New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-97(6)I
Income Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I960718D

On July 18, 1996, a Petition for Advisory Opinion was received from Mitchell M. Gitin, c/o Peter Gold, 280 North Central Avenue, Hartsdale, New York 10530.

The issue raised by Petitioner, Mitchell M. Gitin, is whether income assigned to his ex-wife incident to a divorce and paid to her in 1992 and 1993 must be included in Petitioner's New York adjusted gross income under Article 22 of the Tax Law for 1992 and 1993, respectively.

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

Pursuant to a separation agreement entered into in 1992 by Petitioner and his former wife, Rena Gitin, Rena was to receive $713,333 in 16 equal quarterly installments. That amount represented 40.5 percent of the $1,760,920 due to Petitioner as his partnership share of the income of his former partnership. The amount owed to Petitioner accrued during the time he was a partner, and was also payable in 16 equal quarterly installments. Because of adjustments created by the subsequent payment of partnership expenses properly chargeable against the amount owed Petitioner, his ex-wife was paid the sum of $150,856 in 1992, and $131,099 in 1993. These amounts represented 40.5 percent of the total amount paid by the partnership to Petitioner in each of those years. These amounts do not constitute alimony payments because the payment of these amounts would continue in the event of her death. The agreement provided that Petitioner's ex-wife was to include the payments of partnership income that she received as income for personal income tax purposes.

Section 612(a) of the Tax Law provides: "[t]he New York adjusted gross income of a resident individual means [the individual's] federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in this section." Under section 612 of the Tax Law, there are no modifications that would affect the income at issue in this case.

When computing federal adjusted gross income pursuant to the Internal Revenue Code ("IRC"), section 61(a) of the IRC provides that, unless otherwise excluded by law, gross income means all income from whatever source derived.

Section 1041(a) of the IRC provides that no gain or loss will be recognized on a transfer of property from an individual to a former spouse if the transfer is incident to a divorce. The effect of section 1041 of the IRC is to defer the recognition of gain or loss until the transferee disposes of the property. Temporary regulation section 1.1041-1T(a) of the Treasury Income Tax Regulations provides that only transfers of property (whether real or personal, tangible or intangible) are governed by section 1041 and that transfers of services are not subject to the rules of section 1041.

Internal Revenue Ruling 87-112 (1987-2 CB 207), provides that although section 1041(a) of the IRC "shields from recognition gain that would ordinarily be recognized on a sale or exchange of property, it does not shield from recognition income that is ordinarily recognized upon the assignment of that income to another taxpayer." The ruling held that the income at issue was accrued but unrecognized interest, rather than gain, and section 1041 of the IRC did not shield that income from recognition. Accordingly, the specific rule of section 1.454-1(a) of the Treasury Income Tax Regulations for dispositions of interest-deferred obligations applies to require that the transferor include the accrued interest in income in the year of the transfer.

In Balding v. Commissioner, 98 TC 368, Dec. 48,116, (1992) it was held that payments received by an ex-wife in settlement of her claim to a community property share of her ex-husband's military retirement pay were to be treated as nontaxable gifts, pursuant to sections 1041 and 102 of the IRC, and that they were excludable from the ex-wife's gross income. The ex-wife relinquished any claim to the ex-husband's military retirement pay (and agreed not to bring any further claims with regard to marital property) in consideration of the ex-husband's promise to pay to her $15,000, $14,000 and $13,000 in 1986, 1987 and 1988, respectively. These settlement payments to the ex-wife were not considered to be an anticipatory assignment of income.

In Kochansky v Commissioner, 67 TCM 2665, Dec. 49,785(M), TC Memo. 1994-160, affd 92 F.3d 957, an attorney who assigned his fee from a medical malpractice case to his former wife pursuant to their property settlement was required to include the fee in his gross income, notwithstanding that his ex-wife's share was paid to her. Even though the fee was contingent at the time of assignment, he provided the legal services in the case that generated the fee and, thus, earned the income prior to the assignment. The Tax Court stated:

