STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I940422A

On April 22, 1994, a Petition for Advisory Opinion was received from KPMG Peat Marwick, 345 Park Avenue, New York, New York 10154.

The issue raised by Petitioner, KPMG Peat Marwick, is whether under the scenarios presented herein, the described pension or other retirement benefits qualify as non-taxable "annuity" payments under section 631(b)(2) of the Tax Law and section 132.4(d) of the Personal Income Tax Regulations ("Regulations").

For purposes of each of the following hypothetical scenarios, it should be assumed that the described pension or other retirement benefit meets the following definitional criteria of non-taxable "annuities" under section 132.4(d)(2)(i), (ii), and (iv) of the Regulations:

- it is paid in money only, not in securities of the employer or other property;

- it is payable at regular annual intervals, 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 [in all cases, assume that such period will be 10 years in duration, and that such life expectancy is twelve years]; and

- the individual's right to receive it is evidenced by a written instrument executed by his or her employer, or by a plan established and maintained by the employer in the form of a definite written program communicated to the employees of such employer.

It should also be assumed that in each hypothetical scenario, the individual involved is a living nonresident of New York who is receiving a pension or other retirement benefit (as described above) attributable to his or her former services as an employee in New York.

The retirement date for each hypothetical scenario should be assumed to be December 31, 1993, with each annual pension or other retirement payment to be made on January 1. Thus, in each hypothetical scenario, the first pension or other retirement payment will be made on January 1, 1994.

In each hypothetical scenario, the fund (i.e., corpus) for the pension or other retirement benefit is $300,000. For ease of analysis, no effect should be given to the maximum annual $20,000 pension and annuity exclusion provided by section 612(c)(3-a) of the Tax Law.

In each hypothetical scenario, the question to be resolved is whether the requirement of section 132.4(d)(2)(iii) of the Regulations has been met.

Scenario 1

Taxpayer A will receive equal annual principal payments plus simple interest payments at a fixed rate of 3% on the outstanding balance, with all interest earned during a year paid out with the next year's principal payment. Thus, for example, on January 1, 1994, A will receive $30,000 (i.e., $300,000 ÷ 10), all of which constitutes a payment of principal. On January 1, 1995 (year two), A will receive $38,100, consisting of $30,000 of principal (i.e., [$300,000 - $30,000] ÷ 9) plus all $8,100 of interest earned during 1994 (i.e., [$300,000 $30,000] x 3%).

Scenario 2

Taxpayer B will receive equal annual principal payments plus simple interest payments at a variable rate (tied to the Consumer Price Index - "CPI" rate) on the outstanding balance, with all interest earned during a year paid out with the next year's principal payment. (Assume the respective annual variable interest rates to be as follows: 3% during 1994 (i.e., the 1993 CPI rate of 3% is used as the variable interest rate for 1994), 2% during 1995, 3% during 1996, 2% during 1997, and so on.) Thus, for example, on January 1, 1994, B will receive $30,000, all of which constitutes a payment of principal. On January 1, 1995 (year two), B will receive $38,100, comprised of $30,000 of principal plus $8,100 of interest (see Scenario 1, above). On January 1, 1996 (year three), B will receive $34,800, consisting of $30,000 of principal (i.e.,[$300,000 - $30,000 $30,000] ÷8) plus all $4,800 of interest earned during 1995 (i.e., [$300,000 - $30,000 - $30,000] x 2%).

Scenario 3

Taxpayer C will receive equal annual payments of principal and fixed simple interest (at a rate of 3%), per a mortgage-type amortization schedule with payment on the first day of each year. Thus, at the outset, it can definitely be determined that the 10 year total of interest will be $41,448. The 10 year total of principal and interest payments will, therefore, be $341,448 (i.e., $300,000 of principal plus $41,448 of interest). Each annual payment will be $34,144.81 (i.e., $341,448 ÷ 10).

Scenario 4

Taxpayer D will receive equal principal payments of $30,000 plus interest on the outstanding balance for the prior years. The interest will be based on a simple interest rate of 3% plus an amount equal to the increase in the CPI for the prior year.

Therefore, if the CPI for 1993 was 2%, the interest earned in 1994 will be 5%. Thus, for example, on January 1, 1994, D will receive $30,000 which consists entirely of principal. On January 1, 1995, he will receive $43,500 which consists of $30,000 of principal plus interest of $13,500. This interest was earned in 1994 and is paid with the 1995 principal payment. It is calculated using a 5% interest rate (3% base rate plus 2% CPI for 1993) on the outstanding principal balance for 1994 of $270,000.

On January 1, 1999, he will receive $40,500 consisting of $30,000 of principal (out of the outstanding principal balance for 1998 of $150,000) plus interest of $10,500. The interest is calculated at 7%, which is the 3% floor plus a 4% CPI inflation adjustment for 1997.

The principal portion of these payments will remain constant while the interest portion will change as the remaining principal balance declines and as the CPI fluctuates.

Section 631(b)(2) of the Tax Law provides that "[i]ncome from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property, shall constitute income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in this state."

Section 132.4(d) of the Regulations provides that:

Pensions or other retirement benefits constituting annnuity. (1) General. Where an individual formerly employed in New York State is retired from service and thereafter receives a pension or other retirement benefit attributable to his 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 as defined in paragraph (2) of this subdivision. 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 taxable for New York State personal income tax purposes to the extent that the services were performed in New York State...

(2) Definition. To qualify as an annuity, a pension or other retirement benefit must meet the following retirements:

(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 -nnuity 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.

(iv) The individual's right to receive it must be evidenced by a written instrument executed by his employer, or by a plan established and maintained by the employer in the form of a definite written program communicated to his employees.

Herein, in Scenario 1, Taxpayer A's pension or other retirement benefit meets the requirements of section 132.4(d)(2)(iii)(c) of the Regulations because it is payable in a manner whereby the total of the amount payable is determinable at the annuity starting date directly from the terms of the contract.

In Scenario 2, Taxpayer B's pension or other retirement benefit meets the requirements of section 132.4(d)(2)(iii)(b)(2) of the Regulations because it is payable at a rate that will vary only with the fluctuation in the Consumer Price Index, which is a recognized cost-of-living index.

In Scenario 3, Taxpayer C's pension or other retirement benefit meets the requirements of section 132.4(d)(2)(iii)(c) of the Regulations because it is payable in a manner that the total of the amounts payable is determinable at the annuity starting date by the use of compound interest computations.

In Scenario 4, Taxpayer D's pension or other retirement benefit meets the requirements of section 132.4(d)(2)(iii)(b)(2) of Regulations because it is payable at a rate that will vary only with the fluctuation in the Consumer Price Index, which is a recognized cost-of-living index.

Accordingly, in Scenarios 1, 2, 3 and 4, the pension or other retirement benefit meets all of the requirements of section 132.4(d) of the Regulations and qualifies as an annuity under such section.

DATED: October 19, 1994

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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