New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(2)I
Income Tax
May 23, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I001228B

On December 28, 2000, a Petition for Advisory Opinion was received from Limited Service Corporation, Three Limited Parkway, Columbus, Ohio 43230.

The issues raised by Petitioner, Limited Service Corporation, are:

1. Whether the lump sum distributions from the Nonqualified Plan, described below, to distributees who have terminated their employment with the Limited, Inc. or its affiliates, and who are nonresidents and nondomiciliaries of New York State are exempt from the personal income tax imposed pursuant to Article 22 of the Tax Law ("State PIT").

2. Whether Petitioner is required to withhold State PIT or New York City personal income tax on residents imposed pursuant to Title 11, Chapter 17 of the New York City Administrative Code as authorized by Article 30 of the Tax Law ("City PIT") from distributions from the Nonqualified Plan, described below, that are made to employees of affiliates of The Limited, Inc. where the affiliates do not have an office or transact business in New York State or in New York City, respectively.

3. Whether Petitioner, with regard to distributions made to employees of affiliates of The Limited, Inc. where the affiliates have an office or transact business in New York State or New York City, respectively, (a) is required to withhold State PIT and City PIT from distributions from the Nonqualified Plan, described below, to employees who state that they are New York State residents or New York City residents, respectively, (b) is entitled to rely upon affidavits it receives from employees regarding their state and city of residence in determining whether it is required to withhold State PIT and City PIT from such distributions and (c) is subject to a penalty if Petitioner accepts an affidavit that turns out to be false as long as Petitioner has no actual knowledge that it is false.

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

Petitioner is a wholly-owned indirect subsidiary of The Limited, Inc. Effective January 1, 2000, Petitioner adopted a nonqualified deferred compensation plan for certain employees of affiliates of The Limited Inc., The Limited Supplemental Retirement and Deferred Compensation Plan (the "Nonqualified Plan"). The Nonqualified Plan was adopted to combine two previously established nonqualified plans:

(1) The Limited Supplemental Retirement Plan which provided certain benefits in excess of the limits imposed by sections 401(a)(17) and 415 of the Internal Revenue Code ("IRC"), and

(2) The Limited Deferred Compensation Plan which provided certain benefits in excess of the limits imposed by sections 401(k) and 401(m) of the IRC.

The Nonqualified Plan is a plan described under section 3121(v)(2)(C) of the IRC that solely provides deferred compensation that is retirement income in excess of the limits imposed by sections 401(a)(17), 415, 401(k) and 401(m) of the IRC. The Nonqualified Plan supplements and incorporates various definitions and provisions of The Limited Stores, Inc. Savings and Retirement Plan, a qualified deferred compensation plan for certain employees of The Limited, Inc., and its affiliates (the "Qualified Plan").

Section 3.1 of the Nonqualified Plan provides that an employee who is eligible to participate in the Qualified Plan will automatically become a participant in the Nonqualified Plan, and certain other management and highly compensated employees may also be eligible to participate in the Nonqualified Plan, for the purpose of receiving an amount equal to the amount of retirement contributions not credited to the participant under the Qualified Plan because of the Qualified Plan limitations, as provided in section 5.4 of the Nonqualified Plan.

Section 4.1 of the Nonqualified Plan provides that an eligible participant may elect to defer a certain portion of the participant's compensation. Pursuant to section 5.3 of the Nonqualified Plan, where a participant makes such election the participant will be credited with an amount equal to two times the deferred amount.

Section 7.1 of the Nonqualified Plan provides that all distributions from the Nonqualified Plan made to a participant are paid in a lump sum payment as soon as practicable following the participant's termination of employment by The Limited, Inc. or its affiliates, but no earlier than 30 days following the termination of employment.

Section 9.5 of the Nonqualified Plan provides that the right of a participant or beneficiary to receive a distribution under the plan shall at all times be an unsecured claim against the general assets of The Limited, Inc. or its affiliates, and neither the participant nor any beneficiary shall have any right in or against any specific assets of The Limited, Inc. or its affiliates. If a reserve of assets is established to provide funds for the payment of benefits under the plan, no participant or beneficiary shall have any ownership rights in or to any reserve.

