

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

TSB-A-03(4)I
Income Tax
November 19, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. 1030617A

On June 17, 2003, a Petition for Advisory Opinion was received from Larry J. Green, c/o David A. Schlein, CPA, Lumsden & McCormick, LLP, 403 Main St., Ste 430, Buffalo, New York 14203.

The issues raised by Petitioner, Larry J. Green, are:

1. What portion of the distribution from an Individual Retirement Account (IRA) established by means of a rollover of tax exempt pension funds may be subtracted from federal adjusted gross income when computing New York adjusted gross income for personal income tax purposes under Article 22 of the Tax Law; and
2. If the IRA distribution is partially exempt, what method is used to distinguish the amount that represents a return of tax exempt pension funds rolled over into an IRA from interest or any other gain accrued.

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

Petitioner was an employee of the State University of New York (SUNY). His SUNY pension was held in two Optional Retirement Plans with College Retirement Equities Fund (C.R.E.F.) and Variable Annuity Life Insurance Company (V.A.L.I.C.). During October 2001, the entire balance of the two SUNY accounts was rolled over into a private IRA. Petitioner's age is over 59 1/2 years. All amounts contributed to the IRA were rolled over from his SUNY pension accounts. All earnings credited to the rollover IRA were earned on the accounts transferred from his SUNY pension accounts.

Applicable law and regulations

Section 612(a) of the Tax Law provides:

General. 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 this section.

Section 612(c) of the Tax Law provides, in part:

Modifications reducing federal adjusted gross income. There shall be subtracted from federal adjusted gross income:

* * *

(3)(i) Pensions to officers and employees of this state, its subdivisions and agencies, to the extent includible in gross income for federal income tax purposes;

* * *

(3-a) Pensions and annuities received by an individual who has attained the age of fifty-nine and one-half, not otherwise excluded pursuant to paragraph three of this subsection, to the extent includible in gross income for federal income tax purposes, but not in excess of twenty thousand dollars, which are periodic payments attributable to personal services performed by such individual prior to his retirement from employment, which arise (i) from an employer-employee relationship or (ii) from contributions to a retirement plan which are deductible for federal income tax purposes. However, the term "pensions and annuities" shall also include distributions received by an individual who has attained the age of fifty-nine and one-half from an individual retirement account or an individual retirement annuity, as defined in section four hundred eight of the internal revenue code, and distributions received by an individual who has attained the age of fifty-nine and one-half from self-employed individual and owner-employee retirement plans which qualify under section four hundred one of the internal revenue code, whether or not the payments are periodic in nature. Nevertheless, the term "pensions and annuities" shall not include any lump sum distribution, as defined in subparagraph (A) of paragraph four of subsection (e) of section four hundred two of the internal revenue code and taxed under section six hundred three of this article. Where a husband and wife file a joint state personal income tax return, the modification provided for in this paragraph shall be computed as if they were filing separate state personal income tax returns. Where a payment would otherwise come within the meaning of the term "pensions and annuities" as set forth in this paragraph, except that such individual is deceased, such payment shall, nevertheless, be treated as a pension or annuity for purposes of this paragraph if such payment is received by such individual's beneficiary.

Section 112.3(c)(2)(ii) of the New York State Personal Income Tax Regulations provides, in part:

Distributions from an individual retirement account (IRA) or a self-employed retirement plan (Keogh) will qualify for the pension and annuity income modification whether such distributions are periodic payments or a lump sum distribution....

Opinion

Article 16, section 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."

In *Joseph W. Martiney*, Adv Op St Tax Commn, November 24, 1980, TSB-H-80-(523)I, it was held that the distributions from an IRA established by means of a tax-free rollover of amounts received in the form of a pension from New York State or a subdivision or agency thereof, represents a nontaxable return of principal to the extent that the distribution represents a return of the pension funds "rolled over" into the IRA. To the extent that the distribution represents interest, or any other type of gain earned in the account, such portion would be subject to tax.

In accordance with *Martiney, supra*, when Petitioner receives distributions from the rollover IRA account, only a portion of the distribution is exempt. Regardless of Petitioner's age at the time of distribution, assuming the distributions Petitioner receives from the rollover IRA account are included in his federal adjusted gross income, the portion of a distribution from the rollover IRA account that represents the amount from Petitioner's SUNY pension accounts (C.R.E.F. and V.A.L.I.C.) that were rolled over into the IRA (the contribution), is a return of the contribution and is exempt from New York State personal income tax. Such portion of the IRA distribution would be subtracted from federal adjusted gross income when computing Petitioner's New York adjusted gross income for the taxable year.

Assuming that a distribution during the taxable year is a partial distribution of an IRA established by means of a tax-free rollover, to determine the amount of distribution that represents a return of nontaxable funds, the amount of contributions rolled over from the SUNY pension accounts to the IRA should be divided by the total value of the IRA, including the amount of distribution, at the date of distribution and the result should be multiplied by the amount distributed. This computation is used for the initial year that a distribution is made and each succeeding year until the total amount of nontaxable contributions is recovered. This method essentially parallels the method prescribed in Internal Revenue Service Notice 87-16, 1987-1 CB 446, for determination of the portion of a distribution from an IRA that is attributable to the return of nondeductible contributions.

In addition, section 612(c)(3-a) of the Tax Law and section 112.3(c)(2) of the Personal Income Tax Regulations provide that the balance of the distribution from the rollover IRA account that represents any other amount in the rollover IRA account may not be subject to tax. Since Petitioner is over the age of 59 ½ years, such amount may be added to Petitioner's other pension and annuity income, if any, that meets the conditions of section 612(c)(3-a) of the Tax Law and section 112.3(c)(2) of the Personal Income Tax Regulations for purposes of computing the \$20,000 pension and annuity income modification. The total, but not in excess of \$20,000, would be allowed as a

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subtraction from federal adjusted gross income when computing Petitioner's New York adjusted gross income. Any excess would be subject to tax and would not be allowed as a subtraction from federal adjusted gross income when computing Petitioner's New York adjusted gross income.

DATED: November 19, 2003

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

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