

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

TSB-A-05(3)I
Income Tax
April 27, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I040507B

On May 7, 2004, a Petition for Advisory Opinion was received from New York State United Teachers Benefit Trust, c/o Gerald John DeWolf, Esq., New York State United Teachers Special Counsel, 800 Troy-Schenectady Road, Latham, New York 12110-2455.

The issue raised by Petitioner, New York State United Teachers Benefit Trust, is whether a retired New York State public school teacher's Internal Revenue Code (IRC) section 403(b) tax deferred annuity (TDA) plan distributions are exempt from New York personal income tax, pursuant to section 612(c)(3)(i) of the Tax Law, where the TDA plan salary reduction contributions were made pursuant to section 3109 of the New York Education Law.

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

Petitioner is a tax exempt entity under IRC section 501(c)(5). Petitioner offers a wide variety of health and welfare and financial related benefits to the members of the New York State United Teachers, a statewide voluntary membership association. Petitioner sponsors two TDA programs for its members. In excess of 200,000 members are eligible to participate in one or both of the TDA programs.

Both of Petitioner's TDA programs are authorized by and comply with all IRC section 403(b) rules and regulations. The annuity contracts within such programs:

- (a) are nontransferable by the employee;
- (b) specify the dollar limit on salary reduction contributions;
- (c) require minimum distributions after age 70 ½;
- (d) limit withdrawals of accumulations attributable to salary reduction contributions; and
- (e) provide for the direct rollover of eligible rollover distributions;

all in accordance with the provisions of IRC section 403(b).

By signing a salary reduction agreement, eligible participants authorize their employer to deduct pre-tax contributions from their salary (elective salary reduction contributions). The

amount deducted is put into the TDA and is invested for a participant's retirement. If the participant's employer permits, he or she may participate in both TDA programs provided that maximum allowable contributions are not exceeded. Eligible participants' employers may also make non-elective and matching contributions.

Applicable law and regulations

IRC section 403(b)(1) contains employee annuity provisions for a beneficiary under an annuity purchased by a public school, and provides, in part:

General rule. If -

(A) an annuity contract is purchased -

(i) for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) for an employee (other than an employee described in clause (i)), who performs services for an educational organization described in section 170(b)(1)(A)(ii), by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing . . .

* * *

(B) such annuity contract is not subject to subsection (a),

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums, [and]

* * *

(E) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30),

then contributions and other additions by such employer for such annuity contract shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such contributions and additions (when expressed as an annual addition (within the meaning of section 415(c)(2))) does not exceed the applicable limit under section 415. The amount actually distributed to any distributee under such contract shall be taxable to the distributee (in the year in which so distributed) under section 72 (relating to annuities). . . .

Section 3109 of the Education Law provides, in part:

Each board of education, trustee or trustees in any school district, and each board of cooperative educational services or county vocational education and extension board, in its discretion, may enter into a written agreement with any employee of such school district or board to reduce the annual salary as otherwise payable by law of such employee for the purpose of purchasing an annuity or investing in a custodial account as permitted under section 403(b) of the United States Internal Revenue Code. . . .

Section 612(a) of the Tax Law provides:

General. The New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in this section.

Section 612(c) of the Tax Law provides, in part:

Modifications reducing federal adjusted gross income. There shall be subtracted from federal adjusted gross income:

* * *

(3)(i) Pensions to officers and employees of this state, its subdivisions and agencies, to the extent includible in gross income for federal income tax purposes;

