U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216

Reply to the Attention of:

OPINION NO. 82-23A
Sec. 514, 3(2), 404(a)(1), 403(c)(1)

MAY 21 1982

Honorable Jose Enrique Arraras
President, Treasury Committee
House of Representatives
Capitol
San Juan, Puerto Rico 00901

Dear Sr. Arraras:

This is in reply to your request to Mr. Mario Paoli, Area Administrator, Labor-Management Services Administration, for comments regarding House of Representatives Bill Number 322. Bill Number 322 would amend Law Number 91 which was approved on June 29, 1954, the Puerto Rico Income Tax Act of 1954. Bill Number 322 authorizes the establishment of Individual Retirement Accounts (IRAs) in Puerto Rico and establishes the conditions under which IRA contributions will be deductible under the Puerto Rican income tax law. Your request has been referred to this Office for consideration.

The Department of Labor (the Department) has the responsibility for administering title I of the Employee Retirement Income Security Act of 1974 (ERISA). Section 514 of ERISA provides, in pertinent part:

> SEC. 514. (a) Except as provided in subsection (b) of this section, the provisions of [title I] and title IV shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b). This section shall take effect on January 1, 1975.
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> (2)(A) Except as provided in subparagraph (B), nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.
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> (B) Neither an employee benefit plan described in section 4(a), which is not exempt under section 4(b) (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any

State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(3) Nothing in this section shall be construed to prohibit use by the Secretary of services or facilities of a State agency as permitted under section 506 of this Act.

(4) Subsection (a) shall not apply to any generally applicable criminal law of a State ….

(d) Nothing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 111 and 507(b)) or any rule or regulation issued under any such law.

While section 3(10) of ERISA defines the term "State" to include Puerto Rico, we note that 48 U.S.C. §845 gives the Puerto Rican Legislature the power to amend, alter, modify, or repeal the income tax laws in force in Puerto Rico. Moreover, under various provisions of the United States Internal Revenue Code of 1954, particularly sections 901, 933 and 936, income from sources in Puerto Rico is either not subject to the United States Federal income tax or is eligible for a credit against the Federal income tax for income tax paid to the Commonwealth of Puerto Rico.

In view of section 514(d) of ERISA, title I of ERISA, including section 514(a), does not alter, modify or supersede these provisions of Federal law governing the allocation of authority over income taxation between the United States Congress and the Legislature of Puerto Rico. It is the Department's view, therefore, that income tax laws in force in Puerto Rico which have been duly enacted by the legislature of Puerto Rico are not preempted under section 514(a) of ERISA. Accordingly, if Bill Number 322 is enacted, amendments of the Puerto Rican Income Tax Act of 1954 contained in that bill would not be preempted under section 514(a) of ERISA.

You should be aware, however, that certain IRA programs, including IRA programs established under Puerto Rican income tax law, may constitute employee pension benefit plans covered by title I of ERISA.

To the extent that an IRA program would constitute an employee pension benefit plan covered by title I of ERISA, such a program would have to comply with the applicable ERISA requirements even though those requirements might conflict with Bill Number 322.

Section 3(2)(A) of ERISA defines the term "employee pension benefit plan" to include:

… any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program --

(i) provides retirement income to employees, or

(ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

In 29 C.F.R. §2510.3-2, the Department described certain programs which would not be considered to constitute "employee pension benefit plans" within the meaning of section 3(2)(A) of ERISA. With regard to IRAs, regulation section 2510.3-2(d) provides:

> (d) Individual Retirement Accounts. (1) For purposes of Title I of the Act and this chapter, the terms "employee pension benefit plan" and "pension plan" shall not include an individual retirement account described in section 408(a) of the Code, an individual retirement annuity described in section 408(b) of the Internal Revenue Code of 1954 (hereinafter "the Code") and an individual retirement bond described in section 409 of the Code, provided that –
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> > (i) no contributions are made by the employer or employee association;
> > (ii) participation is completely voluntary for employees or members;
> > (iii) the sole involvement of the employer or employee organization is without endorsement to permit the sponsor to publicize the program to employees or members, to collect contributions through payroll deductions or dues checkoffs and to remit them to the sponsor; and
> > (iv) the employer or employee organization receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions or dues checkoffs.

