

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(1)I
Income Tax
April 12, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I000613A

On June 13, 2000, a Petition for Advisory Opinion was received from Office of the Federal Reserve Benefits System, 95 Maiden Lane, 3rd Floor, New York, New York 10045.

The issue raised by Petitioner, Office of the Federal Reserve Benefits System, is whether for personal income tax purposes the following distributions are subtracted from federal adjusted gross income, pursuant to section 612(c)(3)(ii) of the Tax Law, when the individual receiving such distributions computes his or her New York adjusted gross income:

1. Distributions from the Retirement Plan For Employees of the Federal Reserve System (the "Retirement Plan").
2. Distributions (other than in-service withdrawals) from the Thrift Plan For Employees of the Federal Reserve System (the "Thrift Plan").
3. Distributions from the Retirement Plan for Employees of the Federal Reserve System Benefits Equalization Plan (the "Retirement Plan BEP").
4. Distributions from the Thrift Plan for Employees of the Federal Reserve System Benefits Equalization Plan (the "Thrift Plan BEP").

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner, as agent for the Committee on Plan Administration, administers the Retirement Plan, the Thrift Plan, the Retirement Plan BEP, and the Thrift Plan BEP which collectively provide retirement benefits for employees of the Board of Governors of the Federal Reserve System (the "Board"), the twelve Federal Reserve Banks (the "Banks") and Petitioner (collectively, the "Federal Reserve"). The Retirement Plan and Thrift Plan are sometimes referred to herein collectively as "Qualified System Plans" while the Retirement Plan BEP and Thrift Plan BEP are sometimes referred to herein collectively as "Nonqualified System Plans". Both Qualified System Plans and Nonqualified System Plans compose the Federal Reserve "System Retirement Plans".

Retirement Plan

Petitioner states that the Retirement Plan is a qualified plan under section 401(a) of the Internal Revenue Code ("IRC"). The Retirement Plan is comprised of two distinct benefits

TSB-A-01(1)I
Income Tax
April 12, 2001

structures — the “Bank Plan” and the “Board Plan” — each of which provides a defined level of benefit after retirement based on the salary and number of years of service for the Federal Reserve. Employees of the Board who were hired prior to January 1, 1984, (other than the seven sitting members of the Board of Governors) participate in the Board Plan while all other Federal Reserve Employees (other than the seven sitting members of the Board) participate in the Bank Plan. Employees participating in the Board Plan contribute seven percent of their salary to the Retirement Plan. There is no contribution requirement for employees in the Bank Plan. Distributions under the Retirement Plan are all made in an annuity form of payment except for small distributions which are made in a single lump sum.

Thrift Plan

Petitioner states that the Internal Revenue Service has ruled that the Thrift Plan is a qualified plan under section 401(a) of the IRC with a qualified cash or deferred arrangement within the meaning of section 401(k) of the IRC.

The Thrift Plan, among other provisions, provides that an employee of the Federal Reserve (including members of the Board of Governors) may choose to participate in the Thrift Plan. The Thrift Plan establishes and maintains a “Plan Account” for each participant which may include a savings account (employee may make after-tax contributions under section 401(m) of the IRC), a deductible contribution account (applicable to plan years starting on and after January 1, 1982 and ending on or before December 31, 1986), a deferred compensation account (employee may make contributions under section 401(k) of the IRC), an employer contribution account (employer contributions when employee makes contributions to the savings account and/or deferred compensation account) and a rollover account (employee is permitted to transfer into the Thrift Plan, an “eligible rollover distribution”). A participant may direct that a specified percentage (up to certain statutory limits) of his or her salary be paid into the savings and deferred compensation accounts maintained under the Thrift Plan. The Federal Reserve will match those contributions up to a certain level in the employer contribution account. The Thrift Plan permits, under certain circumstances, three in-service withdrawals per year paid in a lump sum. Such employee withdrawals are subject to the penalty provisions of section 72(t) of the IRC for early distributions from qualified retirement plans. Withdrawals from the deferred compensation account and the employer contribution account are subject to certain other restrictions. The sums that are contributed and transferred, together with any investment growth, less withdrawals, will then be available to the employee following his or her termination of service. Distributions to former employees under the Thrift Plan are made in an annuity form, in a single lump sum, in monthly installments, or with respect to an “eligible rollover distribution” from the Thrift Plan, paid directly to an eligible retirement plan, depending upon the election of the member.

