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

TSB-A-05(2)I
Income Tax
April 4, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I040414A

On April 14, 2004, a Petition for Advisory Opinion was received from Robert M. Braun, 42 Fresh Meadow Drive, Trumbull, CT 06611.

The issues raised by Petitioner, Robert M. Braun, are:

1. Whether $7,500 salary paid to Petitioner for the month of January 2003 is New York source income under section 631 of the Tax Law where Petitioner did not come into New York State at any time during January 2003.

2. Whether deferred commissions received in 2003 are New York source income for purposes of section 631 of the Personal Income Tax Law. If so, what method is used in determining the amount of New York source income where prior services were performed within and without New York.

3. Whether severance pay received in 2003 is New York source income for purposes of section 631 of the Personal Income Tax Law. If so, what method is used in determining the amount of New York source income where prior services were performed within and without New York?

4. Whether Petitioner should include in the column labeled "Federal amount" on his 2003 *Nonresident and Part-Year Resident* Income Tax Return (Form IT-203) (a) his spouse's income, which is not derived from or connected with New York sources, and (b) all taxable refunds received, including refunds received from Connecticut.

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

Petitioner is a resident of Connecticut. Petitioner was employed as a salesman in New York by Thomson Financial (Thomson) until January 31, 2003. Petitioner did not have a written employment contract with Thomson. In 2003, Thomson paid Petitioner a salary of $7,500 for the month of January 2003, and approximately $77,000 in commissions deferred from 2002. All payments received from Thomson were reported on a federal wage and tax statement, Form W-2. Petitioner did not come into New York State at any time during January 2003 and did not perform any services for Thomson inside or outside New York State in 2003. In addition, Petitioner received severance pay from Thomson in the amount of $106,451.45 spread over 16 weeks following the separation. The amount of severance pay was determined by Thomson using a formula based on Petitioner's 2002 income and the number of years with the firm. By letter, Thomson offered a severance package in lieu of any other company benefits, and

by signing the letter Petitioner acknowledged that the severance benefits are more valuable than benefits to which Petitioner would otherwise be entitled.

On February 3, 2003, Petitioner joined Midwood Securities of New York City.

Applicable law and regulations

Section 601(e) of the Tax Law imposes a personal income tax for nonresidents of New York State, and provides, in part:

> Nonresidents and part-year residents. (1) General. There is hereby imposed for each taxable year on the taxable income which is derived from sources in this state of every nonresident and part-year resident individual . . . a tax which shall be equal to the tax base multiplied by the New York source fraction.
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> (2) Tax base. The tax base is the tax computed under subsections (a) through (d) of this section, as the case may be, reduced by the credits permitted under subsections (b), (c), (d) and (m) of section six hundred six, as if such nonresident or part-year resident individual . . . were a resident subject to the provisions of part II of this article.
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> (3) New York source fraction. The New York source fraction is a fraction the numerator of which is such individual's . . . New York source income determined in accordance with part III of this article and the denominator of which is such individual's New York adjusted gross income determined in accordance with part II of this article. . . .

Section 611(b)(2) of the Tax Law provides, in part:

> If the federal taxable income of husband and wife, both of whom are residents, is determined on a joint federal return, their New York taxable income shall be determined jointly.

Section 631of the Tax Law provides, in part:

> (a) General. The New York source income of a nonresident individual shall be the sum of the following: (1) The net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources . . . and
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> (2) The portion of the modifications described in subsections (b) and (c) of section six hundred twelve which relate to income derived from New York sources . . . .
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> (b) Income and deductions from New York sources.

(1) Items of income, gain, loss and deduction derived from or connected with New York sources shall be those items attributable to:

(A) the ownership of any interest in real or tangible personal property in this state; or

(B) a business, trade, profession or occupation carried on in this state; . . .

Section 132.4 of the Personal Income Tax Regulations (Regulations) provides, in part:

Business, trade, profession or occupation carried on in New York State. (a)(1) The New York adjusted gross income of a nonresident individual includes items of income, gain, loss and deduction entering into his Federal adjusted gross income which are attributable to a business, trade, profession or occupation carried on in New York State.

