Department of Taxation and Finance
Office of Counsel

TSB-A-24(11)I
Income Tax
April 24, 2024

Advisory Opinion: TSB-A-24(11)I

The Department of Taxation and Finance ("Department") received a Petition for Advisory Opinion from [REDACTED] ("Petitioner"). The issue is whether distributions to Petitioner from a partnership agreement are: 1) "retirement income" under 4 USC § 114(b)(1); 2) annuity payments; or 3) exempt from New York personal income tax under the Tax Law.

We conclude that the distributions to Petitioner: 1) do not conform to the definition of "retirement income" under 4 USC § 114(b)(1); 2) are not considered annuity payments under 20 NYCRR 132.4(d); and 3) are subject to tax under the Tax Law.

Facts

Petitioner was a partner of a Certified Public Accounting firm ("Firm") that is treated as a partnership for federal and state income tax purposes. The Firm maintains its principal office in New Jersey and also maintains an office in New York City. While working at the Firm, Petitioner maintained an office only in New Jersey ("NJ"). Petitioner is domiciled in NJ and files a NJ resident income tax return. Petitioner retired on December 31, 2020, and no longer provides any services to, nor has any employment with the Firm. The Firm's written partnership agreement ("Agreement") requires mandatory partner retirement at the end of the calendar year that a partner reaches age 67. Section 6.6 of the Agreement provides that upon the withdrawal of an equity partner, regardless of the reason for such withdrawal, the equity partner will receive the balance of their capital account over 24 months, beginning as soon as practicable after the close of the Firm's fiscal year end. Petitioner's capital account was fully paid as of December 15, 2022.

The Firm maintains a qualified retirement plan for its partners under § 401(k) of the Internal Revenue Code ("IRC"). The Agreement also provides additional and unfunded retirement benefits ("retirement payments") to a retiring partner. The retirement payments are contributed by the Firm and are subject to a 25-year length of service vesting requirement. Agreement, Exhibit D, charts the annual percentages to determine monthly deferred compensation/retirement payments. In years 1 and 2 the retired partner receives zero percent or no deferred compensation retirement payments. In years 3 through 10, a retired partner is paid a percentage of an amount equal to 2.75 times the average of the retiring partner's total allocated income as an equity partner over the 3 of the last 8 years the partner received the highest compensation. These payments are subject to annual cumulative Consumer Price Index ("CPI") based increases, based on 1/3 of the increase in the CPI base at the time of retirement, in monthly installments, and are limited by 7.5 percent of the net revenue generated by core services ("net revenue"). If the retirement payments exceed net revenue, then the payments will be reduced pro-rata for all retired equity partners scheduled to receive them in that fiscal year and the balance will be carried over to the following fiscal year(s) until the balance can be paid without exceeding the 7.5 percent of net revenue. The Agreement provides that in the 3rd, 4th and 5th years after a partner retires, the payment will be 16.67 percent of the amount computed above. In the 6th, 7th, 8th, 9th and 10th year after a partner retires, the payment is 10 percent of the amount

computed above. In the 11th year after retirement, and until a retired partner dies, the benefit becomes a fixed amount of $100 per month.

Until the end of calendar year 2022, Petitioner filed a New York State Nonresident Personal Income Tax Return and paid his share of the Firm's New York apportioned income from the Firm. Petitioner asks if any post-2022 retirement payments from the Firm Agreement are subject to NY State income tax.

Analysis

Title 4 of the United States Code (USC) § 114 ("the Pension Source Law") provides that no state may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of the state. The term "retirement income" includes any income from any plan, program, or arrangement that is in writing, that provides for retirement payments in recognition of prior service to be made to a retired partner, and that is in effect immediately before retirement begins, if such income is part of a series of substantially equal periodic payments, not less frequently than annually, made for the life or life expectancy of the recipient or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient, or a period of not less than 10 years. *See* 4 USC § 114(b)(1)(I)(i). The fact that payments may be adjusted from time to time pursuant to such plan, program, or arrangement to limit total disbursements under a predetermined formula, or to provide cost of living or similar adjustments, will not cause the periodic payments provided under such plan, program, or arrangement to fail the "substantially equal periodic payments" test. *Id.*

