New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-97(10)C
Corporation Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C961007A

On October 7, 1996, a Petition for Advisory Opinion was received from Patrick D. Martin, Nixon, Hargrave, Devans & Doyle, Clinton Square, PO Box 1051, Rochester, New York 14603.

The issues raised by Petitioner, Patrick D. Martin, are:

1. Assuming the gross unrelated business taxable income earned by a retirement plan exceeded $1,000 for the plan year ending 19XX, does the plan have to file a New York State tax return for the year or pay New York taxes on the income under Article 13 of the Tax Law?

2. Assuming the gross unrelated business taxable income earned by an individual retirement account ("IRA") exceeded $1,000 for the calendar year ending 19XX, does the IRA have to file a New York State tax return for the year or pay New York taxes on the income under Article 13 of the Tax Law?

3. If the answer to questions 1 or 2 is "yes", does the answer change if the gross amount of unrelated business taxable income earned by the plan or IRA is less than $1,000?

Petitioner submits the following facts as the basis for this Advisory Opinion.

A corporation maintains a retirement plan (the "Plan") that satisfies the requirements for qualified pension and profit-sharing plans under section 401(a) of the Internal Revenue Code ("IRC"). The Plan purchased stock in a public offering. Pursuant to the terms of the offering, a portion of the purchase price was paid one year after the purchase. As a result of this purchase, for the Plan year ending 19XX, the Plan earned income constituting "unrelated business taxable income" as defined in section 512 of the IRC.

An individual maintains an IRA pursuant to section 408(a) of the IRC. The IRA purchased stock in a public offering. Pursuant to the terms of the offering, a portion of the purchase price was paid one year after the purchase. As a result of this purchase, for the calendar year ending 19XX, the IRA earned income constituting "unrelated business taxable income" as defined in section 512 of the IRC.

Section 290 of Article 13 of the Tax Law imposes a tax on the unrelated business taxable income of every organization described in section 511(a)(2) of the IRC and every trust described in section 511(b)(2) of the IRC that carries on an unrelated trade or business in New York. Section 292 of the Tax Law provides that the unrelated business taxable income of a taxpayer subject to tax under Article 13 is the taxpayer's federal unrelated business taxable income, as defined in the IRC for the taxable year, with the modifications described in section 292 of the Tax Law.

Section 511(a)(2) of the IRC provides that the tax imposed by section 511(a)(1) of the IRC "shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a)." (emphasis added)

Section 511(b)(2) of the IRC provides that the tax imposed by section 511(b)(1) of the IRC "shall apply in the case of any trust which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a) and which, if it were not for such exemption, would be subject to subchapter J (section 641 and following, relating to estates, trusts, beneficiaries, and decedents).

Section 501(a) of the IRC provides that an organization described in section 501(c) or (d) or section 401(a) of the IRC shall be exempt from taxation under Subtitle A unless the exemption is denied under section 502 or section 503 of the IRC.

The Employee Retirement Income Security Act of 1974 (ERISA) established a number of tax qualification requirements for retirement plans by amending the Internal Revenue Code. Section 514(a) of ERISA (29 USCS §1144(a)) expressly preempts any and all state laws "insofar as they may now or hereafter relate to any employee benefit plan ...." The phrase "relate[s] to" must be given a "broad common sense meaning" (Ingersoll-Rand, 111 S Ct at 483). Thus, a state law may be preempted even though not specifically designed to affect such plans, and even though any effect is only indirect (Ingersoll-Rand, supra.) However, despite the breadth of the preemption clause, certain state laws "may affect employee benefit plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relates to' the plan." (Shaw, 463 US at 100, n21.)

In Morgan Guaranty Trust Company of New York v Tax Appeals Tribunal, 80 NY2d 44, the New York Court of Appeals discussed whether the New York real property gains tax could be imposed on the sale of real property held by a qualified retirement plan and concluded that the tax was preempted by ERISA. The Court held that "it is clear that this gains tax is preempted because it affects the structure, administration and economics of a covered plan, and therefore 'relate[s] to' it in more than a tenuous, remote or peripheral way." The Court based its result on three factors: the gains tax impacts on the structure and administration of the plan by imposing recordkeeping and reporting requirements; the tax would influence the plan's investment strategy by making certain assets less attractive investments or requiring the retention of an asset that would otherwise have been liquidated; and preemption is consistent with the favorable tax treatment given to benefit plans under the Internal Revenue Code. The Court found that "the gains tax 'directly depletes the funds otherwise available for providing benefits' and flies 'in the face of ERISA's goal of assuring the financial soundness of such plans.' (*Birdsong v. Olson*, 708 FSupp 792, 801[WD Tex].)"

A court, distinguishing Morgan Guaranty, held that the real property tax of the City of New York was not preempted by ERISA (Matter of American Fedn. of Musicians' & Empls.' Pension Fund v Tax Commn of the City of New York, NYLJ, March 10, 1993, at 21, col 5, *affd* 203 AD2d 205, *lv denied* 84 NY2d 803). The court found that the tax was merely peripheral to the plan and not preempted because it was a cost of doing business in New York and not a direct tax on plan profits like the gains tax.

In this case, the Plan described in issue "1" is a qualified plan under section 401(a) of the IRC and it is assumed that it is a plan covered by ERISA. Therefore, the Plan constitutes a trust described in section 511(b)(2) of the IRC. However, based on the broad preemption clause in ERISA and the decision in Morgan, supra, the tax imposed by Article 13 on the unrelated business taxable income of the Plan appears to be preempted by ERISA. The tax imposed under Article 13 affects the structure, administration and economics of the plan and directly depletes the funds otherwise available for providing benefits and therefore relates to the retirement plan "in more than a tenuous remote or peripheral way." Accordingly, no New York taxes can be imposed on the unrelated business income of the Plan and no New York tax returns are required to be filed by the Plan.

With respect to issue "2", section 408(e)(1) of the IRC provides that an IRA account is exempt from federal income tax except that an IRA account is subject to the taxes imposed by section 511 of the IRC. Since section 511 of the IRC applies to an IRA as a result of section 408(e)(1) of the IRC, an IRA is not exempt from federal taxation pursuant to section 501(a) of the IRC. Therefore, an IRA is not an organization or trust described in section 511(a)(2) or section 511(b)(2) of the IRC. Accordingly, an IRA is not subject to the tax imposed by section 290 of Article 13 of the Tax Law on the unrelated business income of the IRA and no New York tax returns are required to be filed by the IRA under Article 13 of the Tax Law.

Based on the foregoing, issue "3" is moot.

/s/
DATED: May 9, 1997 John W. Bartlett
Deputy Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.