* * *

(3-a) Pensions and annuities received by an individual who has attained the age of fifty-nine and one-half, not otherwise excluded pursuant to paragraph three of this subsection, to the extent includible in gross income for federal income tax purposes, but not in excess of twenty thousand dollars, which 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 or (ii) from contributions to a retirement plan which are deductible for federal income tax purposes. However, the term "pensions and annuities" shall also include distributions received by an individual who has attained the age of fifty-nine and one-half from an individual retirement account or an individual retirement annuity, as defined in section four hundred eight of the internal revenue code, and distributions received by an individual who has attained the age of fifty-nine and one-half from self-employed individual and owner-employee retirement plans which qualify under section four hundred one of the internal revenue code, whether or not the payments are periodic in nature. Nevertheless, the term "pensions and annuities" shall not include any lump sum distribution, as defined in subparagraph (A) of

paragraph four of subsection (e) of section four hundred two of the internal revenue code and taxed under section six hundred three of this article. Where a husband and wife file a joint state personal income tax return, the modification provided for in this paragraph shall be computed as if they were filing separate state personal income tax returns. Where a payment would otherwise come within the meaning of the term "pensions and annuities" as set forth in this paragraph, except that such individual is deceased, such payment shall, nevertheless, be treated as a pension or annuity for purposes of this paragraph if such payment is received by such individual's beneficiary.

Section 112.3(c)(1) of the New York State Personal Income Tax Regulations (Regulations) provides:

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 (Tax Law, §612(c)(3)).

(i) 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 or the beneficiary of a deceased public officer or deceased public employee of New York State, 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 or the beneficiary of a deceased public officer or deceased 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.

(ii) This paragraph shall also apply to distributions paid in a taxable year prior to retirement to public officers and public employees which represent a return of contributions to the applicable public retirement program.

(iii) The provisions of this paragraph can be illustrated by the following examples:

Example 1: A retired employee of New York State receives a pension which is taxed under the Internal Revenue Code as annuity income. Since the pension of a retired New York State employee is exempt from New York State personal income tax under New York State law, the amount included in Federal adjusted gross income on account of this pension is subtracted in determining such employee's New York adjusted gross income.

Example 2: A New York State employee leaves state service prior to vesting in the New York State Employee's Retirement System. Contributions made by or on behalf of such employee, as well as all investment earnings accumulated thereon, are to be subtracted in determining such employee's New York adjusted gross income.

Example 3: A retired Federal employee receives a pension which is taxed under the Internal Revenue Code as annuity income. Since the pension of a retired Federal employee is exempt from New York State personal income tax under New York State law, the amount included in Federal adjusted gross income on account of this pension is subtracted in determining such employee's New York adjusted gross income.

Example 4: A retired employee of the State University of New York who elected to participate in the applicable Optional Retirement Program authorized under the Education Law receives a pension, based upon such employee's public service, which is taxed under the Internal Revenue Code as annuity income. Since such pension income is exempt from New York State personal income tax under New York State law because such pension was actually contributed to by New York State, the amount included in Federal adjusted gross income on account of this pension is subtracted in determining such employee's New York adjusted gross income.

Example 5: A retired employee of a public benefit corporation receives a pension from a fund which was not contributed to by New York State, any of its political subdivisions or agencies or the Federal government and which is taxed under the Internal Revenue Code as annuity income. Since such pension income is not exempt from New York State personal income tax under New York State law because such pension was not actually contributed to by New York State, any of its political subdivisions or agencies or the Federal government, the amount included in Federal adjusted gross income on account of this pension is not subtracted in determining such employee's New York adjusted gross income and is therefore included in such employee's New York adjusted gross income.

Section 112.3(c)(2)(i) of the Regulations provides, in part:

Pension and annuity income not subject to the modification referred to in paragraph (1) of this subdivision and not in excess of \$20,000, received by an individual

may be subtracted in determining New York adjusted gross income providing 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 where otherwise provided in this paragraph);

(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.*, individual retirement account [IRA] or self-employed retirement [Keogh]); and

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

Opinion

Article 16, section 5 of the New York State Constitution provides that "All salaries, wages and other compensation, except pensions, paid to officers and employees of the state and its subdivisions and agencies shall be subject to taxation."

