Cite as Det. No. 91-309, 11 WTD 497 (1992).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Determination of Tax Liability of Undisclosed Taxpayer	)	D E T E R M I N A T I O N No. 91-309

[1] RULE 224 and RULE 194: B&O TAX -- SERVICES -- ERISA PREEMPTION OF STATE LAW. The Employee Retirement Income Security Act broadly preempts any state laws deemed to "relate" to qualified benefit plans. The activity of contributing to or receiving benefits from plans is not subject to Washington's B&O tax. However, income received by a plan administrator for its management activity is subject to service B&O tax. Applied to that activity, the B&O tax is a tax on the activity of administering the plan and is calculated on the gross income of the plan administrator only. As such, it is distinguishable from taxes on the plans themselves or taxes calculated with reference to the plan's assets.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Pursuant to WAC 458-20-100(9), taxpayer's representative petitions for ruling on state-tax liability of employee benefit plan created to comply with ERISA regulations.

FACTS AND ISSUES:

Adler, A.L.J. -- Taxpayer's representative requests a ruling on behalf of an undisclosed company, hereinafter referred to as

"Acme." Prior to the contemplated transaction, Acme purchased medical insurance from an outside insurer. The employer and employees each paid fifty percent of the costs of the plan. Acme was informed that the medical plan will be cancelled.

As a replacement, Acme is considering a self-funded plan. It expects the plan to be virtually identical to the cancelled one, both in coverage levels and contribution obligations. Acme will either administer the plan itself or may create a wholly-owned subsidiary to operate the plan. Acme expects to use the services of a consultant specializing in ERISA regulations to create a qualified plan under the Act.

Acme obtained an opinion from the Washington State Insurance Commission that ERISA qualification would result in the plan not being subject to the insurance-regulation laws of Washington, due to the federal preemption statute. As a result, Acme believes the plan would be exempt from B&O tax under RCW 82.04.320, which provides that

> this chapter shall not apply to any person in respect to insurance business upon which a tax based on gross premiums is paid to the state...

Acme requests answers to the following questions:

1. Is the self-insurance plan which Acme may establish subject to B&O tax? Doesn't ERISA preempt the B&O tax because application of the B&O tax "would directly impinge on the assets of the plan as well as the manner in which those assets are used to pay the necessary benefits" to the employees?

   a. If taxable, which B&O tax categories apply?

2. If the plan is taxable, are Acme's contributions to the plan subject to B&O tax?

DISCUSSION:

[1] The Employee Retirement Income Savings Act of 1974 (ERISA) contains broad language governing its application. First is the "preemption" clause, which states ERISA supersedes "any and all State laws insofar as they may now or hereafter relate to any employment benefit plan." ERISA, Section 514(a); 29 U.S.C. Section 1144(a).

Second, the Act reserves to the States the right to regulate insurance, banking, or securities. ERISA, Section 514(b)(2)(A); 29 U.S.C. Section 1144(b)(2)(A), the "savings" clause.

Finally, the Act states that no ERISA plan "shall be deemed to be an insurance company or other insurer...or to be engaged in the business of insurance...for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies." ERISA, Section 514(b)(2)(B); 29 U.S.C. Section 1144(b)(2)(B), the "deemer" clause. This is, presumably, the reason that the insurance commissioner concluded that Acme's plan would not be subject to the state's insurance laws. The fact that the plan is not an "insurer" subject to state insurance regulations does not, of itself, exempt the plan from B&O tax. Technically, the exemption from B&O tax, RCW 82.04.320, cited by taxpayer's representative would only apply if the taxpayer qualified as an insurer and then would only apply as to that income received from premium payments.

ERISA covers both employee welfare, or benefit, plans and employee pension plans. Among welfare plans are any qualifying plans for covering virtually any type of employee benefit, from medical expenses to vacation time.

