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

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Income Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I090617A

Petitioner [redacted], in a petition dated June 17, 2009, requests an advisory opinion regarding whether the distributions from a nonqualified deferred compensation plan consisting of an unfunded contractual promise to make payments in the future (the Plan) that is sponsored by his former employer (Employer) qualify for the $20,000 income subtraction under Tax Law section 612(c)(3-a). If it is determined that the distributions qualify for the income subtraction, Petitioner further requests guidance concerning how the distributions should be reported on his New York State Personal Income Tax return.

We conclude that, because the Plan distributions qualify as pension income, the $20,000 income subtraction under Tax Law section 612(c)(3-a) is allowable. The amount listed in box 11 of the Federal form W-2 that Petitioner receives from the Plan should be reported to New York State as pension income.

Facts

The Plan is an unfunded contractual agreement between Petitioner and his former Employer under which Petitioner provided services to Employer in exchange for Employer's promise that Petitioner would receive payment for such services over a period of time after he met certain qualifications, such as age. Petitioner, who has attained the age of 59 ½, receives distributions from the Plan. The payments from the Plan are periodic and will continue for at least ten years.

Analysis

Section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual is the individual's Federal adjusted gross income (FAGI) with the modifications specified in section 612. Tax Law section 612(c)(3)(i) provides a subtraction modification for pensions paid to officers and employees of New York State, its subdivisions and agencies, to the extent included in FAGI, while Tax Law section 612(c)(3)(ii) provides a similar subtraction for pensions paid to officers and employees of the United States, the District of Columbia, any territory, possession or political subdivision of any territory or possession. Additionally, up to $20,000 of income that was included in FAGI due to distributions from pensions and annuities that are not subject to the subtraction modifications provided by Tax Law section 612(c)(3) are eligible for the subtraction modification provided by Tax Law section 612(c)(3-a) if the taxpayer is at least 59 ½, and the distributions are "periodic payments attributable to personal services performed by such individual prior to his retirement from employment, which arise (i) from an employer-employee relationship." (Tax Law § 612[c][3-a].)

While not binding on the Department, in two determinations issued by the Division of Tax Appeals *Matter of Bourns* (DTA No. 821404 [February 21, 2008]) and *Matter of Musliner* (DTA No. 821426 [Small Claims Determination, March 13, 2008]), distributions from similar nonqualified plans were found to constitute pension and annuity income that is eligible for the subtraction modification provided by Tax Law section 612(c)(3-a). In both *Bourns* and *Musliner*, the Department argued that the

distributions were reported to the taxpayers on Federal Form W-2, which evidenced that the payments constituted wages and, thus, were not eligible for the pension and annuity income subtraction modification afforded by Tax Law section 612(c)(3-a).

A different conclusion was reached in *Matter of Flanter*, (DTA No. 818698 [August 22, 2002], *aff'd* Tax Appeals Tribunal [February 27, 2003]) where the distributions at issue were made by an Internal Revenue Code (IRC) former section 457 plan. In *Flanter*, the Administrative Law Judge concluded that pursuant to the Internal Revenue Code and Treasury Regulations (26 C.F.R.), distributions from an IRC former section 457 plan were deemed to be wages, not payments from a pension or annuity, and, thus, were not eligible for the subtraction modification afforded by Tax Law section 612(c)(3-a). *Flanter* has been rendered moot since the Federal Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. Law 107-16) amended IRC section 3401 to provide that remuneration paid to an employee under an IRC 457 plan does not constitute wages for IRC Chapter 24 purposes. *See* IRC §3401(a)(12)(E).

The issue presented requires a two-step analysis. First, what is the proper characterization of the distributions received from the Plan? Second, do distributions from the Plan constitute "pensions and annuities" income within the purview of Tax Law § 612(c)(3-a)?

