New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-09(10)I
Income Tax
September 10, 2009

As of October 20, 2020, the conclusion in this Advisory Opinion is no longer accurate!

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I090724A

Petitioner [redacted], in a petition dated July 12, 2009, requests an advisory opinion regarding the Personal Income Tax treatment of distributions from an Individual Retirement account (IRA) that was funded with assets rolled over in a direct trustee-to-trustee transfer from Petitioner's Internal Revenue Code § 403(b) tax-deferred annuity plan (TDA).

We conclude that because the TDA was funded with contributions from the Elmont Free Union School District (EFUSD), which is a New York State public employer, distributions that are attributable to a rollover contribution to the IRA from the TDA are not included in New York taxable income pursuant to §612(c)(3)(i). However, any gain or income earned on the amount of the rollover is included in Petitioner's New York taxable income to the extent that it does not qualify for the $20,000 income subtraction under Tax Law §612(c)(3-a).

Facts

Petitioner was an elementary school teacher with the EFUSD in Nassau County. As authorized by Education Law § 3109, EFUSD offered its elementary school teachers the opportunity to enter into salary reduction agreements for the purpose of participating in the TDA. It is presumed for purposes of this Opinion that the TDA is a qualified plan under Internal Revenue Code § 403(b). During her tenure with the EFUSD, Petitioner participated in the TDA. The TDA provided the employees with multiple investment options, of which each participant had to select at least one.[1] On July 1, 2007, Petitioner retired from her teaching position with EFUSD. As required by Article XI, § 8 of the collective bargaining agreement between the Elmont Board of Education and the Elmont Elementary Teachers' Association (the Collective Bargaining Agreement), at the time of her retirement, EFUSD contributed the cash value of 40% of Petitioner's accrued unused sick leave to the TDA.

Analysis

Pursuant to Education Law § 3109, an EFUSD elementary school teacher may agree to reduce his or her annual salary to become a participant in the TDA sponsored by EFUSD. Contributions to a TDA are excluded from gross income in the year of contribution, while distributions paid to the participant are included in gross income in the year of distribution. **(**Internal Revenue Code § 403(b).) Further, Internal Revenue Code § 403(b) provides that eligible rollover distributions from the TDA to an IRA are excluded from gross income in the year of distribution.

[1] The fact that a participant may have an account with more than one of the investment vehicles that participate in the 403(b) plan is of no consequence because all of the accounts are collectively part of the same 403(b) plan. Simply because an employee has accounts with three different investment firms rather than with one investment firm does not remove the plan from its status as a tax-exempt 403(b) plan.

Article 16, § 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."

Section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means the individual's federal adjusted gross income (FAGI) with the modifications specified in § 612. Tax Law § 612(c)(3)(i) provides that, to the extent includible in gross income for federal income tax purposes, pensions paid to officers and employees of New York State, its subdivisions, and agencies will be subtracted from an individual's FAGI. Section 112.3(c)(1) of the New York State Personal Income Tax Regulations (Regulations) provides that retirement benefits paid to a public officer will qualify for the exemption pursuant to Tax Law § 612(c)(3)(i) if the benefits relate to the services performed by the public officer "and all or a portion of which are actually contributed to (rather than merely being deemed contributed to) by New York State." Tax Law § 612(c)(3-a) provides that, for pensions and annuities that are not subject to the subtraction modifications provided by Tax Law § 612(c)(3), a taxpayer who is at least 59 ½ may subtract from FAGI up to $20,000 of any of those pensions and annuities.

