U.S. Department of Labor

Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210

JAN 21 1986

86-05A
Sec.

Mr. Daniel B. Stone
Ivins, Phillips & Barker
1700 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Dear Mr. Stone:

This is in response to your letters on behalf of the Employers Council on Flexible Compensation. In those letters, you requested an advisory opinion as to the effect of the preemption provisions of section 514 of the Employee Retirement Income Security Act of 1974 (ERISA) on state and municipal taxation of "elective deferrals" of income by participants in plans qualified under section 401(k) of the Internal Revenue Code (the Code).

Section 401(k) of the Code provides that a profit-sharing or stock bonus plan will not fail to be a qualified plan under section 401(a) of the Code merely because such plan includes a qualified cash or deferred arrangement. Section 401(k)(2) defines the term "qualified cash or deferred arrangement" to include arrangements in which an employee "may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash." If certain other conditions are met, the effect of an election to have an employer make payments to a trust under the plan is to defer the employee's federal tax liability with regard to those payments. As such, these employer payments are referred to as "elective deferrals" of income by the employee.

You indicate that a memorandum published on December 30, 1982 by the Chief Counsel of the Pennsylvania Department of Revenue (hereinafter, Chief Counsel's Memorandum) determined that such elective deferral payments must be included in the employee's gross yearly income subject to tax under the Pennsylvania Personal Income Tax Law, 72 P.S. §§7301-7303 (1985 Supp.). The memorandum concluded that such elective deferral payments are actually employee contributions to the plan and as such are included in the employee's gross income and are subject to state tax withholding requirements.

You request an opinion from the Department of Labor (the Department) that the application of the Pennsylvania state tax law pursuant to the Chief Counsel's Memorandum is preempted under section 514 of ERISA. You indicate that the Pennsylvania state tax law "relates to" affected 401(k) plans and, pursuant to established doctrine, should be preempted on that basis.

ERISA section 514 provides in relevant part:

> Sec. 514. (a) Except as provided in subsection (b) of this section, the provisions of this title 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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> (c) For purposes of this section:
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> (1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State.
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> (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 title.

It is clear from your submissions that the Chief Counsel's Memorandum is treated as "State Law" under section 514(c) of ERISA. It does not appear that any of the general exceptions to preemption in section 514(b) of ERISA are applicable in this situation. The Chief Counsel's Memorandum interpreting Pennsylvania state tax law will be preempted, therefore, so long as the Department finds that it is a state law which "relates to" an employee benefit plan.

In Shaw v. Delta Airlines, Inc., 103 S. Ct. 2890 (1983), the Supreme Court indicated that section 514(a) was to be interpreted broadly and its preemptive effect not limited to only laws specifically dealing with employee benefit plans. Id. at 2900. Consistent with this approach, courts have on a number of occasions addressed the effect of the application of state tax laws to employee benefit plans. Courts have found that section 514(a) preempts state tax levies on employee benefit plans in order to recover taxes owed by plan participants. Franchise Tax Board v. Construction Laborers Vacation Trust for Southern California, 679 F.2d 1307 (9th Cir. 1982), vacated on jurisdictional grounds, 463 U.S. 1 (1983); Northwest Airlines v. Roemer, 5 EBC 1307 (D. Minn. 1984). Similarly, courts have found that section 514(a) preempts the imposition of state tax laws directly on plans themselves. General Split Corp. v. Mitchell, 523 F. Supp. 427 (E.D. Wisc. 1981); National Carriers Conference Committee v. Heffernan, 454 F. Supp. 914 (D. Conn. 1978). In each of these cases, the courts addressed situations in which the application of

the state tax law would impinge directly upon the assets held by the plan or the manner in which the plan used those assets to pay benefits.

Your application presents a different situation. The Chief Counsel's Memorandum does not seek to apply Pennsylvania state tax law to employee benefit plans or their assets. Rather, the Memorandum provides an interpretation of the amounts to be included in an individual's taxable income for the purposes of the Pennsylvania Personal Income Tax Law. As such, there is no alienation of benefits or interference with plan administration, but rather a definition of the state personal income tax consequences to a plan participant of an elective deferral of income under a 401(k) plan. In the Department's view, a state law which merely defines the extent to which personal income is subject to state personal income tax does not "relate to" an employee benefit plan within the meaning of section 514(a) of ERISA and is therefore not preempted by ERISA.[1]

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (copy enclosed). Accordingly, this letter is issued subject to the provisions of the procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

Elliot I. Daniel
Assistant Administrator for Regulations and Interpretations

Enclosures

[1] See letter to Sen. Jacob K. Javits (November 14, 1978, copy enclosed) (ERISA does not preempt New York state law requiring shareholders of professional corporations to add to their personal income the amount by which the corporation’s contribution to a pension plan exceeds the maximum contribution allowance for such plan.)