

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

TSB-A-01(3)I
Income Tax
July 31, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I001114K

On November 14, 2000, a Petition for Advisory Opinion was received from Kenneth W. & Janice W. Freeman, 15 West 81st Street, New York, New York 10024.

The issue raised by Petitioners, Kenneth W. & Janice W. Freeman, is whether certain items of income that were paid to Kenneth W. Freeman in 1996, but were earned in previous years during the period he was a nonresident of New York City are taxable for New York City personal income tax.

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

Kenneth W. Freeman was a resident of Corning, New York until September 1, 1996, at which time he removed his children from the Corning School District and enrolled them in school in New York City. Kenneth W. Freeman was assigned to temporarily work in New Jersey, and had a transitional apartment in New York City during 1996. He spent a total of 200 nights and days in New York City for 1996, allocated as 80 days and nights prior to his family relocation and 120 days and nights after his family relocated. Petitioners state that he appears to meet the definition of a statutory resident of New York City for the tax year 1996. Therefore, this Advisory Opinion assumes that Kenneth W. Freeman was a statutory resident of New York City for tax year 1996.

Kenneth W. Freeman's wage compensation included in his federal adjusted gross income for taxable year 1996 consisted of the following:

(a) Restricted stock awards paid by his previous employer:

	<u>AWARD DATE</u>	<u>AMOUNT</u>
(1)	04-24-86	\$ 615,810
(2)	12-03-86	280,143
(3)	12-05-90	50,325
(4)	12-01-93	419,375
(5)	12-07-94	419,375
(6)	02-01-95	196,687
(7)	12-06-95	<u>608,094</u>
	Sub-total	\$2,589,809
(8)	02-07-96	<u>31,034</u>
	TOTAL	\$2,620,843

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(b) Cash award pre 1996	\$ 139,860
(c) Funding pension trust	363,058 *
(d) Deferred Compensation pre 1996 (bonus)	265,411 **
Deferred Compensation pre 1996 (bonus)	275,289 **
(e) 1995 Bonus (Goal Sharing- general bonus)	<u>7,418</u>
TOTAL	\$1,051,036

* Petitioner states that this is what is commonly called a “Rabbi Trust”

** Petitioner states that this is an unfunded nonqualified deferred compensation plan

The term “Rabbi Trust” is used to describe a certain type of trust that is a nonqualified irrevocable trust established by an employer to fund its obligation to pay deferred compensation to officers or employees following retirement. The assets and income of the trust are subject to the claims of the employer’s general creditors in the event of the employer’s bankruptcy or insolvency. It is so called, because a rabbi was the recipient of the first favorable Internal Revenue Service Letter Ruling regarding such trust.

Discussion

The New York City personal income tax on residents is authorized by Article 30 of the Tax Law. Section 1301(b) of Article 30 of the Tax Law provides that “[a]ll the provisions of the local laws imposing the taxes authorized by this article shall be identical to the corresponding provisions of article twenty-two of this chapter, except as to rate and except as otherwise provided in this article, so far as the provisions of such article twenty-two can be made applicable to the taxes authorized, with such limitations and modifications as may be necessary in order to adapt such language to the city income taxes authorized by this article.”

Section 1305(a)(2) of Article 30 of the Tax Law and section 11-1705(b)(1)(B) of the Administrative Code of the City of New York provide that a city resident individual means an individual who is not domiciled in such city but maintains a permanent place of abode in such city and spends in the aggregate more than one hundred eighty-three days of the taxable year in such city, unless such individual is in active service in the armed forces of the United States. Such a resident individual is commonly called a “statutory resident”, and in this case it is assumed that Kenneth W. Freeman is a statutory city resident for calendar year 1996.

Pursuant to section 1303 of Article 30 of the Tax Law and section 11-1711(a) of the Administrative Code of the City of New York, the city taxable income of a city resident individual is the same as his New York taxable income as defined in section 611 of the Tax Law.

Section 611 of the Tax Law provides that the New York taxable income of a resident individual is the individual’s New York adjusted gross income less the individual’s New York deduction and New York exemptions as determined under Article 22 of the Tax Law. Section 612(a)

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of the Tax Law provides that the New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in section 612 of the Tax Law. There is no modification under section 612 of the Tax Law to change the taxable year that income which is reflected in the taxpayer's federal adjusted gross income is included for New York State and New York City income tax purposes.

Section 605(a)(3) of Article 22 of the Tax Law and section 11-1705(a)(3) of the Administrative Code of the City of New York provide that a taxpayer's method of accounting under such laws is the same as the individual's method of accounting for federal income tax purposes.

