New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-09(9)I
Income Tax
July 28, 2009

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I080708D

Petitioner Lawrence Faraone, in a petition dated July 3, 2008, requests an advisory opinion regarding the Personal Income Tax treatment of distributions from an Individual Retirement Account (IRA), Internal Revenue Code § 457 Deferred Compensation Plan (457 Plan), Roth IRA or other eligible retirement plan that was funded, at least in part, by a lump sum distribution that was transferred in a direct trustee-to-trustee transfer from the New York State Police and Firefighters Retirement System to the IRA, 457 Plan, Roth IRA or other eligible retirement plan.

We conclude that distributions that are attributable to a rollover contribution to an IRA, 457 Plan, or other eligible retirement plan that is not a Roth IRA are not included in New York taxable income pursuant to §612(c)(3)(i). However, for an IRA, 457 Plan or eligible retirement plan that is not a Roth IRA, any gain or income earned on the amount of the rollover is included in Petitioner's New York taxable income to the extent that it does not qualify for the $20,000 income subtraction under Tax law §612(c)(3-a). For Roth IRAs, the amount of the rollover will not be included in New York taxable income pursuant to §612(c)(3)(i) and, pursuant to Internal Revenue Code § 408A(d), the distributions will not be included in Federal gross income.

Facts

The Petitioner is a member of the New York State Police and Firefighters Retirement System (NYPFRS). Chapter 735 of the Laws of 2006 provides that certain members of NYSPFRS may elect to receive an optional retirement benefit consisting of a partial lump sum distribution and a reduced service retirement allowance. At the member's election, the lump sum can be either (i) directly rolled over to an IRA, 457 Plan, Roth IRA, or other eligible retirement plan, or (ii) paid directly to the member. Petitioner is eligible to elect to receive the optional retirement benefit.

Analysis

Section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means the individual's federal adjusted gross income with the modifications specified in § 612. Tax Law § 612(c)(3)(i) provides that, to the extent includible in gross income for federal income tax purposes, pensions paid to officers and employees of New York State, its subdivisions and agencies will be subtracted from an individual's federal adjusted gross income (FAGI). Tax Law § 612(c)(3-a) provides that, for pensions and annuities that are not subject to the subtraction modifications provided by Tax Law § 612(c)(3), a taxpayer 59 ½ or older may subtract from FAGI up to $20,000 of any of those pensions and annuities.

In Albert Zelony, Adv Op Comm T&F, July 24, 2002, TSB-A-02(5)I, it was concluded that when a taxpayer rolls over his or her New York State pension benefits to an IRA, the amount received from the pension fund represents a nontaxable distribution, and is not subject to New York personal income tax. Any subsequent distributions from the IRA will be exempt to the extent that they represent a return of principal attributable to the pension rollover. Any other amounts received will be subject to tax.

In this case, if the Petitioner rolls over the lump sum distribution to an IRA, then as in Zelony, when the Petitioner receives distributions from the rollover IRA, only a portion of the distribution is exempt. The portion of the distribution from the rollover IRA that represents the rollover contribution from NYSPFRS is a return of the NYSPFRS contribution. If this portion of the distribution is included in the Petitioner's federal adjusted gross income, when the Petitioner computes his New York adjusted gross income, the amount of the distribution that represents the NYSPFRS contribution will qualify for the income subtraction under Tax Law § 612(c)(3)(i). This result will be the same if the Petitioner rolls over the lump sum distribution into a 457 Plan or any other type of qualified retirement plan other than a Roth IRA.

The portion of the distributions from a rollover IRA, 457 Plan, or other non-Roth IRA qualified retirement plan that does not constitute a return of any contribution to NYSPFRS is not exempt from New York State taxation. This portion of the distribution can consist of other contributions to the rollover IRA, 457 Plan, or other non-Roth IRA qualified retirement plan, as well as earnings on the amount of the NYSPFRS rollover and the other contributions. If the Petitioner has reached the age of 59½, the balance of a distribution that does not represent a return of the NYSPFRS contribution may be subtracted in computing New York adjusted gross income, but only up to $20,000. (Tax Law § 612(c)(3-a) and 20 NYCRR 112.3(c)(2).) Any excess would not be allowed as a subtraction from federal adjusted gross income when computing Petitioner's New York adjusted gross income.

Therefore, when the Petitioner receives a distribution from a rollover IRA, 457 Plan, or other non-Roth qualified retirement plan, the Petitioner must determine the portion of the distribution that is a return of the NYSPFRS contribution and the portion that is either a return of other contributions or the gains earned by the rollover IRA, 457 Plan or other non-Roth qualified retirement plan. The amount that will qualify for the income subtraction modification under Tax Law §612(c)(3)(i) is determined by multiplying the amount of the distribution by a fraction, the numerator of which is the NYSPFRS rollover contribution and the denominator of which is the current value of the IRA before the distribution. As discussed above, the portion that does not qualify for the subtraction modification under Tax Law §612(c)(3)(i) may qualify for the $20,000 income subtraction under Tax Law § 612(c)(3-a). This amount is determined by subtracting the amount that is determined to be the portion that is the return of the NYSPFRS rollover contribution from the amount of the distribution. Further, the portion of the distribution that is deemed to be a return of the NYSPFRS rollover contribution reduces the balance of the NYSPFRS rollover contribution in the IRA, 457 Plan, or other non-Roth qualified retirement plan. In the next taxable year, when determining the portion of a distribution that is a return of the NYSPFRS contribution to the rollover IRA, 457 Plan, or other non-Roth qualified retirement plan, the Petitioner will use the most recently computed balance of the NYSPFRS rollover contribution in the numerator.

If the Petitioner elects to rollover the lump sum distribution to a Roth IRA, any amount of the rollover that is included in Federal adjusted gross income pursuant to Internal Revenue Code § 408A will qualify for the income subtraction under Tax Law § 612(c)(3)(i) because it is a return of the Petitioner's contribution to NYSPFRS. Pursuant to Internal Revenue Code § 408A(d), the distributions from the Roth IRA will not be included in Federal gross income, and thus will not be taxable in New York.

Accordingly, pursuant to Tax Law §612(c)(3)(i), the Petitioner is allowed to subtract from the Petitioner's FAGI the portion of the distribution from an IRA, 457 Plan, or other non-Roth qualified retirement plan that is attributable to the Petitioner's NYSPFRS rollover contribution that is included in the Petitioner's FAGI. Further, if Petitioner has attained the age of 59½, any distributions from a rollover IRA, 457 Plan, or other non-Roth qualified retirement plan that do not constitute a return of the Petitioner's NYSPFRS rollover contribution may be subtracted from Petitioner's FAGI to the extent that the distributions, when added to any other pension and annuity income that is not subject to the modification provided by Tax Law §612(c)(3), do not exceed $20,000 and were included in Petitioner's FAGI. If the Petitioner directs that the lump sum be rolled over into a Roth IRA, the amount of the rollover will not be included in New York taxable income pursuant to §612(c)(3)(i) and, pursuant to Internal Revenue Code § 408A(d), the distributions will not be included in Federal gross income.

DATED: July 28, 2009

/S/
Jonathan Pessen
Director of Advisory Opinions
Office of Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.