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(b) The New York adjusted gross income of a nonresident individual rendering personal services as an employee includes the compensation for personal services entering into his Federal adjusted gross income, but only if, and to the extent that, his services were rendered within New York State. Compensation for personal services rendered by a nonresident individual wholly without New York State is not included in his New York adjusted gross income, regardless of the fact that payment may be made from a point within New York State or that the employer is a resident individual, partnership or corporation. Where the personal services are performed within and without New York State, the portion of the compensation attributable to the services performed within New York State must be determined in accordance with sections [132.17 through 132.19] of this Part.

(c) If personal services are performed within New York State, whether or not as an employee, the compensation for such services includible in Federal adjusted gross income constitutes income from New York State sources, regardless of the fact that (1) such compensation is received in a taxable year after the year in which the services were performed, or (2) such compensation is received by someone other than the person who performed the services.

(d) *Pensions or other retirement benefits constituting an annuity.* (1) General. Where an individual formerly employed in New York State is retired from service and thereafter receives a pension or other retirement benefit attributable to his former services, the pension or retirement benefit is not taxable for New York State personal income tax purposes if the individual receiving it is a nonresident and if it constitutes an *annuity* as defined in paragraph (2) of this subdivision. Where a pension or other

retirement benefit does not constitute an annuity, it is compensation for personal services and, if the individual receiving it is a nonresident, it is taxable for New York State personal income tax purposes to the extent that the services were performed in New York State. The term *compensation for personal services* as used in the foregoing sentence includes, but is not limited to, amounts received in connection with the termination of employment, amounts received upon early retirement in consideration of past services rendered, amounts received upon retirement for consultation services, and amounts received upon retirement under a covenant not to compete. For allocation rules, see section 132.20 of this Part.

Section 132.18 (a) of the Regulations provides, in part:

(a) If a nonresident employee (including corporate officers, but excluding employees provided for in section 132.17 of this Part) performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State. The items of gain, loss and deduction (other than deductions entering into the New York itemized deduction) of the employee attributable to his employment, derived from or connected with New York State sources, are similarly determined. However, any allowance claimed for days worked outside New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employer. In making the allocation provided for in this section, no account is taken of nonworking days, including Saturdays, Sundays, holidays, days of absence because of illness or personal injury, vacation, or leave with or without pay.

Section 132.20 of the Regulations provides:

Pensions and other retirement benefits. If a pension or other retirement benefit does not qualify as an annuity under section 132.4(d) of this Part, and is attributable to services performed wholly within New York State, the entire amount included in the individual's Federal adjusted gross income is likewise includible in his New York adjusted gross income. If the pension or other retirement benefit is attributable to services performed wholly outside New York State, no part of the amount received is includible in the individual's New York adjusted gross income. Where the employee's services were performed partly within and partly without New York State, the amount includible in the individual's New York adjusted gross income is the proportion of the amount included in the individual's Federal adjusted gross income which the total compensation, received from the employer for the services performed in New York State during a period consisting of the portion of the taxable year prior to retirement and the three taxable years immediately preceding the retirement, bears to the total compensation received from the employer during such period for services performed both within and without New York

State. For purposes of this section, the compensation for services performed within New York State must be determined separately for each taxable year or portion of a year in accordance with the applicable provisions of section 132.17, 132.18 or 132.19 of this Part. A determination of the portion of a pension or other form of deferred compensation attributable to New York State on the basis of a period of time greater than the period referred to above may be made if the individual establishes, to the satisfaction of the [Commissioner of Taxation and Finance], the amount of his total yearly compensation for a longer period of time and the amount allocable to New York State in each year in accordance with the applicable provisions of sections 132.17 through 132.19 of this Part. (For taxability of pensions and other retirement benefits in general, see section 132.4(d) of this Part.)

