

This TSB-M is obsolete and should not be used. See TSB-M-07(2)I, *Changes to New York Tax Treatment of Certain Retirement Payments Made to Nonresident and Part-Year Resident Partners*. To continue reading TSB-M-06(3)I, scroll down.

**New York Tax Treatment of Certain Retirement Payments
Made to Nonresident and Part-Year Resident Partners**

This memorandum sets forth the Department's position on whether payments made in recognition of prior services to a retiring or retired nonresident or part-year resident partner pursuant to a "nonqualified" retirement plan maintained by a partnership are covered by section 114 of Title 4 of the US Code and, if they are not covered, how payments from the plan should be treated for New York personal income tax purposes.

General

Section 114 of Title 4 of the US Code provides that only the state of which a person is a resident or domiciliary may tax the person on his or her retirement income. Section 114(b) provides that retirement income includes income received from the following plans:

- (A) a qualified trust under section 401(a) of the Internal Revenue Code of 1986 that is exempt under section 501(a) from taxation;
- (B) a simplified employee pension as defined in section 408(k) of such Code;
- (C) an annuity plan described in section 403(a) of such Code;
- (D) an annuity contract described in section 403(b) of such Code;
- (E) an individual retirement plan described in section 7701(a)(37) of such Code;
- (F) an eligible deferred compensation plan (as defined in section 457 of such Code);
- (G) a governmental plan (as defined in section 414(d) of such Code);
- (H) a trust described in section 501(c)(18) of such Code; or
- (I) any plan, program, or arrangement described in section 3121(v)(2)(C) of such Code, if such income—
 - (i) is part of a series of substantially equal periodic payments (not less frequently than annually) made for—
 - (I) 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
 - (II) a period of not less than 10 years, or

- (ii) is a payment 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 1 or more of sections 401(a)(17), 401(k), 401(m) 402(g), 403(b), 408(k), or 415 of such Code or any other limitation on contributions or benefits in such Code on plans to which any such sections apply.

Discussion

The plans described in sections 114(b)(A)-(H) are all qualified plans under the Internal Revenue Code (IRC). Since the plans at issue here are not qualified, the plans will fall within the provisions of section 114 only if they are a plan described in section 114(b)(I). The plan described in section 114(b)(I) is any plan, program or arrangement described in IRC section 3121(v)(2)(C) that meets certain specified requirements. Section 3121 contains the definitions applicable to the employment tax. Section 3121(v)(2)(C) defines “nonqualified deferred compensation plans” for the purpose of determining whether or not deferred amounts are employee wages for purposes of the employment tax. Since a partner is not an employee of a partnership for purposes of the employment tax (See Rev. Rul. 69-184; 1969-1C.B. 256), section 3121(v)(2)(C) does not apply to partners. Accordingly, payments made to a retired partner from a nonqualified plan are not from a plan described in section 114(b)(I).

Based upon the above, it is the Department’s position that payments made to a retiring or retired nonresident or part-year resident partner under a nonqualified partnership retirement plan are not covered by section 114 of Title 4. As a result, payments received by a nonresident or part-year resident retiring or retired partner under these plans where the payments do not constitute an annuity under section 132.4(d) of the Personal Income Tax Regulations¹ must be taken into account in computing the partner’s New York personal income taxes as follows.

New York State nonresident individuals

Section 601(e) of the New York State Tax Law imposes a personal income tax on the portion of a nonresident individual’s taxable income that is derived from New York sources. The tax is equal to the tax computed as if the individual were a New York State resident for the entire year, reduced by certain credits, multiplied by the income percentage.

The numerator of the fraction used to compute the income percentage is the individual’s New York source income. The New York source income of a nonresident individual is the sum of the items of income, gain, loss and deduction entering into the individual’s federal adjusted gross income derived from or connected with New York sources and any New York addition and

¹ See Matter of Pidot (118 AD2d 915, 499 NYS2d 482, affd 69 NY2d 837, 513 NYS2d 965, holding that payments were an annuity) and Matter of Walsh (Tax Appeals Tribunal, Number 19, 1992, affd on other grounds Walsh v. Tax Appeals Tribunal, 196 AD2d 367, 609 NYS2d 405, holding that payments were not an annuity.)

subtraction modifications under sections 612(b) and 612(c)² of the Tax Law that relate to the income derived from New York sources (i.e., New York adjusted gross income from New York sources.) The denominator of the fraction used to compute the income percentage is the nonresident individual's New York adjusted gross income from all sources for the entire year.