Pursuant to section 3109 of the Education Law, a person employed by the Board of Education, a trustee or trustees in any school district, or by the Board of Cooperative Educational Services or County Vocational Education and Extension Board, may agree to reduce his or her annual salary and become a participant in a tax deferred annuity program. Petitioner's TDA programs are authorized by section 3109 of the Education Law and meet the requirements of IRC section 403(b).

In *Robert Weitzman*, Adv Op Comm T&F, December 16, 2002, TSB-A-02(9)I, the issue was whether distributions from an IRC 403(b) TDA plan were exempt from New York State personal income tax pursuant to section 612(c)(3)(i) of the Tax Law. The petitioner was a retired high school teacher from the Board of Education of the City of New York. Pursuant to section 3109-A of the Education Law, a person employed by the Board of Education of the City of New York may agree to reduce his or her annual salary and become a participant in a tax deferred annuity program. The New York City Teachers' Retirement System (NYCTRS) TDA program meets the requirements of IRC section 403(b) and is maintained pursuant to section 13-582 of the Administrative Code of the City of New York (New York Administrative Code). The distributions from that plan are specifically exempt from New York State and New York City personal income taxes pursuant to section 13-561 of the New York Administrative Code,

which was enacted by the New York State Legislature. In the *Weitzman* opinion, it was determined that since the distributions to the petitioner are exempt pursuant to section 13-561 of the New York Administrative Code, it is not necessary to consider whether the provisions of section 612(c)(3)(i) of the Tax Law apply to such distributions.

However, Petitioner's TDA plan in the present case is distinguished from a retired New York City public school teacher's IRC 403(b) TDA plan. The exemption from New York State personal income tax provided by section 13-561 of the New York Administrative Code applies only to distributions from the NYCTRS TDA program. This exemption does not apply to distributions made to a retired New York State public school teacher under Petitioner's TDA plan.

Section 612(c)(3) of the Tax Law exempts from personal income tax pensions paid to officers and employees of New York State, its subdivisions and agencies. Section 112.3(c)(1) of the Regulations relates to the subtraction modification for pensions paid to public officers and public employees of New York State, its political subdivisions or agencies or the federal government. On August 1, 1994, section 112.3(c)(1) of the Regulations was amended to clarify that pensions and other retirement benefits paid would qualify for the modification if they relate to services performed as a public officer or public employee of, and include amounts actually contributed by, the State, its political subdivisions or agencies, or the federal government.

Section 612(c)(3-a) of the Tax Law and section 112.3(c)(2) of the Regulations provide that when an individual reaches 59½ years of age, pensions and annuities not otherwise excluded under section 612(c)(3) received by the individual, but not in excess of \$20,000, may be subtracted from federal adjusted gross income when computing New York adjusted gross income if certain conditions are met.

Where the State, its political subdivisions or agencies, or the federal government, do not make any contribution to the TDA plan, distributions received by a retired New York State public school teacher do not constitute a pension or retirement benefit exempt from New York personal income tax, pursuant to section 612(c)(3)(i) of the Tax Law and section 112.3(c)(1)(i) of the Regulations.

However, section 612(c)(3-a) of the Tax Law and section 112.3(c)(2) of the Personal Income Tax Regulations provide that when a retired public school teacher reaches the age of 59 ½ years, distributions received from Petitioner's TDA programs which do not qualify for exemption under section 612(c)(3) of the Tax Law may be added to the individual's other pension and annuity income, if any, that meets the conditions of such section 612(c)(3-a) and section 112.3(c)(2) of the Regulations for purposes of computing the \$20,000 pension and annuity income modification. The total, but not in excess of \$20,000, may be subtracted from federal adjusted gross income when computing New York adjusted gross income.

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If Petitioner's TDA plan distributions received by a retired New York State public school teacher are attributable to amounts actually contributed (rather than merely being deemed to be contributed) by New York State, its political subdivisions or agencies, then such distributions constitute a pension or retirement benefit exempt from New York personal income tax, pursuant to section 612(c)(3)(i) of the Tax Law and section 112.3(c)(1)(i) of the Regulations.

DATED: April 27, 2005

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