

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

TSB-A-02(2)I
Income Tax
July 24, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I010726A

On July 26, 2001, a Petition for Advisory Opinion was received from Edward B. Gorewitz, 135 Ashland Place, Apt 9-A, Brooklyn, New York 11201.

The issues raised by Petitioner, Edward B. Gorewitz, are:

1. Whether distributions from a section 457 of the Internal Revenue Code deferred compensation plan qualify for the pension and annuity exclusion up to \$20,000, under section 612(c)(3-a) of the Tax Law, beginning in 2002 as a result of the Federal Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16.
2. Whether (a) such distributions may be rolled over into an individual retirement account (IRA) tax-free, and (b) distributions made from the IRA will qualify for the exclusion under such section 612(c)(3-a) of the Tax Law.

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

Petitioner is a retired New York State employee who is a participant in the New York State Deferred Compensation Plan which is a government deferred compensation plan under section 457 of the Internal Revenue Code ("IRC"). Petitioner expects to begin taking distributions from the plan effective June 2002.

Applicable Law and Regulations

Section 607(a) of the Tax Law provides that for purposes of New York personal income tax, "[a]ny term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute...."

Federal Law

Section 457(a) of the IRC provides:

- (1) In general. – Any amount of compensation deferred under an eligible deferred compensation plan, and any income attributable to the amounts so deferred,

shall be includible in gross income only for the taxable year in which such compensation or other income —

(A) is paid to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(A), and

(B) is paid or otherwise made available to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(B).

(2) Special rule for rollover amounts. — To the extent provided in section 72(t)(9), section 72(t) shall apply to any amount includible in gross income under this subsection.

Section 457(b) of the IRC provides that the term “eligible deferred compensation plan” means “a plan established and maintained by an eligible employer (1) in which only individuals who perform service for the employer may be participants.”

Section 457(e)(1) of the IRC provides that the term “eligible employer” means:

(A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and

(B) any other organization (other than a governmental unit) exempt from tax under this subtitle [A].

The Federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), in part, amended sections 402 (taxability of beneficiary of employees’ trust), 457 (deferred compensation plans) and 3401 (defining wages for withholding tax purposes) of the IRC to allow for trustee-to-trustee transfers between eligible deferred compensation plans established and maintained by eligible employers under section 457(e)(1)(A) (“section 457 government plans”) and eligible retirement plans under section 402(c)(8)(B) of the IRC, and to change the characterization of distributions from section 457 government plans, effective January 1, 2002.

EGTRRA added section 457(e)(16) of the IRC, which provides, in pertinent part:

Rollover Amounts. — (A) General Rule. — In the case of an eligible deferred compensation plan established and maintained by an employer described in subsection (e)(1)(A) [of section 457] if —

(i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4)),

(ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and

(iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid....

Section 402(c)(4) of the IRC defines the term “eligible rollover distribution,” in part, as follows:

For purposes of this subsection, the term “eligible rollover distribution” means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include –

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made –

(i) for the life ... of the employee ..., or

(ii) for a specified period of 10 years or more,

(B) any distribution to the extent such distribution is required under section 401(a)(9) , and

(C) any distribution which is made upon hardship of the employee.

Section 402(c)(8)(B) of the IRC provides that the term “eligible retirement plan” means:

(i) an individual retirement account described in section 408(a),

(ii) an individual retirement annuity described in section 408(b) (other than an endowment contract),

(iii) a qualified trust,

(iv) an annuity plan described in section 403(a),

(v) an eligible deferred compensation plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), and

(vi) an annuity contract described in section 403(b).

EGTRRA added section 3401(a)(12)(E) of the IRC. Section 3401(a) of the IRC provides, in part:

Wages. – For purposes of this chapter, the term “wages” means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid

* * *

(12) to, or on behalf of, an employee or his beneficiary

* * *

(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A)....

New York Law and Regulations

Section 612(a) of the Tax Law defines New York adjusted gross income of a resident individual as the individual's federal adjusted gross income with certain modifications. Section 612(c)(3) of the Tax Law and section 112.3(c)(1) of the Personal Income Tax Regulations (“Regulations”) contain a subtraction modification for pensions and other retirement benefits paid to public officers and public employees of New York State, its political subdivisions or agencies or the Federal government. Section 112.3(c)(1)(i) of the Regulations provides, in part:

Retirement benefits provided for in clauses (a) and (b) of this subparagraph which are included in Federal adjusted gross income, relate to services performed as public officers or public employees and all or a portion of which are actually contributed to (rather than merely being deemed contributed to) by New York State, its political subdivisions or agencies or the Federal government, shall be subtracted in computing New York adjusted gross income:

(a) pensions and other retirement benefits (including, but not limited to, annuities, interest and lump sum payments) paid to a public officer or public employee ... of New York, its political subdivisions or agencies;

(b) pensions and other retirement benefits (including but not limited to annuities, interest and lump sum payments) paid to a public officer or public employee ... of the United States, its territories or possessions, or political subdivisions of such territories or possessions, the District of Columbia, or any agency or instrumentality of any one of the foregoing.