Section 1.451-1 of the Treasury Regulations provides the general rule for determining the taxable year that income is included in gross income for federal income tax purposes. Section 1.451-(a) states, in pertinent part, that:

Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income from the taxable year in which the determination can be made....

Pursuant to section 1.451-1(a) of the Treasury Regulations, under a cash method of accounting, income is includible in gross income when it is actually received or constructively received, and under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

In Internal Revenue Service Rev. Rul. 69-649, the issue concerned the constructive receipt of income under the cash method of accounting. In the ruling the Service held that incentive bonuses awarded to employees at the discretion of the employer-corporation, to be paid at a designated future time in accordance with provisions of a nonqualified unfunded deferred compensation plan, are not constructively received by the employees until such bonus awards are actually received by or otherwise made available to the employees, whichever is earlier. The Service reasoned that the obligations of the corporation under this supplementary retirement plan are merely contractual and are not funded or secured, and the awards are nonassignable. Therefore, the employee's control of receipt of the incentive bonus is subject to substantial limitations or restrictions until it is actually

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received by or otherwise made available to the employee, whichever is earlier. The Service also held that the employer-corporation is entitled to deduct the deferred bonus award only in the taxable year in which payments are actually made to the employee or his legal representative, to the extent the payments are ordinary and necessary expenses under section 162 of the IRC.

Section 83 of the Internal Revenue Code provides rules for the taxation of property that is transferred to an employee in connection with the performance of services and that is subject to restrictions that affect its value. The person who performed such services generally includes in gross income the fair market value of the property over any amount paid for it, in the first taxable year in which the rights of the person having beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

In Internal Revenue Service Letter Ruling 8730041, April 28, 1987, the Service held that a nonqualified irrevocable trust termed a "rabbi trust" was established by an employer to fund its obligation to pay deferred compensation to key executives following retirement. The assets of the trust, including the income generated by those assets, were expressly made subject to the claims of the employer's general creditors in the event of the employer's bankruptcy or insolvency. Because of the provision regarding the employer's creditors, the interests of the employees in the trust cannot be considered to be substantially vested since these interests are either not transferable or are subject to a substantial risk of forfeiture. The Service held that under section 83 of the Internal Revenue Code, the amounts contributed to the trust by the employer and the earnings thereon are not currently includible in the income of the key executive who participates in the deferred compensation agreement.

Section 1307(b) Article 30 of the Tax Law, and section 11-1754 of the Administrative Code of the City of New York, provide that if an individual changes his status during the taxable year from city nonresident to city resident, he shall, regardless of his method of accounting, accrue for the portion of the taxable year prior to such change of status any items of income, gain, loss or deduction accruing prior to the change of status. Such accruals shall be made as provided in section 639(b) (formerly section 654(c)) of Article 22 of the Tax Law. Section 639(b) of the Tax Law provides for accruals when an individual changes status from a nonresident to a resident of New York during the taxable year. It provides as follows:

If an individual changes status from nonresident to resident [the individual] shall, regardless of [the individual's] method of accounting, accrue to the period of nonresidence any items of income, gain, loss or deduction, items of tax preference or ordinary income portion of a lump sum distribution accruing prior to the change of status, with the applicable modifications and adjustments to federal adjusted gross income, itemized deductions and items of tax preference under sections six hundred twelve, six hundred fifteen and six hundred twenty-two, other than items derived from or connected with New York sources, if not otherwise properly includible or

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allowable for New York income tax purposes for such period or for a prior taxable year under [the individual's] method of accounting.

However, in this case, it is assumed that Kenneth W. Freeman is a statutory city resident for calendar year 1996, pursuant to section 1305(a)(2) of Article 30 of the Tax Law and section 11-1705(b)(1)(B) of the Administrative Code of the City of New York. Accordingly, Kenneth W. Freeman did not have a change of residence for New York City income tax purposes for taxable year 1996. Therefore, the provisions of section 1307(b) of Article 30 of the Tax Law, section 11-1754 of the Administrative Code of the City of New York and section 639(b) of Article 22 of the Tax Law are not applicable.

The income that Kenneth W. Freeman actually received in 1996 when he was a statutory city resident individual, that was attributable to services performed prior to 1996, was included in his federal adjusted gross income for taxable year 1996 pursuant to section 1.451.-1(a) of the Treasury Regulations. Pursuant to section 1303 of Article 30 of the Tax Law, section 11-1711(a) of the Administrative Code of the City of New York and section 612 of the Tax Law, Kenneth W. Freeman may not exclude such income from his city taxable income computed for 1996.

DATED: July 31, 2001

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