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

TSB-A-00(7)I
Income Tax
September 6, 2000

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I000413A

On April 13, 2000, a Petition for Advisory Opinion was received from Howard F. Gordon, 500 Ridgefield Road, Wilton, Connecticut 06897.

The issue raised by Petitioner, Howard F. Gordon, is whether his severance pay is subject to New York State personal income tax under Article 22 of the Tax Law.

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

Petitioner is a resident of Connecticut. Petitioner was employed as a Sales Director by a New York State corporation until December 3, 1999. Through 1999, Petitioner filed his New York State personal income tax returns reporting New York wages based on the number of working days in New York State.

Petitioner will receive monthly severance pay until August 31, 2000. Petitioner will not work in New York State at any time during 2000.

Discussion

Section 601(e) of the Tax Law imposes a personal income tax for each taxable year on a nonresident individual's taxable income which is derived from sources in New York State. The tax is computed as if the individual were a resident, reduced by certain credits, and apportioned to New York by the New York source fraction, the numerator of which is the individual's New York source income and the denominator of which is the individual's New York adjusted gross income.

Section 631(a) of the Tax Law provides that the New York source income of a nonresident individual includes the net amount of items of income, gain, loss and deduction entering into the individual's federal adjusted gross income derived from or connected with New York sources.

Section 631(b)(1)(B) of the Tax Law provides that items of income, gain, loss and deduction derived from or connected with New York sources include those items attributable to a business, trade, profession or occupation carried on in New York State.

For purposes of determining New York source income, section 132.4(b) of the Personal Income Tax Regulations ("Regulations") provides that a nonresident individual, rendering personal services as an employee, includes the compensation for personal services entering into the individual's federal adjusted gross income to the extent that the individual's services were rendered

within New York State. Where the personal services are performed within and without New York State, the portion of the compensation attributable to the services performed within New York State must be determined in accordance with sections 132.16 through 132.18 of the Regulations.

Section 132.4(d)(1) of the Regulations provides that where an individual formerly employed in New York State is retired from service and thereafter receives a pension or other retirement benefit attributable to the individual's former services, the pension or retirement benefit is not taxable for New York State personal income tax purposes if the individual receiving it is a nonresident and if it constitutes an *annuity*. Where a pension or other retirement benefit does not constitute an annuity, it is compensation for personal services, and if the individual receiving it is a nonresident, it is included in New York source income to the extent that the services were performed in New York State. The term *compensation for personal services* includes, but is not limited to, amounts received in connection with the termination of employment, amounts received upon early retirement in consideration of past services rendered.

Section 132.20 of the Regulations provides that if a pension or other retirement benefit does not qualify as an annuity under section 132.4(d) of the Regulations and is attributable to services performed partly within and partly without New York State, the amount includible in the individual's New York source income is determined as follows. Multiply the amount of the pension or other retirement benefit by a fraction, the numerator of which is the amount of total compensation, included in the individual's federal adjusted gross income, that was received from the employer for the services performed in New York State during a period consisting of the portion of the taxable year prior to retirement and the three taxable years immediately preceding the retirement, and the denominator of which is the total compensation, included in the individual's federal adjusted gross income, that was received from the employer during such period for services performed both within and without New York State. The compensation for services performed within New York State must be determined separately for each taxable year or portion of a year in accordance with the applicable provisions of section 132.17, 132.18 or 132.19 of the Regulations. A determination of the portion of a pension or other retirement benefit attributable to New York State on the basis of a period of time greater than that period referred to above may be made if the individual establishes, to the satisfaction of the Commissioner of Taxation and Finance, the amount of the individual's total yearly compensation for a longer period of time and the amount allocable to New York State in each year in accordance with the applicable provisions of section 132.17 through 132.19 of the Regulations.

In Matter of Donahue v Chu, 104 AD2d 523, the nonresident taxpayer entered into a five-year employment contract with his New York employer. The agreement provided that at the conclusion of the five-year period, the taxpayer would provide consulting services over the next ten years at the rate of $20,000 per year. In the fifth year of the contract, the taxpayer and the employer entered into a second agreement terminating the initial employment agreement. As consideration for the relinquishment of these future rights, the taxpayer received the remainder of his final year's salary, as well as the sum of $107,361. The Court held that the payment was not New York source

income, because the right to future employment was originally secured by consideration having no connection with New York (i.e., the promise to work in the future). When the taxpayer entered into the contract, he had secured a right to future employment. In the later agreement, which terminated the employment contract, the taxpayer received a payment in exchange for relinquishing this right.

In Matter of John A and Deborah D. Laurino, Dec St Tax Trib, May 20, 1993, TSB-D-93-(8)I, the Tribunal stated that it read Donahue, supra, to stand for the proposition that where a nonresident possesses a right to future employment secured by consideration having no connection with New York, and relinquishes that right in exchange for a lump sum settlement, the lump sum settlement is not taxable to New York. It concluded "that in determining whether income is 'derived from or connected with New York sources' it is necessary to identify the activity upon which the income was secured or earned (Matter of Halloran, [Tax Appeals Tribunal, August 2, 1990]. Thus, in making this determination, the consideration given by [John Laurino] in exchange for the right to the income at issue is the controlling factor." In Laurino, what the employer sought from the petitioner in exchange for the right to a lump sum payment was the petitioner's act of continued service up to the time that a change of control in the corporation occurred. Because it was this continuing service to the employer performed by the petitioner predominantly in New York which constituted the consideration for the lump sum payment, the percentage of this payment allocated to New York was properly taxed, as it was derived from or connected with New York sources. There was no merit to the petitioner's argument that the lump sum payment was an alternative to future employment which would have occurred outside New York and, thus, was not taxable to New York.

In Matter of Peter F. and Barbara D. McSpadden, Dec St Tax Trib, September 15, 1994, TSB-D-94-(32)I, the petitioner's employment contract provided petitioner with employment through December 31, 1990. Petitioner and his employer negotiated a settlement wherein it was agreed petitioner would relinquish his contractual rights under the employment agreement in exchange for a lump sum payment. Petitioner's rights under the employment agreement were originally secured by consideration having no connection to New York, i.e., petitioner's promise to work for the corporation in the future. Therefore, the petitioner was compensated for all services rendered up to his termination date of May 18, 1988, and was owed no monies for past services. He did not perform any future services or employment of any nature and thus was not paid upon retirement for consultation services. The payment was not severance pay, nor was it made in exchange for a covenant not to compete. The Tribunal held that the payment in question was not compensation for personal services rendered, but rather was a payment made in exchange for the taxpayer's relinquishment of a future contractual right to employment and was not subject to New York State personal income tax.

Accordingly, unless there was a contractual employment relationship and the termination pay is in exchange for the employee's right to future employment, the payment is considered to be for prior services and is New York source income to a nonresident (Laurino, supra,). If the severance

payments are compensation for personal services that are attributable to past services rendered within New York State such payments are included in the New York source income for taxable year 2000 pursuant to section 631 of the Tax Law. However, if the severance payments are compensation for personal services that are attributable to past services rendered within and without New York State pursuant to section 132.4(d) of the Regulations, the portion of Petitioner's severance pay that is attributable to New York sources is determined based on the provisions of section 132.20 of the Regulations. Petitioner states that in prior years, he determined his compensation for services performed within New York State by the method contained in section 132.18 of the Regulations, which is based on the number of working days in New York for the taxable year divided by the total number of working days for the taxable year. This method should be used to attribute the severance pay that is attributable to past services rendered within New York State using the period consisting of the portion of the taxable year prior to retirement and the three taxable years immediately preceding the retirement, as set forth in section 132.20 of the Regulations.

If the severance payments are compensation in exchange for Petitioner's right to future employment, the payments are not considered a payment for prior services performed, and such payments would not be included in New York source income for taxable year 2000 pursuant to section 631 of the Tax Law.

DATED: September 6, 2000

/s/
John W. Bartlett
Deputy Director
Technical Services Division

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