> [w]e start with the basic proposition that income is taxed to those who earn it. Lucas v. Earl, 281 US 111, 114,115 (1930); Helvering v. Horst, 311 US 112, 115-117 (1940); Helvering v. Eubank, 311 US 122, 124-125 (1940). This proposition has been described as "One of the primary principles of our system of income taxation". Vercio v. Commissioner, 73 TC 1246, 1253 (1980). Thus, when income has been assigned to another, "The choice of the proper taxpayer revolves around the question of which person ... in fact controls the earning of the income rather than the question of who ultimately receives the income. Id. at 1253; Vnuk v. Commissioner, 621 F2d 1318, 1320 (8th Cir 1980), affg. [Dec. 36,037(M)] TC Memo. 1979-164.
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> In the instant case, there is no dispute as to whose efforts produced the income here at issue.... There is nothing in the record to suggest that the assigned income was earned by any person other than petitioner. Nor has the petitioner even attempted to argue otherwise. Since the assigned income was clearly earned by petitioner, he is taxable on the assignment of it, pursuant to the principle established in Lucas v. Earl, supra. ...

> Petitioner ... assigned compensation earned through the performance of his services as an attorney. The fact that his stake in the lawsuit was contingent on the outcome of future events does not make it any less compensatory. Cf. Wilkinson v. United States 157 Ct. Cl. 847, 304 F2d 469, 473-474, 477 (1962).... In short, petitioner transferred personal service income and not income producing property to his ex-wife....

In Berger v Commissioner, 71 TCM 2160, Dec. 51,179(M), 1996-76, the Tax Court held that the nonrecognition rule in section 1041 of the IRC did not bar application of the clear reflection of income rule where property with economically accrued income elements was transferred. In the case, which involved the transfer by a husband to his wife of his share of a cemetery business, the court held that although the husband recognized no gain on the transfer under the nonrecognition rule, the transfer triggered the accrual of the husband's share of the income from crypt sales that had been previously deferred and that would not have been otherwise includable in income until the completion of the mausoleum. The Tax Court stated that:

> [a]n assignment of income is generally disregarded unless the underlying income-producing property is also transferred. See generally, 3 Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, ch.75 (2d ed. 1991 & Supp. 1995). Usually there is no property underlying personal service income so that assignment of personal service income is disregarded, and the taxpayer who earned the income is taxed on it under Lucas v Earl, [supra]....

In the instant case, Petitioner was due $1,760,920 as his partnership share of the income of his former partnership. The amount owed Petitioner accrued during the time he was a partner, and was payable in 16 equal quarterly installments. Pursuant to a separation agreement entered into in 1992 by Petitioner and his former wife, she was to receive $713,333 in 16 equal quarterly installments, which was 40.5 percent of Petitioner's partnership income. After the adjustments properly chargeable against the amount owed Petitioner for partnership expenses, Petitioner's ex-wife was paid $150,856 in 1992, and $131,099 in 1993, representing 40.5 percent of the amount received by Petitioner.

Pursuant to temporary regulation section 1.1041-1T(a) of the Treasury Income Tax Regulations, transfers of services are not subject to the rules of section 1041 of the IRC. As explained in Rev Rul 87-112, supra, Ltr Rul 8820086, Kochansky, supra, and Berger, supra, section 1041 of the IRC does not shield from recognition income that is ordinarily recognized upon the assignment of that income to another taxpayer. Usually there is no property underlying personal service income and that the assignment of personal service income is disregarded and the taxpayer who earned the income is taxed on it. These cases are distinguished from Balding, supra, where the settlement payments received by the ex-wife in return for the ex-wife's relinquishment of her claim to the ex-husband's military retirement pay were not considered to be an assignment of the ex-husband's military retirement pay.

Accordingly, in the instant case, the amounts paid to Petitioner's ex-wife in 1992 and 1993 pursuant to the separation agreement constitute the assignment of the income owed to Petitioner as his share of partnership income that accrued during the time he was a partner of the former partnership. Since these amounts were earned by the Petitioner, the Petitioner recognizes the income upon the assignment of it. Therefore, when computing Petitioner's New York adjusted gross income under section 612 of the Tax Law, these amounts should be included in Petitioner's starting point, federal adjusted gross income computed pursuant to section 61 of the IRC for those years.

/s/
DATED: August 6, 1997 John W. Bartlett
Deputy Director
Technical Services Bureau

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