

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

TSB-A-03(5)I
Income Tax
November 19, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I030620A

On June 20, 2003, a Petition for Advisory Opinion was received from Richard Epstein, 1535 Kevin Place, East Meadow, New York 11554. Petitioner, Richard Epstein, provided additional information pertaining to the Petition on July 23, 2003.

The issues raised by Petitioner are:

1. Whether distributions received from an Individual Retirement Account (IRA) established by means of a tax-free rollover or direct transfer of amounts received from an Internal Revenue Code (IRC) section 403(b) tax-deferred annuity plan (IRC 403(b) plan) are exempt from New York personal income tax.
2. If the answer to Issue 1. is yes, 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 retired on July 1, 2003, at the age of 56 from the Board of Education of the City of New York. Petitioner was a Tier 1 pension member. While working for the Board of Education of the City of New York, Petitioner contributed to his New York City Teachers' Retirement IRC 403(b) plan. After retiring, Petitioner rolled over funds from his New York City Teachers' Retirement IRC 403(b) plan into a private IRA.

Applicable law and regulations

IRC section 403(b)(1) contains employee annuity provisions for a beneficiary under an annuity purchased by a public school, and provides, in part:

General rule. If -

(A) an annuity contract is purchased -

(i) for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),

TSB-A-03(5)I
Income Tax
November 19, 2003

(ii) for an employee (other than an employee described in clause (i)), who performs services for an educational organization described in section 170(b)(1)(A)(ii), by an employer which is a State , a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing...

* * *

(B) such annuity contract is not subject to subsection (a),

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums,

* * *

and

(E) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30),

then contributions and other additions by such employer for such annuity contract shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such contributions and additions (when expressed as an annual addition (within the meaning of section 415(c)(2))) does not exceed the applicable limit under section 415. The amount actually distributed to any distributee under such contract shall be taxable to the distributee (in the year in which so distributed) under section 72 (relating to annuities)....

Section 3109-A of the Education Law authorizes the reduction of salaries of teachers in New York City school districts for the purpose of purchasing tax deferred annuities. The tax deferred annuity program of the New York City Teachers' Retirement System, which implements this provision, is set forth in section 13-582 of the Administrative Code of the City of New York (New York Administrative Code).

Section 13-582.a of the New York Administrative Code provides that "Any member for whom a salary reduction agreement is executed pursuant to . . . section three thousand one hundred nine-A of the education law shall thereby become a participant in the tax-deferred annuity program...."

Section 13-582.f of the New York Administrative Code adopts the provisions of section 13-561 of the New York Administrative Code by reference, and provides that as such section applies "to the contributions made by a contributor and the benefits provided thereby, shall apply separately

TSB-A-03(5)I
Income Tax
November 19, 2003

and independently to the tax-deferred annuity net contributions and the benefits provided thereby....”

Section 13-561 of the New York Administrative Code, as amended by Chapter 248 of the Laws of 1994, (formerly section B20-48.0 as enacted by Chapter 929 of the Laws of 1937) provides a general state and local income tax exemption for payments made under the New York City Teachers' Retirement System, and provides, in part:

Exemption from tax, execution, etc. The right of a person to a pension, a pension-providing-for-increased-take-home-pay, an annuity, or a retirement allowance, to the return of contributions, the pension, pension-providing-for-increased-take-home-pay, annuity, or retirement allowance itself, any optional benefit, any other right accrued or accruing to any person under the provisions of this chapter, and the moneys in the various funds provided for by this chapter, are hereby exempt from any state or municipal tax, and exempt from levy and sale, garnishment, attachment or any other process whatsoever, and shall be unassignable except as in this chapter specifically otherwise provided....

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

TSB-A-03(5)I
Income Tax
November 19, 2003

"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

Pursuant to section 3109-A of the Education Law, a person employed by the Board of Education of the City of New York may agree to reduce his or her annual salary and become a participant in a tax deferred annuity program. The New York City Teachers' Retirement System tax deferred annuity program is authorized by IRC section 403(b), and is maintained pursuant to section 13-582 of the New York Administrative Code. Distributions from the IRC 403(b) plan maintained pursuant to section 13-582 of the New York Administrative Code are exempt from New York State and New York City personal income taxes pursuant to section 13-561 of the New York Administrative Code.

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 *Robert Weitzman*, Adv Op Comm T&F, December 16, 2002, TSB-A-02(9)I, it was held that distributions received by the petitioner from his New York City Teachers' Retirement IRC

TSB-A-03(5)I
Income Tax
November 19, 2003

403(b) plan are exempt from New York State personal income tax pursuant to section 13-561 of the New York Administrative Code.

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 of the IRC 403(b) plan that was rolled over into the IRA (the contribution) is a return of the IRC 403(b) plan contribution and is exempt for New York State purposes pursuant to section 13-561 of the New York Administrative Code. 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 or direct transfer of amounts received from Petitioner's IRC 403(b) plan, to determine the amount of distribution that represents a return of nontaxable funds, divide the amount of contributions rolled over from the IRC 403(b) plan to the IRA by the total value of the IRA, including the amount of distribution, at the date of distribution and multiply the result 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, including any other contributions or interest or any other type of gain or income earned, may not be subject to tax. When Petitioner reaches 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 subtraction from federal adjusted gross income when computing Petitioner's New York adjusted

TSB-A-03(5)I
Income Tax
November 19, 2003

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.