In the preface to this regulation, the Department stated it wanted to make clear that IRAs which were not established or maintained by an employer or an employee organization would not be employee pension benefit plans under section 3(2) of ERISA. While the regulation addresses only IRAs described in sections 408(a), 408(b), and 409 of the United States Internal Revenue Code of 1954, the definition in section 3(2) of ERISA includes any IRA, including those established under Puerto Rican income tax law, that was established or is maintained by an employer or an employee organization, or by both. Accordingly, the criteria set forth in §2510.3-2(d) would generally be applicable in determining whether an IRA program established under Puerto Rican income tax law would amount to an employee pension benefit plan within the meaning of section 3(2)(A) of ERISA.

Additionally, in Opinion 81-80A (issued December 18, 1981) and Opinion 82-13A (issued February 17, 1982), the Department stated that if certain criteria were met, the Department would not consider an employer to have "endorsed" an IRA program within the meaning of regulation section 2510.3-2(d)(iii) if offered to employees through payroll deductions. Copies of Opinions 81-80A and 82-13A are enclosed.

It would appear that some IRA programs which would be described in section 169(b) of Law Number 91 if Article 2 of Bill Number 322 is enacted would constitute "employee pension benefit plans" within the meaning of section 3(2) of ERISA. They would therefore be subject to title I of ERISA.

Section 169(a)(3) of the Bill would require that no less than 85 percent of the funds of the trust comprising the IRA be invested in (1) obligations of the Commonwealth of Puerto Rico or of its instrumentalities or political subdivisions, or (2) mortgage loans created for the construction of residential properties. The remaining 15 percent of the funds of the trust must be invested within Puerto Rico.

Section 404(a)(1) of ERISA provides, in relevant part, that a fiduciary shall discharge his or her duties with respect to a covered employee benefit plan solely in the interest of the participants and beneficiaries and for the exclusive purpose or providing benefits to participants and their beneficiaries and of defraying reasonable expenses of administering the plan. It also requires the fiduciary to act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character with like aims, and to diversify the investments of the plan so as to minimize the risk of large losses.

In addition, section 403(c)(1) of ERISA provides that with certain exceptions not here relevant, the assets of a plan must be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

Bill Number 322 attempts to limit the degree to which fiduciaries of IRA programs subject to title I could diversify the investments of such programs so as to minimize the risk of large losses, as required under section 404(a)(1)(C) of ERISA. It appears, moreover, that the Bill attempts to require investments that might not be consistent with the requirement in section 404(a)(1)(B) of ERISA that fiduciaries of these programs discharge their duties with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims. Finally, the Bill attempts to require that the investment of assets of these programs be conducted for purposes other than providing benefits to participants and their beneficiaries and defraying reasonable administrative expenses and to be conducted otherwise than solely in the interests of participants and beneficiaries.

Accordingly, if conflicts exist between the provisions of section 169(a)(3) of the Bill and title I of ERISA, as is most probably the case, fiduciaries subject to title I would have to follow the requirements of that title and not of section 169(a)(3). Otherwise, they would be subject to suit by the Department or plan participants and beneficiaries and liable for damages resulting from their breach of fiduciary duty.

We are enclosing for your further information a letter to Mr. Edward F. Sutkowski dated November 6, 1981, which addresses the prudence and exclusive benefit requirements in a similar context.

I hope that the views of the Department expressed herein will be of assistance in your consideration of Bill Number 322.

Sincerely,

Jeffrey N. Clayton
Administrator
Pension and Welfare Benefit Programs

Enclosures