Example: A, a nonresident of New York State, performs services both within and without New York State for a corporate employer under an employment contract whereby for each year's services he is to receive a salary of $40,000 during the period of employment and an additional $100,000 payable in 10 equal annual installments commencing after his employment terminates. A terminates his employment on July 1, 1977, when he is 50 years of age and his life expectancy is 25.5 years. Since the payments are not to run for at least one half of A's life expectancy, they do not qualify as an annuity under section 132.4(d) of this Part. Assuming that the New York State percentages for allocating his salary were 50 percent for 1974, 60 percent for 1975, 75 percent for 1976, and 40 percent for the first half of 1977, the portion of additional payments to be included in New York adjusted gross income would be computed as follows:

	Total compensation	*New York*	*portion*
1974	$ 40,000	(50%)	$20,000
1975	40,000	(60%)	24,000
1976	40,000	(75%)	30,000
1977 (6 months)	20,000	(40%)	8,000
Totals	$140,000		$82,000

$\frac{\$82,000}{\$140,000}$ X $10,000 = $5,857.14 includible annually in A's New York adjusted gross income.

Opinion

Section 601(e) of the Tax Law imposes a personal income tax on the taxable income

which is derived from New York sources of a nonresident individual. The tax is equal to the tax computed as if the individual were a New York State resident for the entire year, reduced by certain credits, and then multiplied by the income percentage (i.e., New York source fraction). The numerator of the fraction used to compute the income percentage is the individual's New York source income for the entire year. The denominator of the fraction used to compute the income percentage is the nonresident's New York adjusted gross income from all sources for the entire year.

Section 631(a) of the Tax Law provides that the New York source income of a nonresident individual is the sum of the items of income, gain, loss and deduction entering into federal adjusted gross income derived from or connected with New York sources and any New York addition and subtraction modifications under section 612(b) and (c) of the Tax Law that relate to income derived from New York sources.

In the *Matter of Donahue v Chu*, 104 AD2d 523, the nonresident taxpayer entered into a five-year employment contract with his New York employer. The agreement provided that at the conclusion of the five-year period the taxpayer would provide consulting services over the next ten years at the rate of $20,000 per year. In the fifth year of the contract, the taxpayer and the employer entered into a second agreement terminating the initial employment agreement. As consideration for the relinquishment of these future rights, the taxpayer received the remainder of his final year's salary, as well as the sum of $107,361. The Court held that the payment was not New York source income, because the right to future employment was originally secured by consideration having no connection with New York (i.e., the promise to work in the future). When the taxpayer entered into the contract, he had secured a right to future employment. In the later agreement, which terminated the employment contract, the taxpayer received a payment in exchange for relinquishing this right.

In the *Matter of John A. and Deborah D. Laurino*, Dec St Tax Trib, May 20, 1993, DTA No. 807912, the Tribunal stated that it read *Donahue, supra*, to stand for the proposition that where a nonresident possesses a right to future employment secured by consideration having no connection with New York and relinquishes that right in exchange for a lump sum settlement, the lump sum settlement is not taxable to New York. It concluded "that in determining whether income is 'derived from or connected with New York sources' it is necessary to identify the activity upon which the income was secured or earned (*Matter of Halloran*, [Tax Appeals Tribunal, August 2, 1990, DTA No. 806902]). Thus, in making this determination, the consideration given by [John Laurino] in exchange for the right to the income at issue is the controlling factor." In *Laurino*, *supra,* what the employer sought from the petitioner in exchange for the right to a lump sum payment was the petitioner's act of continued service up to the time that a change of control in the corporation occurred. Because it was this continuing service to the employer performed by the petitioner predominantly in New York which constituted the consideration for the lump sum payment, a portion of this payment was derived from or connected with New York sources. There was no merit to the petitioner's argument that the lump

sum payment was an alternative to future employment which would have occurred outside New York and, thus, was not taxable to New York.

In the *Matter of Peter F. and Barbara D. McSpadden*, Dec St Tax Trib, September 15, 1994, DTA No. 810895, the petitioner's employment contract provided petitioner with employment through December 31, 1990. The petitioner and his employer negotiated a settlement wherein it was agreed the petitioner would relinquish his contractual rights under the employment agreement in exchange for a lump sum payment. The petitioner's rights under the employment agreement were originally secured by consideration having no connection to New York, i.e., the petitioner's promise to work for the corporation in the future. Therefore, the petitioner was compensated for all services rendered up to his termination date of May 18, 1988, and was owed no monies for past services. He did not perform any future services or employment of any nature and thus was not paid upon retirement for consultation services. The payment was not severance pay, nor was it made in exchange for a covenant not to compete. The Tribunal held that the payment in question was not compensation for personal services rendered, but rather was a payment made in exchange for the taxpayer's relinquishment of a future contractual right to employment and was not subject to New York State personal income tax.