Characterization of the Distributions from the Plan

The question of whether deferred compensation distributed from a retirement plan can be characterized as both "wages" and "pension and annuity" income was addressed in *Flanter*, *Bourns* and *Musliner*. In *Flanter*, the Administrative Law Judge concluded that distributions from an IRC former § 457 plan could not be "pension and annuity" income because the distributions were "wages" pursuant to IRC section 3401(a) as it existed prior to the enactment of the Federal Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. Law 107-16). The Administrative Law Judge in *Bourns* specifically rejected the argument that any distributions that are "wages" for income tax withholding purposes cannot also be characterized as "pensions and annuities" income within the purview of Tax Law section 612(c)(3-a).

Amounts deferred under a nonqualified deferred compensation plan are considered to be "wages" for the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA), which are IRC Subtitle C Employment Taxes. (*See*, IRC §§ 3121[a], and 3306[b].) Each of these employment taxes is individually codified in a specific Chapter of the IRC. (*See*, IRC Subtitle C, Chapters 21 and 23.) Each Chapter includes a definition of "wages" that, through the use of language "[f]or purposes of this chapter," is limited to that specific Chapter of the IRC. (IRC §§ 3121[a] and 3306[b].) Due to the statutory limitations placed on the applicability of these definitions, they cannot be relied upon to determine the character of distributions for income tax (IRC Subtitle A) purposes.

For Federal income tax purposes, the taxation of unfunded nonqualified deferred compensation plans is governed by IRC sections 83 and 409A.[1] Section 409A, which includes provisions for the constructive receipt and recognition of all unrecognized deferred compensation when a nonqualified plan fails to meet specified statutory criteria, is not at issue here. Thus, the Plan is taxable pursuant to IRC section 83. Pursuant to IRC section 83, property that is transferred to a person in exchange for the provision of services is included in the person's gross income as compensation in the first taxable year

[1] If the Plan had been funded through either a nonexempt trust or the use of an annuity, the provisions of IRC sections 402(b) or 403(c), respectively, would also apply to the Plan.

that either (i) the person's right to the property is not subject to a substantial risk of forfeiture or (ii) the person's rights in the property are transferrable. (IRC § 83[a]; 26 CFR § 1.83-1[a][1].)

Accordingly, each amount taxable to Petitioner will be characterized based upon the provision of the IRC under which the tax is imposed. For FICA and FUTA the amounts are characterized as "wages." For income tax purposes, the amounts included in Petitioner's income are characterized as "compensation." Thus, a single distribution from the Plan could constitute both "wages" for employment tax purposes and "compensation" for income tax purposes. (*See,* Rev. Rul 2007-48, I.R.B. 2007-30 [July 23, 2007].)

"Pensions and Annuities" Income Pursuant to Tax Law section 612(c)(3-a)

For New York State residents, the starting point for the computation of personal income tax liability is FAGI. (Tax Law § 612.) Gross income includes "[c]ompensation for services, including fees, commissions, fringe benefits, and similar items." (IRC § 61[a][1]). The Treasury Regulations interpret IRC section 61(a)(1) to include, among other things, wages, "retired pay of employees, pensions, and retirement allowances." (*See*, 26 CFR § 1.61-2[a][1]). FAGI is defined as gross income minus the deductions prescribed by IRC section 62, none of which are relevant to this opinion. (IRC § 62.) Thus, although not wages, the Plan distributions are part of FAGI and are taxable unless subject to a New York subtraction modification.

Section 612(c)(3-a) provides a subtraction modification up to $20,000 for compensation included in FAGI if the recipient has attained the age of fifty-nine and one-half and if the money is paid in periodic payments and is attributable to personal services performed by the recipient for his or her employer prior to retirement. The amounts that Petitioner receives from the Plan are only paid after his separation from service to his employer and are paid annually in the month of January. Since Petitioner has attained the age of fifty-nine and one-half, these payments qualify as pension payments. Accordingly, the distributions received by Petitioner from the Plan constitute "pensions and annuities" income within the purview of Tax Law §612(c)(3-a) and are eligible for the subtraction modification afforded by such section to the extent that the distributions, when added to any other pension and annuity income, do not exceed $20,000 and were included in Petitioner's FAGI. Petitioner will report the distributions received from the Plan as pensions and annuities income.

DATED: February 10, 2010

/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.