Federal and state courts have found that Congress intentionally used broad language in enacting ERISA:

> Congress used the words "relate to" in Section 514(a) in their broad sense. It did not mean to pre-empt only state laws specifically designed to affect employee benefit plans. That interpretation would have made it unnecessary for Congress to enact ERISA Section 514(b)(4); 29 U.S.C. Section 1144(b)(4), which exempts from pre-emption "generally" applicable criminal laws of a State. We also emphasized that to interpret the pre-emption clause to apply only to state laws dealing with the subject matters covered by ERISA, such as reporting, disclosure, and fiduciary duties, would be incompatible with the provision's legislative history because the House and Senate versions of the bill that became ERISA contained limited pre-emption clauses, applicable only to state laws relating to specific subjects covered by ERISA. These were rejected in favor of the present language in the Act, "indicating that the section's pre-emptive scope was as broad as its language." FMC Corp. v. Holliday, 111 S.Ct. 403 (1990), citing Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 103 S.Ct. 2890, 77 L.Ed.2d 490 (1983). (Emphasis supplied.)

Generally, where any state statute would have the effect of creating a hardship on the plan, ERISA preempts it. In FMC, the

Court was considering a Pennsylvania subrogation statute which would have had the effect of prohibiting an ERISA benefit plan from recovering medical payments from an insured who later received a settlement following an automobile accident. The Court found that the statute was preempted, because it could subject plan administrators to the hardship of having to calculate plan coverage levels and benefits based on differing state regulations if all state subrogation statutes were not preempted by ERISA.

Congress' concern was that such "a situation would produce considerable inefficiencies which the employer might choose to offset by lowering benefit levels." As a result, the Court concluded that the intent was to ensure that benefit plans would be governed by only a single set of regulations. FMC, citing Fort Halifax Packing Co. v. Coyne, 482 U.S. 1, 107 S.Ct. 2211 2216-2217, 96 L.Ed.2d 1 (1987).

The Court has also ruled that ERISA's scope is so broad it preempts even state laws with only collateral or indirect effects on employee benefit plans. Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 101 S.Ct. 1907, 68 L.Ed.2d 402 (1981).

As to the question of whether the plan itself would be subject to B&O tax, we believe the facts as given would indicate that it would not. If Acme creates a qualified plan under ERISA, those regulations will control. Both because of ERISA's "deemer" clause and because Acme currently intends the plan to be self-funded, Acme's operation of the plan should not make Acme an "insurance company." If Acme chooses to purchase an insurance package from an outside insurer, that company is considered to be an insurer of the plan, and it remains subject to state insurance laws under the "savings" clause, which reserves to the states the right to regulate insurance companies and their contracts. Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724, 740-741, 105 S.Ct. 2380, 2389, 85 L.Ed.2d 728 (1985). In such a case, regulation of Acme is still controlled by ERISA, but regulation of the outside insurer is controlled by state law.

Because of ERISA's broad preemption language, we believe the plan itself would not be subject to tax. This means contributions to the plan would not be taxable. However, Washington's B&O tax is a transaction tax, not an income tax. As a result, Acme's income would be fully subject to the applicable B&O taxes, regardless of whether some of that income was intended to be or was later used as plan contributions. This result differs from the federal income tax. Payments out of the plan would not be taxable. Federal law now taxes some portions of payments, such as those deemed to be for lost wages. Washington, however, does not tax

wages; as a result, payments from the plan to the employees would not be subject to state taxes.

In 1983, Congress amended ERISA to specifically provide that state tax laws relating to employee benefit plans are also preempted. 29 U.S.C. Section 1144(b)(5)(B)(i). In Birdsong v. Olson, 708 F. Supp. 792, 797 (W.D.Tex. 1989), the court was considering application of ERISA to state tax laws. Citing the 1983 amendment, the federal district court in Texas followed those in Minnesota and Connecticut, noting:

> The House Conference Report stated that "preemption is continued with respect to....any State tax law relating to employee benefit plans."
> The Court therefore finds that Congress has expressly indicated that state tax laws related to employee welfare benefit plans are preempted.

