments, thus directly forcing the choice of facing or avoiding the gains tax. It thus appears clear that while the gains tax is a tax of general application, it does relate to the administration of the subject ERISA plan and hence is preempted.[5]

N. The petition of Morgan Guaranty Trust Company of New York is hereby granted and the Audit Division is directed to refund to petitioner the gains tax paid under protest together with interest thereon.

DATED: Albany, New York
December 22, 1988

---

[4]Sale of the real property was described as the only realistic option available (Finding of Fact "6").

[5]Since failure by the Plan to dispose of the prohibited asset would result in violation of ERISA standards, the Plan (by its Trustee) was forced to weigh the choice of failing to dispose and thus becoming subject to the excise tax on prohibited transactions (see, I.R.C. § 4975), versus disposing of the property and incurring the gains tax liability.

/s/ Dennis M. Galliher

ADMINISTRATIVE LAW JUDGE