The Limited Stores, Inc., an indirect subsidiary of The Limited, Inc., previously requested and received an Advisory Opinion regarding the withholding tax treatment of distributions from The Limited Supplemental Retirement Plan. (The Limited Stores, Inc., Adv Op Comm T&F,

September 6, 2000, TSB-A-00(6)I). The opinion held that The Limited Supplemental Retirement Plan was a plan or arrangement as described in section 3121(v)(2)(C) of the IRC, and the lump sum distributions from such plan met the requirements of section 114(b)(1)(I)(ii) of Title 4 of the US Code. The lump sum distributions from the plan received by nonresidents and nondomiciliaries of New York State were exempt from State PIT. Where affiliates of The Limited, Inc. did not have an office or transact business in New York State, the petitioner was not required to withhold State PIT or City PIT from distributions from the plan to employees of those affiliates. However, where an affiliate of The Limited, Inc. had an office or transacted business in New York State, it was required to withhold State PIT or City PIT from distributions from the plan to employees who were residents of New York State, or New York City, respectively. The opinion also held that the petitioner could rely on Form IT-2104.1 - New York State Certificate of Nonresidence and Allocation of Withholding Tax and Form IT-2104.2 - City of New York Certificate of Nonresidence, respectively, that it received from an employee of an affiliate of The Limited, Inc. to determine whether an employee was a resident of New York State or New York City, respectively. (Note that Form IT- 2104.1 has subsequently been revised, and Form IT-2104.2 is now obsolete.)

Discussion

Issue 1

Section 114(a) of Title 4 of the US Code, as added by Public Law 104-95, January 10, 1996, and applicable to amounts received after December 31, 1995, provides that "[n]o State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State)." Section 114(b)(1) of Title 4 of the US Code defines the term "retirement income" as any income from, among other things:

> (I) any plan, program, or arrangement described in section 3121(v)(2)(C) of [the IRC], if such income –
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> (i) is part of a series of substantially equal periodic payments ... or
>
> (ii) is a payment received after termination of employment and under a plan, program, or arrangement (to which such employment relates) maintained solely for the purpose of providing retirement benefits for employees in excess of the limitations imposed by 1 or more of sections 401(a)(17), 401(k), 401(m), 402(g), 403(b), 408(k), or 415 of [the IRC] or any other limitation on contributions or benefits in [the IRC] on plans to which any of such sections apply.

Section 3121(v)(2)(C) of the IRC defines a "nonqualified deferred compensation plan" as any plan or any arrangement for the deferral of compensation other than a plan described in section 3121(a)(5) of the IRC (generally, ERISA or "qualified plans").

Pursuant to section 114 of Title 4 of the US Code, New York State may not impose State PIT on the retirement income of a nonresident or nondomiciliary individual after December 31, 1995. In this case, the Nonqualified Plan is a plan or arrangement as described in section 3121(v)(2)(C) of the IRC, and the lump sum distributions from such plan meet the requirements of section 114(b)(1)(I)(ii) of Title 4 of the US Code. Therefore, for purposes of State PIT, the lump sum distributions from the Nonqualified Plan received by nonresidents and nondomiciliaries of New York State will be treated as retirement income as defined in section 114(b) of Title 4 of the US Code.

Accordingly, the lump sum distributions from the Nonqualified Plan, to distributees who have terminated their employment with The Limited, Inc. or its affiliates, and are nonresidents and nondomiciliaries of New York State, are exempt from State PIT pursuant to section 114(a) of Title 4 of the US Code.

Issue 2

Section 671(a) of the Tax Law provides that "every employer maintaining an office or transacting business within this state and making payment of any wages taxable under this article shall deduct and withhold from such wages for each payroll period a tax computed in such manner as to result, so far as practicable, in withholding from the employee's wages during each calendar year an amount substantially equivalent to the tax reasonably estimated to be due under this article resulting from the inclusion in the employee's New York adjusted gross income or New York source income of his wages received during such calendar year." (Emphasis added.)

Similarly, Section 11-1771 of the New York City Administrative Code provides that "every employer maintaining an office or transacting business within this city or state and making payment ... of any wages taxable under this chapter ... shall deduct and withhold from such wages for each payroll period a tax ..." (Emphasis added.)

Accordingly, pursuant to section 671(a) of the Tax Law, Petitioner is not required to withhold State PIT from distributions from the Nonqualified Plan that are made to employees of affiliates of The Limited, Inc. where the affiliates do not have an office or transact business in New York State. Likewise, pursuant to section 11-1771 of the New York City Administrative Code, the withholding of City PIT is not required from such distributions to employees of affiliates of The Limited, Inc. where the affiliates do not have an office or transact business in New York State.

Issue 3

Section 671(a) of the Tax Law provides that "every employer maintaining an office or transacting business within this state and making payment of any wages taxable under this article shall deduct and withhold from such wages ...." (Emphasis added.)

Similarly, section 11-1771 of the New York City Administrative Code provides that "every employer maintaining an office or transacting business within this city or state and making payment ... of any wages taxable under this chapter ...". (Emphasis added.)

Section 171.3(a) of the Personal Income Tax Regulations provides that payments which are considered wages for federal income tax withholding purposes are also wages for purposes of withholding New York State personal income tax.