Since the starting point for computing New York adjusted gross income is federal adjusted gross income, the amount of payments received from these plans by a nonresident individual partner is included in computing the partner's New York State tax as if he or she were a resident and the partner's New York adjusted gross income from all sources for the entire year (the denominator of the income percentage.) The method used to determine the portion of the retirement payments includable in federal adjusted gross income that is includable in the partner's New York source income (the numerator of the income percentage) for the taxable year is dependent upon the partner's status for the tax year and how the payments were treated by the partnership for federal income tax purposes, as described below:

- If the partner's interest in the partnership is not totally liquidated during the tax year³ and, therefore, the payments are treated by the partnership as payments under section 736(a) of the Internal Revenue Code, then the amount of the payments that is includable in New York source income is equal to the amount of the payments includable in federal adjusted gross income for the year multiplied by the partnership's New York allocation percentage for the tax year.
- If the partner's interest in the partnership is totally liquidated during the year⁴ and, therefore, the federal payments do not qualify as payments under section 736(a) of the Internal Revenue Code, then the amount of the payment includable in federal adjusted gross income for the tax year that is includable in New York source income is determined based on where the partner performed services for the partnership prior to retirement (Matter of Johnson et al., Tax Appeals Tribunal, May 30, 1996).

If the partner performed no services for the partnership in New York State prior to retirement, none of the payments are includable in New York source income. If the partner performed all of his or her services for the partnership in New York State prior to retirement, the entire amount of the payments is includable in New York source income. If the partner performed services for the partnership both inside and outside New York State prior to retirement, then the amount includable in New York source income is determined by multiplying the

² The Tax Appeals Tribunal, in Matter of Blue, held that retirement payments made to partners under a nonqualified plan do not qualify for the pension and annuity exclusion under section 612(c)(3-a) of the Tax Law. Accordingly, that modification is not an issue here.

³ The partner's interest is not totally liquidated if the partner still has a capital account, is entitled to a share of partnership profits, or is liable for partnership losses.

⁴ The partner's interest is totally liquidated if the partner has no capital account, is not entitled to a share of partnership profits, and is not liable for partnership losses.

payments by a fraction, whose numerator is the number of days the partner performed services for the partnership inside New York during the portion of the tax year prior to retirement and the three tax years immediately preceding the year of retirement, and whose denominator is the total number of days the partner performed services for the partnership both inside and outside New York State during that period.

Note: A longer period of time may be used if the partner can establish the number of days that services were performed inside and outside the state for the longer period.

New York State nonresident estates and trusts

A nonresident estate or trust computes its New York State personal income tax in the same manner as a nonresident individual. Accordingly, if a partner's retirement payments are paid to an estate or trust, the rules applicable to nonresident individuals also apply to a nonresident estate or trust in computing its New York source income, New York adjusted gross income from all sources, and New York State tax as if a resident for the entire year. In addition, in the case where the partner's interest in the partnership is totally liquidated, any allocation is based on where the partner performed services for the partnership prior to retirement.

Yonkers nonresidents

The Yonkers nonresident earnings tax is imposed on wages and net earnings from self-employment derived from Yonkers sources. If the payments under the plan constitute net earnings from self-employment for federal income tax purposes, the payments would be subject to the Yonkers nonresident earnings tax to the extent the payments are derived from or connected with Yonkers sources. The same allocation methods applicable to New York State nonresidents are used to determine the amount of the payments derived from Yonkers sources, except that (1) the partnership's Yonkers allocation percentage would be used if the partner's interest in the partnership is not totally liquidated, or (2) the number of days the partner performed services inside and outside Yonkers would be used if the partner's interest in the partnership is totally liquidated.