Retirement Plan BEP

Petitioner states that the Retirement Plan BEP is an unfunded nonqualified defined benefit excess-type pension plan jointly maintained by the Board and the Banks. It is designed to be complementary to the Retirement Plan. Generally, the Retirement Plan BEP provides eligible participants and their beneficiaries with supplemental retirement and ancillary death benefits equal to the difference between the benefits they are entitled to under the Retirement Plan and the benefits they would have been entitled to under the Retirement Plan but for the application of sections 401(a)(17) and 415 of the IRC. Benefits under the Retirement Plan BEP accrue and vest at the same time as the corresponding benefit under the Retirement Plan. Benefits under the Retirement Plan BEP are not payable prior to such participant's retirement under the Retirement Plan or death, if earlier.

Thrift Plan BEP

Petitioner states that the Thrift Plan BEP is an unfunded nonqualified defined contribution excess-type pension plan jointly maintained by the Board and the Banks. It is designed to be complementary to the Thrift Plan. Generally, the Thrift Plan BEP provides that an account will be established for each Thrift Plan participant whose employer matching contribution under the Thrift Plan is limited by application of section 401(a)(17) of the IRC. A participant's Thrift Plan BEP account is credited each month with an amount equal to the difference between the employer matching contribution such participant is credited with under the Thrift Plan for the month and the employer matching contribution such participant would have been credited with under the Thrift Plan for the month but for the application of section 401(a)(17) of the IRC. The participant's Thrift Plan BEP account is thereafter credited with earnings at the rate of return equal to the rate of return for the Thrift Plan investments elected by the participant with respect to such participant's employer matching contribution account for the same period. Amounts credited to a participant's Thrift Plan BEP account vest at the same time as the corresponding employer matching contribution under the Thrift Plan. A participant's Thrift Plan BEP account balance is not payable to a participant until after the participant retires or otherwise terminates employment.

After retirement, the distributions from the Retirement Plan, the Thrift Plan, the Retirement Plan BEP, if any, and the Thrift Plan BEP, if any, are includible in gross income for federal income tax purposes.

Discussion

Section 612 of Article 22 of the Tax Law provides that the New York adjusted gross income of a resident individual means the individual's federal adjusted gross income with the modifications specified in such section 612. Section 612(c)(3)(ii) of the Tax Law provides that there shall be

TSB-A-01(1)I
Income Tax
April 12, 2001

subtracted from federal adjusted gross income, pensions to officers and employees of the United States of America, any territory or possession or political subdivision of such territory or possession, the District of Columbia, or any agency or instrumentality of any one of the foregoing, to the extent includible in gross income for federal income tax purposes.

Such provision was added in 1989 in response to the United States Supreme Court decision in Davis v Michigan Department of the Treasury, 109 S Ct 1500, 103 L Ed 2d 891, which held that states, such as New York, that exempt pensions of their own employees from income taxes must provide a similar exemption to employees of the federal government. See, TSB-M-89(9)I. The Court relied on 4 USC §111 which provides as follows: “[t]he United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States ... by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.”

Section 112.3(c)(1)(i)(b) of the Personal Income Tax Regulations (“Regulations”), provides that pensions and other retirement benefits (including but not limited to annuities, interest and lump sum payments) paid to a public officer or public employee of an instrumentality of the United States is subtracted from federal adjusted gross income in computing New York adjusted gross income.

The federal reserve banks have been deemed to be federal instrumentalities for purposes of immunity from state taxation. (Lewis v United States, 680 F2d 1239 and Federal Reserve Bank of Boston v Comm of Corporations & Taxation, 499 F2d 60, after remand, 520 F2d 221.)

On March 23, 1976, the Internal Revenue Service issued a private letter ruling to the representative of the Federal Reserve Employee Benefits System. The Internal Revenue Service concluded that the Federal Reserve System is an instrumentality of the United States for purposes of section 414(d) of the Internal Revenue Code (“IRC”) and that the employee’s deferred compensation plans established and maintained by the Board of Governors of the Federal Reserve System, the federal reserve banks and the Office of the Federal Reserve Employees Benefit System, constitute governmental plans within the meaning of section 414(d) of the IRC and are exempt from the provisions of Title II of ERISA [Employee Retirement Income Security Act of 1974] to the extent that governmental plans are exempt. The Internal Revenue Service discussed this issue with the Office of Employee Benefits Security, Department of Labor and that Office concurred.

The term “pension” is not defined in Article 22 of the Tax Law. However, section 607 of the Tax Law provides that “[a]ny term used in [Article 22] shall have the same meaning as when used in comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required.” Pension plans are treated in section 401 of the Internal Revenue Code (“IRC”). It was held in Richard J. Alexanderson, Adv Op Comm T&F, March 19, 1985, TSB-A-85(2)I, that payments paid from a plan constituting a qualified pension plan within the

TSB-A-01(1)I
Income Tax
April 12, 2001

meaning of section 401 of the IRC would constitute a “pension” within the meaning of section 612(c)(3-a) of the Tax Law.