Further, the court held, at 709 F.Supp. 801:

> Tax measures which are aimed specifically at employer contributions do not differ in substance from taxes imposed on the income of such plans; and one should not escape preemption where the other would not. Unlike other forms of state regulation that may affect the costs of these plans in an incidental fashion, state taxation directly depletes the funds otherwise available for providing benefits. To permit this to occur would fly in the face of ERISA's goal of assuring the financial soundness of such plans. (Emphasis supplied.)

We believe ERISA's broad preemption application would control with regard to state taxes which would apply to contributions to, distributions from, and investment income generated by a qualified plan.

B&O TAX ON SERVICE FEES EARNED BY THE PLAN ADMINISTRATORS

A different question is that of whether fees received by the plan administrator for its management services would be subject to B&O tax. No precedent exists which is directly on point. The cases discussing ERISA to date have either involved nontax statutes or have dealt with taxes specifically mentioning plans, such as the Texas Administrative Services Tax. E-Systems, Inc. v. Pogue and La Quinta Motor Inns, Inc. v. Reynolds, consolidated at 929 F.2d 1100 (5th Cir. 1991). No cases considering Washington's business and occupation tax have been heard. However, a number of jurisdictions have held that neutral taxes of general

application, which only incidentally affect plans, are not preempted by ERISA.

For example, the Texas tax at issue in E-Systems and La Quinta was imposed on either the plans or their fiduciaries or administrators and was calculated in part on the basis of benefits provided under the plans. In E-Systems and La Quinta, the courts found such a scheme was directly related to such plans, and the tax was preempted.

Where the tax is found to be imposed on all persons in a class and does not specifically mention or single out ERISA plans, we believe the tax would be sustained. As a result, if Acme's plan administrator receives a fee for rendering the service, we believe the administration fee would be subject to service B&O tax. This is because the B&O tax on the service-provider's fee only is a general tax applied to the gross income of all service providers, regardless of the type of services they render. As such, it is a
general tax not related to any ERISA plan and is a "neutral tax of general application." Firestone Tire & Rubber v. Neusser, 810 F.2d 550 (6th Cir. 1987).

In Firestone, the company implemented two benefit plans which received contributions from employees. The City of Akron, Ohio, enacted a two-percent tax on the income of all residents and of all persons earning wages in the city. Firestone appealed, arguing that the tax related to the plans. The Sixth Circuit reviewed cases from other circuits, including National Carriers' Conference Committee v. Heffernan, 454 F.Supp. 914 (D.Conn. 1978), which preempted a statute because it

> is not merely a general taxing provision that catches employee benefit plans in its wide sweep. On the contrary, the tax is specifically directed at such plans exclusively. (Emphasis supplied.)

In Northwest Airlines, Inc. v. Roemer, 603 F.Supp. 7 (D.Minn. 1984), the court preempted a statute which permitted tax levies on benefit payments from an ERISA plan on the grounds that the levies would have a direct effect on the plan.

The Firestone court, 810 F.2d at 554, held that unlike the provisions in those cases and others, the Akron tax was on the income of all employees. As such, it was

> a neutral tax of general application. The ordinance taxes income without regard to the ultimate disposition of that income. Consequently, the present case does

> not come within the reasoning of those decisions. (Emphasis supplied.)

As a result, we believe that B&O tax would apply to income received by a plan administrator for its services. Because the administrator is not an insurer, its income would be subject to tax under the B&O tax, RCW 82.04.290, instead of under the insurance premiums tax, Chapter 48.14 RCW. If Acme creates a subsidiary to administer the plan and the services are partially or wholly rendered outside Washington, apportionment rules would apply. See WAC 458-20-194, ...

Taxpayers are entitled to request a ruling pursuant to WAC 458-20-100(9). Normally, a taxpayer would be permitted to rely upon the ruling for reporting purposes and as support of the reporting method in the event of an audit. The identity of the taxpayer has not been disclosed in this request for a ruling, and the ruling is based upon only the facts that were disclosed by the taxpayer's representative. Since we will not be able to inform the taxpayer of any future changes in our position, this ruling may not be effective for future application by the taxpayer and will not necessarily be binding on the Department should the position of the Department change. It also shall not be binding if there are relevant facts which are in existence but not disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes.

DATED this 5th of November 1991.