New York State part-year resident individuals

A New York State part-year resident individual computes his or her New York State tax in the same manner as a nonresident individual. However, the New York source income of a part-year resident individual (the numerator of the income percentage) is the sum of the following:

1. The individual's New York adjusted gross income from all sources for the resident period, determined as if the individual's tax year for federal income tax purposes were limited to the resident period;

2. The individual's New York adjusted gross income derived from or connected with New York sources for the nonresident period, determined as if the individual's tax year for federal income tax purposes were limited to the nonresident period; and
3. The special accruals required under section 639 of the Tax Law that relate to adjusted gross income.

Accordingly, in the case of a part-year resident individual partner, the amount of the federal payments includable in New York source income is computed as follows:

- If the partner's interest is not totally liquidated during the year and, therefore, the payments are treated by the partnership as payments under section 736(a) of the IRC, the partner will first apply the "proration method" or "direct accounting" method under section 636(f) of the Tax Law to determine the amount of the federal payments that are attributable to the resident and nonresident periods. The total amount attributable to the resident period is includable in New York source income. The amount attributable to the nonresident period, multiplied by the partnership's New York allocation percentage, is includable in New York source income for the nonresident period.
- If the partner's interest is totally liquidated during the year and, therefore, the payments are not treated as payments under section 736(a) of the IRC, the total payments actually received during the resident period are includable in New York source income. The portion of the payments actually received during the nonresident period that is includable in New York source income is determined using the rules described above for New York State nonresident partners whose interest is totally liquidated. In the case of a partner who changed status from resident to nonresident, days worked inside and outside the state for the portion of the tax year prior to retirement and the three preceding tax years are determined as if the partner were a nonresident during the entire allocation period.

Part-year New York State resident trusts

A part-year resident trust computes its New York State tax in the same manner as a part-year resident individual. Accordingly, if a partner's retirement payments are paid to a trust and the trust changes resident status, the amount of the payments includable in the trust's New York source income is computed using the same methods that apply to part-year resident individuals. In addition, in the case where the partner's interest in the partnership is totally liquidated, any allocation is based on where the partner performed services for the partnership prior to retirement.

Part-year New York City residents

A New York City part-year resident individual or trust is subject to the New York City personal income tax on all income attributable to the period of residence. The same methods used to determine the amount of these payments that is attributable to the resident period in the case of a New York State part-year resident individual or trust are used to determine the amount of the payments attributable to the New York City resident period in the case of a part-year city resident individual or trust.

Part-year Yonkers residents

A part-year Yonkers resident individual or trust is subject to the Yonkers income tax surcharge for the period of residence and, if applicable, the Yonkers nonresident earnings tax for the period of nonresidence. The Yonkers income tax surcharge is equal to the allocated net New York State tax for the resident period multiplied by the Yonkers income tax surcharge rate. The allocated net New York State tax for the resident period is equal to the net New York State tax for the entire year (the sum of all state taxes imposed by Article 22 of the Tax Law on the individual or trust, reduced by any allowable state credits) multiplied by a fraction. The numerator of the fraction is the individual's or trust's New York adjusted gross income for the period of Yonkers residence. The denominator of the fraction is the individual's or trust's New York adjusted gross income for the entire year. The nonresident earnings tax, if applicable, is based upon wages or net-earnings from self-employment derived from Yonkers sources for the period of nonresidence.

Accordingly, a Yonkers part-year resident will use the methods explained above for New York State part-year residents to determine the amount of payments includable in New York adjusted gross income for the entire year that are attributable to the Yonkers resident and nonresident periods. The total amount attributable to the resident period is includable in the numerator of the fraction used to compute the allocated net New York State tax. If the payments are considered net earnings from self-employment for federal income tax purposes, the amount attributable to the nonresident period would be subject to the nonresident earnings tax to the extent that the payments are derived from Yonkers sources. The same allocation methods applicable to New York State nonresidents are used to determine the amount of the payments attributable to the nonresident period that are derived from Yonkers sources, except that (1) the partnership's Yonkers allocation percentage would be used if the partner's interest in the partnership is not totally liquidated, or (2) the number of days the partner performed services inside and outside Yonkers would be used if the partner's interest in the partnership is totally liquidated.