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

TSB-A-81 (9) I
Income Tax
December 31, 1981

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. I801229C

On December 29, 1980 a Petition for Advisory Opinion was received from Shinazo Irie, 110-35 71st Avenue, Forest Hills, New York 11375.

The issue raised is the appropriate method of computing the addition to federal adjusted gross income required, under section 612(b)(7) of the Tax Law (Personal Income Tax), of a shareholder in a professional service corporation which has taken a federal income tax deduction based on contributions, paid on behalf of the shareholder, to a qualified plan.

Section 612(b)(7) of the Tax Law presently provides that in computing New York adjusted gross income a shareholder of a professional service corporation must add to his federal adjusted gross income the amount deducted by the corporation on its federal return for payments to a qualified plan on behalf of the shareholder, reduced by the maximum amount which would be deductible by the shareholder, in computing his federal adjusted gross income, for payments to a qualified plan, if the shareholder were a self-employed individual. The limit on deductible corporate contributions to a qualified plan, with respect to any individual employee, generally exceeds that applicable to a qualified plan established for a self-employed individual. The effect of section 612(b)(7) of the Tax Law is thus to require an add-back of the difference between the corporate deduction and the maximum amount which would have been deductible by the shareholder were he self-employed.

Prior to the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"), the "maximum amount which would be deductible" by a self-employed individual for contributions to a qualified plan was the lesser of $2,500 or 10% of earned income "from the trade or business with respect to which the plan is established" (I. R. C. §404(e)). ERISA raised this limit to the lesser of $7,500 or 15% of such earned income, with respect to qualified plans other than defined benefit plans. However, ERISA also, for the first time, made available to self-employed individuals defined benefit plans and provided, in I.R.C. §401(j)(6), that the limitation contained in I.R.C. §404(e) is not applicable to such defined benefit plans, instead, I.R.C. §401(j), and regulations promulgated pursuant thereto, provide for maximum annual benefits which may be accrued with respect to each year of plan participation. Such figure is determined based on the plan beneficiary's age at the commencement of his participation and his annual compensation. The maximum deductible contribution to such a plan is computed as the amount necessary to properly fund the same, pursuant to I.R.C. §§ 404(a) and 412. Such computation clearly requires the utilization of various actuarial assumptions, I.R.C. §402(c)(3]) accordingly provides that such assumptions as to costs, liabilities, rates of interest and other factors "shall be determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and

reasonable expectations) and which, in combination, offer the actuary's best estimate of anticipated experience under the plan". It follows that although the guidelines set forth in I.R.C. §401(j) may have been originally intended to translate the $7,500/15% limitation applicable to defined contribution plans into a roughly comparable limitation on the benefits sought to be ensured by a defined benefit plan established for a self-employed individual, the utilization of varying actuarial assumptions, as well as actual plan experience, can yield a higher (or lower) ceiling on deductible contributions. See House Conference Report No. 93-1280, 1974 US Code Congr. Adm. News p. 5113.

In light of the foregoing considerations, the language contained in Section 612(b)(7) of the Tax Law is to be applied as follows. A shareholder of a professional service corporation which makes federally deductible contributions to a defined benefit plan must add to his federal adjusted gross income an amount equal to the difference between his share of the corporate deduction and the federally deductible contribution he could have made, were he self-employed, to a plan (1) which commenced at the time his current participation in his corporate plan commenced, (2) the required contributions to which were computed based on the same reasonable actuarial assumptions and plan experience utilized with respect to the corporate plan, (3) which provided for an accrual of benefits equal to the lesser of the accrual of benefits provided for under the corporate plan (with respect to such individual) and the maximum accrual of benefits permissible under applicable provisions of the Internal Revenue Code, and (4) which otherwise conformed to all limitations and requirements applicable to a defined benefit plan of a self-employed individual under the provisions of the Internal Revenue Code. In each instance the burden will be on the taxpayer to establish the correct figure to be employed. Appropriate supporting documents should be submitted with the taxpayer's personal income tax return. Where such burden is not met, the amount to be subtracted from the taxpayer's share of the corporate deduction is the lesser of $7500 or 15% of the earned income derived by the taxpayer from the trade or business with respect to which the plan is established. (This is the limit provided in I..R.C. §404(e) applicable to post-ERISA years prior to 1982.)

It is to be noted that Section 612(b)(7) of the Tax Law has been amended by Chapter 358 of the Laws of 1981, applicable to taxable years commencing on or after January 1, 1982. As amended, such provision will require an addition to federal adjusted gross income equal to the difference between the taxpayer's share of the corporate deduction and the lesser of $7500 or 15% of "the earned income derived by such taxpayer from such corporation during such taxpayer's taxable year." The present Advisory Opinion will therefore not be applicable to taxable years commencing on or after January. 1, 1982.

DATED: November 4, 1981

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau