New York State Department of Taxation and Finance
Office of Counsel

TSB-A-20(8)I
Income Tax
October 6, 2020

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

The Department of Taxation and Finance ("Department") received a Petition for Advisory Opinion from [redacted] ("Petitioner"). Petitioner asks whether payments from its nonqualified deferred compensation plans to nonresidents at the time of distribution are New York source income for personal income tax purposes and subject to income tax reporting and withholding.

We conclude that the payments made to nonresidents after termination of employment conform to the definition of "retirement income" under 4 USC § 114(b)(1)(I)(ii), and are not subject to New York State income tax withholding and reporting. Payments made to nonresidents prior to termination of employment do not conform to the definition of "retirement income" under 4 USC § 114(b)(1)(I)(ii) and will be subject to personal income tax reporting and withholding.

Facts

Petitioner maintains offices and transacts business in various states including New York. Petitioner maintains a 401(k) Plan and a Pension Plan, both of which are qualified plans that qualify for favorable tax treatment under section 401(a) of the Internal Revenue Code ("IRC"). IRC §§ 401(a)(17), 401(k), 401(m), 402(g) and 415 limit the contributions and benefits participants can receive under the 401(k) Plan, and IRC §§ 401(a)(17) and 415 limit the benefits participants can receive under the Pension Plan. Petitioner also maintains two unfunded plans, [redacted] and the [redacted], that are nonqualified deferred compensation plans as defined in IRC § 3121(v)(2)(C). The sole purpose of the nonqualified plans is to supplement participants' qualified plan benefits by providing benefits in excess of one or more of the statutory limits that apply to the qualified plans.

[redacted] Plan provides for elective deferrals, company matching contributions, and several types of non-elective company contributions. A participant is eligible to make elective deferrals under the [redacted] Plan for a plan year only if the participant is eligible to make elective deferrals under the 401(k) Plan for that plan year. Similarly, a participant is eligible to receive a particular type of company contribution under the [redacted] Plan for a plan year only if the participant is eligible to receive the same type of company contribution under the 401(k) Plan for that plan year. In addition, a participant is eligible to receive company contributions under the [redacted] Plan only with respect to compensation that is not taken into account for purposes of calculating the participant's company contributions under the 401(k) Plan. [redacted] Plan also permits Petitioner to make additional, discretionary company contributions, although this provision is rarely invoked in practice.

[redacted] Plan generally provides for payment following a participant's termination of employment. Payments may be made in the form of a single lump sum or between two and ten

annual installments. If a participant dies before benefits have been paid in full, the remainder of the participant's benefit is paid to one or more designated beneficiaries in a single lump sum payment.

A participant is eligible for a benefit under the [redacted] Plan only if the participant is eligible for a benefit under the Pension Plan. A participant's [redacted] Plan benefit equals the Pension Plan benefit the participant would have accrued under the Pension Plan without regard to the IRC §§ 401(a)(17) and 415 limits, minus the Pension Plan benefit the participant actually accrued under the Pension Plan. [redacted] Plan generally provides for payment following a participant's termination of employment. Payments may be made in the form of a single lump sum, a single-life annuity, or a joint and survivor annuity. Different portions of a participant's [redacted] Plan benefit may be paid in different forms. If a participant dies before benefit payments begin, the participant's benefit is paid to one or more designated beneficiaries in a single lump sum or a single-life annuity.

Effective January 1, 2005, the nonqualified plans became subject to the requirements of IRC § 409A and remain in compliance with that section. In order to comply with IRC § 409A, benefits subject to IRC § 409A must be paid upon a participant's "separation from service," as that term is defined for purposes of IRC § 409A. In limited circumstances, a participant's "separation from service" is not the same as the date the participant terminates employment with Petitioner for other purposes. As a result, for example, payment would be required if a participant's level of services decreases by at least 80% (but less than 100%), or if a participant is on a leave of absence (including disability leaves of absence) for longer than six months. These rules were designed in accordance with IRS rules to prevent abusive arrangements in which participants could avoid "terminating" by working very few hours or taking an extended leave, thereby delaying their payments. Any attempt by Petitioner or the participant to postpone such payments until the participant terminates employment would trigger substantial tax penalties under IRC § 409A.

In accordance with section 10.01 of the [redacted] Plan and section 8.01 of the [redacted] Plan, all amounts payable under the unfunded nonqualified plans constitute general unsecured obligations of Petitioner and are paid out of Petitioner's general assets. Also, the nonqualified plans are plans described in IRC § 3121(v)(2)(C). The sole purpose of the nonqualified plans is to allow participants to make elective deferrals and/or receive company-provided benefits that they are unable to make or receive under the qualified plans because of the limitations imposed under IRC §§ 401(a)(17), 401(k), 401(m), 402(g) and 415.

Petitioner states that when distributions are made from the plan they are reported on Form W-2, Box 1, are subject to federal income tax withholding and are considered supplemental wages for federal income tax withholding purposes. Treas. Reg. § 31.3402(g)-1(a)(1)(i).

Analysis

Tax Law § 631(a) provides that the New York source income of a nonresident individual shall be the sum of the net amount of items of income, gain, loss and deduction entering into his or her federal adjusted gross income derived from or connected with New York sources, including those

items attributable to a business, trade, profession or occupation carried on in the State. Tax Law § 671(a) and 20 NYCRR 171.1 require that every employer maintaining an office or transacting business within New York State and making payment of any wages taxable under the personal income tax must deduct and withhold from the employee's wages an amount of tax substantially equivalent to the New York State personal income tax reasonably estimated to be due resulting from the inclusion in the employee's New York adjusted gross income or New York source income of his or her wages received during the calendar year. Tax Regulation 20 NYCRR 171.3(a) provides that payments that are considered wages for Federal income tax withholding purposes also are considered wages for payments of withholding for New York State personal income tax. Tax Law § 674(a) and 20 NYCRR 174.1 require that every employer required to deduct and withhold taxes from wages under the personal income tax must file a New York State withholding tax return and pay over the taxes required to be deducted and withheld.

4 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 such state. The term "retirement income" means any income from qualified plans, including IRC §§ 401(a) & 401(k) plans. See 4 USC § 114(b)(1)(A)-(H). It also includes income from any plan, program, or arrangement described in IRC § 3121(v)(2)(C) if such income (i) 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, 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 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)(I).

In Advisory Opinions TSB-A-00(6)I and TSB-A-01(2)I, the Department determined that under the Pension Source Law, lump sum payments to nonresident employees from a nonqualified deferred compensation plan maintained by their employer were not New York source income for New York State personal income tax purposes. Like Petitioner's nonqualified plans, the nonqualified plan referenced in those opinions provided a benefit in excess of the benefit the employee was entitled to receive from a tax-qualified profit-sharing plan, due to the application of various IRC limits, and provided for payment following the employee's termination of employment. Also, in Advisory Opinion TSB-A-16(1)I, the Department determined that, under the Pension Source Law, a lump sum payment to a nonresident employee after termination of employment from a nonqualified deferred compensation plan maintained by the retiree's former employer was not New York source income for New York State personal income tax purposes. The nonqualified plan referenced in that opinion provided a benefit in excess of the benefit the employee was entitled to receive from a tax-qualified plan due to the application of the IRC § 401(a)(17) limit.

In some respects, the facts in this matter are substantially similar to the facts set forth in Advisory Opinions TSB-A-00(6)I, TSB-A-01(2)I and TSB-A-16(1)I. The nonqualified plans are plans described in IRC § 3121(v)(2)(C) and the purpose of the nonqualified plans is to allow participants to

make elective deferrals and/or receive company-provided benefits that they are unable to make or receive under the qualified plans because of the limitations imposed under IRC §§ 401(a)(17), 401(k), 401(m), 402(g) and 415. However, the plans here differ from the plans considered in those advisory opinions because, in order to comply with IRC § 409A, the plan benefits in this matter may in certain situations be received by participants prior to termination of their employment.

We conclude that the payments made by Petitioner to nonresident former employees after termination of employment from Petitioner's [redacted] plans that are maintained for the sole purpose of providing employees benefits in excess of the compensation limitations under the limitations imposed under IRC §§ 401(a)(17), 401(k), 401(m), 402(g) and 415 conform to the definition of "retirement income" under 4 USC § 114(b)(1)(I)(ii). Therefore, those payments will not be subject to New York State income tax, income tax withholding or reporting. However, payments made by Petitioner to nonresident employees prior to termination of employment do not come within the definition of "retirement income" under 4 USC § 114(b)(1)(I)(ii) and are not protected by the Pension Source Law. Therefore, any income, gain, loss or deduction derived from New York sources with respect to the distributions to the nonresident individuals from these plans will be subject to New York personal income tax. Moreover, since the payments received by the nonresident from the nonqualified deferred compensation plans are considered wages for Federal income tax withholding purposes, the payments also will be considered wages for New York State withholding tax purposes and Petitioner must deduct and withhold from these payments an amount of tax substantially equivalent to the New York State personal income tax reasonably estimated to be due and file a New York State withholding tax return and pay over the taxes required to be deducted and withheld.

DATED: October 6, 2020

/S/
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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.