In *New York State United Teachers Benefit Trust*, Adv Op Comm T&F, April 27, 2005, TSB-A-05(3)I, it was concluded that if a 403(b) plan receives actual, not merely deemed, contributions from the State, its political subdivisions or agencies, or the federal government, then the 403(b) plan is a pension or retirement benefit within the meaning of Tax Law § 612(c)(3) and Regulations 112.3(c)(1). In *Albert Zelony*, Adv Op Comm T&F, July 24, 2002, TSB-A-02(5)I, it was concluded that when a taxpayer rolls over his or her New York State pension benefits to an IRA, the amount received from the pension fund represents a nontaxable distribution, and is not subject to New York personal income tax. In *Lawrence Faraone*, Adv Op Comm T&F, TSB-A-09(9)I, it was concluded that any distributions from an IRA that was funded with rollover contributions from a New York State pension will be exempt pursuant to Tax Law § 612(c)(3)(i) to the extent that they represent a return of principal attributable to the pension rollover. Any other amounts received will be subject to tax; however, these distributions are eligible for the subtraction modification provided by Tax Law § 612(c)(3-a).

In this case, Petitioner participated in the EFUSD 403(b) plan through a salary reduction agreement. Additionally, Article XI, § 8 of the Collective Bargaining Agreement required EFUSD to make an employer contribution to the TDA in an amount equaling the cash value of 40% of Petitioner's accrued sick leave to the TDA when Petitioner retired. Article XI, § 1 of the Collective Bargaining Agreement specifically provided that employees could not receive cash instead of the mandatory employer TDA contribution to the TDA. Because Petitioner was not allowed to receive cash for the amounts contributed to the TDA and the Collective Bargaining Agreement required the employer contribution, the TDA is exempt from tax pursuant to Tax Law § 612(c)(3)(i) and Regulations 112.3(c)(1). Thus, the portion of the distributions that Petitioner receives from the IRA that constitutes a return of the rollover contributions to the IRA from the TDA is exempt from New York State taxation.

The portion of the distributions from the IRA that does not constitute a return of any rollover contribution to the IRA from the TDA is not exempt from New York State taxation. This portion of the distribution can consist of other contributions to the IRA, as well as earnings on the amount of the TDA rollover and any other contributions. If Petitioner has reached the age of 59½, the balance of a distribution that does not represent a return of the TDA rollover contribution may be subtracted in computing New York adjusted gross income, but only up to $20,000. (Tax Law § 612(c)(3-a) and 20 NYCRR 112.3(c)(2).) Any excess would not be allowed as a subtraction from FAGI when computing Petitioner's New York adjusted gross income.

Therefore, when Petitioner receives a distribution from the IRA, Petitioner must determine the portion of the distribution that is a return of the TDA rollover contribution and the portion that is either a return of other contributions or the gains earned by the IRA. The amount that will qualify for the income subtraction modification under Tax Law §612(c)(3)(i) is determined by multiplying the amount of the distribution by a fraction, the numerator of which is the TDA rollover contribution and the denominator of which is the current value of the IRA before the distribution.

The portion of the distribution that does not qualify for the subtraction modification under Tax Law §612(c)(3)(i) may qualify for the $20,000 income subtraction under Tax Law § 612(c)(3-a). This amount is determined by subtracting the amount that is the return of the TDA rollover contribution from the amount of the distribution. The balance is eligible for the $20,000 deduction. Further, the portion of the distribution that is deemed to be a return of the TDA rollover contribution reduces the balance of the TDA rollover contribution in the IRA. In the next taxable year, when determining the portion of a distribution that is a return of the TDA contribution to the IRA, Petitioner must use the most recently computed balance of the TDA rollover contribution in the numerator.

Accordingly, pursuant to Tax Law §612(c)(3)(i), Petitioner is allowed to subtract from Petitioner's FAGI the portion of the distribution from the IRA that is attributable to Petitioner's TDA rollover contribution that is included in Petitioner's FAGI. Further, if Petitioner has attained the age of 59½, any distributions from the IRA that do not constitute a return of Petitioner's TDA rollover contribution may be subtracted from Petitioner's FAGI to the extent that the distributions, when added to any other pension and annuity income that is not subject to the modification provided by Tax Law §612(c)(3), do not exceed $20,000 and were included in Petitioner's FAGI.

DATED: September 10, 2009

/S/
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Director of Advisory Opinions
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