In Charles E. Rockey, Adv Op Comm T&F, June 29, 1990, TSB-A-90(8)I, it was held that pension payments from the Federal Reserve Retirement Plan administered by the Office of the Federal Reserve Employee Benefits System and subject to the direction and control of the Board of Governors and the federal reserve banks are pension payments paid to an employee of an instrumentality of the United States, and therefore were exempt from tax pursuant to section 612(c)(3)(ii) of the Tax Law.

In Joseph T. DiGianni, Adv Op Comm T&F, January 21, 1994, TSB-A-94(1)I, the issue was whether distributions from the Federal Employees’ Thrift Savings Plan (“Plan”) are exempt under section 612(c)(3) of the Tax Law. The opinion held that distributions to participants who were covered by the Federal Employees’ Retirement System (“FERS”) were part of the participant’s pension and exempt pursuant section 612(c)(3)(ii), but distributions to participants who were covered by the Civil Service Retirement System (“CSRS”) were supplemental to the participant’s pension and not exempt pursuant to section 612(c)(3)(ii). However, distributions to CSRS employees did qualify for the up to \$20,000 exclusion under section 612(c)(3-a) of the Tax Law. The distinction was attributable to differences in the provisions of the retirement systems. The FERS consisted of a combination of social security, a defined benefit plan (basic annuity) and a defined contribution plan (the Plan). FERS employees automatically received employer contributions into the Plan, and if the employee elected to make contributions into the Plan, the government matched, to a certain level, such contributions. Therefore, distributions from the Plan were part of the FERS employee’s pension. However, the CSRS consisted of a defined benefit plan (annuity) only. CSRS employees could voluntarily participate in the Plan by making employee contributions, but the government did not make any contributions into the Plan, and the distributions were not part of the employee’s pension.

Conclusions

Distributions from the Retirement Plan – As concluded in Charles Rockey, supra, the Retirement Plan is a pension or other retirement benefit within the meaning of section 612(c)(3)(ii) of the Tax Law and section 112.3(c)(1)(i)(b) of the Regulations, and the distributions from the Retirement Plan are exempt from personal income tax pursuant to such section 612(c)(3)(ii) of the Tax Law.

Distributions from the Thrift Plan – Petitioner states that the Thrift Plan is a qualified plan under section 401(a) of the IRC and a profit-sharing plan within the meaning of section 401(k) of the IRC. Where an employee chooses to participate, the Federal Reserve will match the member’s contributions up to a certain level, similar to the government contributions made in DiGianni, supra,

TSB-A-01(1)I
Income Tax
April 12, 2001

for FERS employees. Following Alexanderson, supra, and DiGianni, supra, distributions from the Thrift Plan, constitute a “pension or other retirement benefit” as contemplated under section 612(c)(3)(ii) of the Tax Law and section 112.3(c)(1)(i)(b) of the Regulations. Since the distributions from the Thrift Plan are paid to an employee of an instrumentality of the United States, such distributions constitute pension or other retirement distributions pursuant to section 612(c)(3)(ii) of the Tax Law. Accordingly, the distributions from the Thrift Plan (other than in-service withdrawals) are exempt from personal income tax pursuant to such section 612(c)(3)(ii) of the Tax Law.

Distributions from the Retirement Plan BEP – Petitioner states that the Retirement Plan BEP is an unfunded nonqualified defined benefit excess-type pension plan that is designed to be complementary to the Retirement Plan. As such, the Retirement Plan BEP is also a pension or other retirement benefit for purposes of section 612(c)(3)(ii) of the Tax Law and section 112.3(c)(1)(i)(b) of the Regulations. Accordingly, distributions from the Retirement Plan BEP are also exempt from personal income tax pursuant to section 612(c)(3)(ii) of the Tax Law.

Distributions from the Thrift Plan BEP – Petitioner states that the Thrift Plan BEP is an unfunded nonqualified defined contribution excess-type pension plan that is designed to be complementary to the Thrift Plan. As such, the Thrift Plan BEP, like the Thrift Plan, is a pension or other retirement benefit for purposes of section 612(c)(3)(ii) of the Tax Law and section 112.3(c)(1)(i)(b) of the Regulations. Accordingly, like the distributions from the Thrift Plan, the distributions from the Thrift Plan BEP are exempt from personal income tax pursuant to section 612(c)(3)(ii) of the Tax Law.

DATED: April 12, 2001

/s/
Jonathan Pessen
Tax Regulations Specialist III
Technical Services Division

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