Section 1309 of Article 30 of the Tax Law provides that "a tax imposed pursuant to the authority of this article shall provide that the tax shall be withheld from the wages of city residents in the same manner and subject to the same requirements, to the greatest extent possible, as provided in sections six hundred seventy-one through six hundred seventy-eight of this chapter ...." Accordingly, payments which are considered wages for purposes of withholding of New York State personal income tax are also considered wages for purposes of withholding of New York City personal income tax.

Section 31.3401(a)-1(b) of the Treasury Regulations provides that, for federal income tax purposes, in general, pensions and retirement pay are wages subject to withholding. However, no withholding is required with respect to amounts paid to an employee upon retirement which are taxable as annuities under the provisions of section 72 or 403 of the Internal Revenue Code. If a nonqualified deferred compensation plan provides for an unfunded and unsecured promise to make payments at some future point in time, payments from the plan are subject to federal income tax withholding when they are received by the employee. (See, e.g. Rev Rul 82-176, 1982-2 CB 223; Rev Rul 77-25, 1977-1 CB 301.)

Section 35.3405-1(Q&A– A-21) of the Treasury Regulations provides that:

> A-21. Q. An employer maintains a nonqualified deferred compensation plan such as a supplemental executive retirement ("top hat") plan. Payments under the plan are made in the form of a single sum payment at retirement. Amounts paid at retirement are includible in income as compensation in the year received. Must the payor withhold on these amounts according to the rules in section 3405?
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> A. No. Section 3405(d)(1)(B)(i) provides that a designated distribution on which withholding is required does not include amounts that are wages without regard to the rules of section 3405. Therefore, withholding on payments that are includible in income as compensation are based on the rules for withholding on wages contained in section 3402.

In this case, the Nonqualified Plan is a nonfunded plan, and it is assumed that the distributions to the participants from such Nonqualified Plan are wages pursuant to sections 31.3401(a)-1(b) and 35.3405-1(Q&A–A-21) of the Treasury Regulations.

Accordingly, pursuant to section 671(a) of the Tax Law, Petitioner is not required to withhold State PIT from distributions from the Nonqualified Plan that are made to employees of affiliates of The Limited, Inc. where the affiliates have an office or transact business in New York but the employees are nonresidents of New York State, because such distributions are not taxable under State PIT. (See Issue 1 above.) Since, City PIT is imposed only on residents of New York City, Petitioner is not required to withhold City PIT from distributions from the Nonqualified Plan where the employees are nonresidents of New York City.

However, the provisions of section 114 of Title 4 of the US Code, which exempt the retirement income of a nonresident or nondomiciliary individual after December 31, 1995 from State PIT do not apply to a resident individual of New York State or New York City. Accordingly, pursuant to section 671(a) of the Tax Law, withholding of State PIT is required by Petitioner from distributions from the Nonqualified Plan that are made to employees of affiliates of The Limited, Inc. where the affiliates have an office or transact business in New York State, and the employees are residents of New York State. Likewise, pursuant to section 11-1771 of the New York City Administrative Code, withholding of City PIT is required by Petitioner from distributions from the Nonqualified Plan that are made to employees of affiliates of The Limited, Inc. where the affiliates have an office or transact business in New York State, and the employees are residents of New York City.

Further, pursuant to section 171.6(b)(5) of the State PIT regulations, an employer must withhold State PIT from all wages paid to an employee who is a nonresident of New York State that performs services partly within and partly without New York State, unless there is filed with the employer a *Certificate of Nonresidence and Allocation of Withholding Tax* on Form IT-2104.1, or unless the employer maintains adequate current records to accurately determine the amount of wages from New York State sources. Therefore, Petitioner may rely on Form IT-2104.1 - New York State, City of New York and City of Yonkers Certificate of Nonresidence and Allocation of Withholding Tax (the old Form IT -2104.1 - New York State Certificate of Nonresidence and Allocation of Withholding Tax may be used if the employer already has it on file), and Form IT-2104.2 - City of New York Certificate of Nonresidence (although obsolete, this form may be used if the employer already has it on file) that Petitioner receives from an employee of an affiliate of The Limited, Inc. to determine that the employee is not a resident of New York State or New York City in determining whether it is required to withhold State PIT and City PIT, as applicable, from the distributions from the Nonqualified Plan that are made to such employee.

Finally, where Petitioner relies on Form IT-2104.1 (both old and new) or Form IT-2104.2 no penalty will be asserted if the Form that Petitioner relies on contains false information if

Petitioner has no knowledge that it is false. However, pursuant to section 685(s) of the Tax Law, where an individual makes a statement under section 671 of the Tax Law which results in a decrease in the amounts deducted and withheld under State PIT or City PIT, respectively, and as of the time such statement was made, there was no reasonable basis for such statement, such individual may be subject to the penalty imposed under section 685(s) of the Tax Law.

DATED: May 23, 2001

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