In this matter, the Agreement is in writing, it provides for retirement payments in recognition of prior service to a retired partner, and it was in existence before retirement began. However, it must be determined if the retirement income is a series of substantially equal periodic payments or payments from an excess benefit plan to be excluded from New York State income tax. The phrase "substantially equal periodic payments" is not defined for purposes of 4 USC § 114(b)(1)(I)(i). In TSB-A-96(7)I, the Division looked to an analogous provision within IRC § 402(c) and Treas. Reg § 1.402(c)-2 that defined "substantially equal periodic payments" regarding installment payments from qualified defined contribution plans to interpret this phrase. TSB-A-96(7)I noted that a series of substantially equal periodic payments is generally determined at the time payments begin and without regard to contingencies or modifications that have not yet occurred. Also, a series of payments made using the declining balance of years method, whereby the distribution is calculated by dividing the account balance by a number of years remaining in the period, will qualify as substantially equal periodic payments. *Id.*

As noted above, the Agreement allows for retirement payments equal to 16.67 percent of a computed amount based on the retired partner's average allocated income computed over a period of 3 years beginning in 2022. Then, in the next 5 years, the retirement payments are reduced to 10 percent of the computed amount for years beginning in 2025. In addition, for years beginning in 2030, the payments are a set amount equal to $100.00 per month for all subsequent years until the partner's death. Accordingly, the retirement payments provided for in the Agreement will not meet the requirement of substantially equal periodic payments: the payments differ substantially by using different percentages of payment amounts based on the year of payment and by changing the method of computing payment amounts from a formula based on an equity partner's past earnings to a fixed dollar amount. As the retirement income does not meet the requirement

of a substantially equal periodic payment, it will not be excluded from Petitioner's income pursuant to 4 USC § 114(b)(1)(I)(i).

The Pension Source Law also allows retirement income to be excluded from income of a nonresident partner if the retirement payments are received after termination of employment and under a plan, program, or arrangement (to which such employment relates) maintained solely for the purpose of providing retirement benefits for employees in excess of the limitations imposed by one or more of IRC §§ 401(a)(17), 401(k), 401(m), 402(g), 403(b), 408(k), or 415 or any other limitation on contributions or benefits in the IRC on plans to which any of such sections apply. *See* 4 USC § 114(b)(1)(ii). In this matter, there are no facts that indicate within the Agreement or otherwise that the Agreement was maintained solely to provide supplemental retirement benefits to equity partners in excess of the limitations of the Firm's 401(k) plan. *See* TSB-A-16(1)I & TSB-A-01(2)I. Therefore, the exclusion in 4 USC § 114(b)(1)(ii) is not applicable.

Tax Law § 632(a) provides that New York source income of a nonresident partner includes the portion derived from or connected with NY sources of a partner's distributive share of items of partnership income, gain, loss and deduction entering into federal adjusted gross income. 20 NYCRR 132.4 provides that where an individual formerly employed in New York State is retired from service and receives a pension or other retirement benefit attributable to former services, the pension or retirement benefit is not taxable for NYS personal income tax purposes if the individual receiving it is a nonresident and if it is an annuity.

20 NYCRR 132.4(d)(2) provides that to qualify as an annuity, a pension or other retirement benefit must meet the following requirements:

(i) It must be paid in money only, not in securities of the employer or other property.

(ii) It must be payable at regular intervals, at least annually, for the life of the individual receiving it, or over a period not less than half of such individual's life expectancy as of the date payments begin....

(iii) It must be payable:

(a) at a rate which remains uniform during such life or period; or

(b) at a rate which varies only with:

(1) the fluctuation in the market value of the assets from which such benefits are payable;

(2) the fluctuation in a specified and generally recognized cost-of-living index; or

(3) the commencement of social security benefits; or

(c) in such a manner that the total of the amounts payable is determinable at the annuity starting date either directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory. The term annuity starting date in the case of any contract or plan is the first day of the first period for which an amount is received as an annuity by the individual under the contract or plan...

In this matter, the payments to Petitioner are paid in money and at regular intervals, at least annually over the Petitioner's life. However, the annuity does not meet the requirements in 20 NYCRR 132.4(d)(2)(iii) as it is not payable at a uniform rate, or a rate that varies based on the market value of assets, a cost-of-living index or the commencement of social security benefits. Finally, the total amounts payable cannot be determined at the annuity start date from the Agreement or by using other mortality tables or compound interest computations, or both. Accordingly, the retirement benefits paid to Petitioner do not meet the definition of an annuity under the Tax Law, and the amounts paid to Petitioner are taxable under Tax Law § 632(c).

Dated: April 24, 2024

/s/

Brian McCann
Principal Attorney

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. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.