Section 612(c)(3-a) of the Tax Law contains a subtraction modification for pension and annuity income, other than pensions and other retirement benefits paid to public officers and public employees of New York State, its political subdivisions or agencies or the federal government that are exempt pursuant to section 612(c)(3) of the Tax Law.

Section 612(c)(3-a) of the Tax Law and section 112.3(c)(2)(i) of the Regulations provide that pension and annuity income not in excess of \$20,000, received by an individual, may be subtracted in determining the individual's New York adjusted gross income provided the following conditions are met:

(a) the pension and annuity income must be included in federal adjusted gross income;

(b) the pension and annuity income must be received in periodic payments (except distributions from an individual retirement account [IRA] or self-employed retirement plan [Keogh]);

(c) the pension and annuity income must be attributable to personal services performed by such individual, prior to such individual's retirement from employment, which arises from either an employer-employee relationship or from contributions to a retirement plan which are tax deductible under the Internal Revenue Code (*e.g.*, IRA or Keogh); and

(d) such individual receiving the pension and annuity income must be 59 ½ years of age or over.

Opinion

The New York State Deferred Compensation Plan was established and is maintained under the provisions of section 457 of the IRC for public employees of New York State and its political subdivisions. Pursuant to Department of Taxation and Finance Technical Services Bureau

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Memorandum TSB-M-85-(16)I, December 27, 1985, distributions from the New York State Deferred Compensation Plan do not qualify for the exclusion for New York State pension and other retirement benefits that is contained in section 612(c)(3) of the Tax Law.

Further, prior to January 1, 2002, the effective date of the pertinent EGTRRA provisions, distributions from the New York State Deferred Compensation Plan were not considered to be pension and annuity income under section 612(c)(3-a) of the Tax Law. Pursuant to section 607(a) of the Tax Law, terms have the same meaning for personal income tax purposes as under the IRC, and prior to January 1, 2002, such distributions were considered to be wages under section 35.3405-1T, A-23 of the Treasury Regulations, and did not qualify as pensions or annuities for federal income tax purposes. (See Richard C. Spaulding, Adv Op Comm T&F, April 12, 1988, TSB-A-88-(4)I.)

However, as a result of EGTRRA's addition of section 3401(a)(12)(E) of the IRC, effective January 1, 2002, section 457 government plan distributions are excluded from the definition of the term "wages" for federal income tax purposes. Therefore, effective January 1, 2002, distributions from the New York State Deferred Compensation Plan are treated as pension and annuity income under such section 612(c)(3-a) of the Tax Law. Further, effective January 1, 2002, a distribution that meets the rollover requirements of new section 457(e)(16) of the IRC will not be subject to tax under section 612 of the Tax Law for the year of rollover. When funds are rolled over from the New York State Deferred Compensation Plan to either an IRA or other qualified plan, distributions made from the IRA or other qualified plan will be treated as pension and annuity income under section 612(c)(3-a) of the Tax Law in the year of distribution.

Accordingly, with respect to Issue 1, Petitioner's distributions from the New York State Deferred Compensation Plan will be treated as pension and annuity income under section 612(c)(3-a) of the Tax Law. If Petitioner meets all of the conditions of such section 612(c)(3-a), Petitioner's distributions from the New York State Deferred Compensation Plan, up to \$20,000 for a taxable year, may be excluded when Petitioner computes his New York adjusted gross income under section 612 of the Tax Law. To meet the conditions of section 612(c)(3-a) of the Tax Law, Petitioner must be at least 59 ½ years of age, the distributions must be made in periodic payments, and the distributions must be included in federal adjusted gross income.

With respect to Issue 2, where Petitioner's distributions from the New York State Deferred Compensation Plan are rolled over into an IRA pursuant to the provisions of section 457(e)(16) of the IRC, such distributions are not subject to tax for the taxable year of the rollover. For the taxable year that Petitioner receives distributions from such IRA, the distributions will be treated as pension and annuity income under section 612(c)(3-a) of the Tax Law. If Petitioner is 59 ½ years of age when he receives the distributions from such IRA, and the distributions are included in federal adjusted gross income, Petitioner may exclude up to \$20,000 of such distributions, pursuant to section 612(c)(3-a) of the Tax Law, when he computes his New York adjusted gross income under section 612 of the Tax Law. Note that for any taxable year that Petitioner also has other pension and

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annuity income described in section 612(c)(3-a) of the Tax Law that is eligible for exclusion, the total exclusion may not exceed \$20,000.

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/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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