In the *Matter of Arthur Hull Hayes v State Tax Commn*, 61 AD2d 62 [1978], the petitioner was a nonresident working as a consultant for a New York based company under an agreement which allowed him to work at home. The court held that since the petitioner performed no services in New York for the income in question and did not maintain an office or place of business in New York, the income was not received from a source in New York. The court stated that "A nonresident who works in another state but who performs no work in New York is not subject to New York State tax liability no matter for whose convenience or necessity he performs the work."

In issue 1, Petitioner was employed by Thomson until January 31, 2003, and received a salary of $7,500 for the month of January. Petitioner did not perform any personal services for Thomson either inside New York State or outside New York State during 2003. Since Petitioner did not perform any services for Thomson during January 2003, the $7,500 received is considered compensation for personal services in connection with the termination of employment and is consideration for past services rendered pursuant to section 132.4(d) of the Regulations. See issue 3 below for allocation rules with respect to this amount and the other severance payments received by Petitioner in 2003.

In issue 2, Petitioner's commissions received in 2003 that are deferred from 2002 are compensation for personal services that are attributable to services rendered during 2002 and are included in the New York source income for taxable year 2003 pursuant to section 631 of the Tax Law and section 132.4(c) of the Regulations to the extent services were provided in New York during 2002. Where the deferred commissions are compensation for personal services that are attributable to services rendered within and without New York State during 2002, the portion of Petitioner's deferred commissions that are attributable to New York sources

is determined based on the provisions of section 132.18 of the Regulations. Therefore, if the personal services rendered by Petitioner during 2002 were wholly within New York State, the entire amount of deferred commissions included in Petitioner's federal adjusted gross income is likewise included in Petitioner's New York source income for taxable year 2003. If the personal services rendered by Petitioner during 2002 were performed partly within and partly without New York State, the amount of deferred commissions attributable to New York sources for taxable year 2003 is the amount determined using the same ratio Petitioner used to determine Petitioner's compensation for personal services rendered as an employee attributable to New York sources for taxable year 2002. Such ratio is computed pursuant to section 132.18 of the Regulations, and is based on the number of working days employed within and without New York during 2002.

In issue 3, Petitioner did not have a contractual employment relationship with Thomson. Since Petitioner's separation from Thomson did not involve a termination of a contractual employment relationship, this case is distinguishable from *Donahue, supra*. Accordingly, since Petitioner did not have a contractual employment relationship with Thomson and the severance payments are not in exchange for Petitioner's right to future employment, the payments are considered to be for prior services. The severance payments, including the $7,500 in salary discussed in issue 1, are compensation for personal services that are attributable to past services and if the services were performed wholly within New York State, the entire amount of severance payments is New York source income for taxable year 2003 pursuant to section 631 of the Tax Law. However, if the severance payments are compensation for personal services that are attributable to past services rendered within and without New York State, pursuant to section 132.4(d) of the Regulations, the portion of Petitioner's severance pay that is attributable to New York sources is determined based on the provisions of section 132.20 of the Regulations. Pursuant to section 132.20 of the Regulations, the portion of the severance payments and the $7,500 salary that is includible in Petitioner's New York source income in 2003 is the proportion of such amount included in Petitioner's federal adjusted gross income which the total compensation received from Thomson for the services performed in New York State during a period consisting of the portion of the taxable year prior to retirement and the three taxable years immediately preceding the retirement bears to the total compensation received from Thomson during such period for services performed both within and without New York State. Since Petitioner did not perform any services for Thomson for taxable year 2003, this allocation is based only on the three previous years, 2000, 2001, and 2002. For purposes of the allocation, the deferred commissions that Petitioner received in 2003 that were attributable to services performed in 2002, should be included in the total compensation received from Thomson for services performed during taxable year 2002. For purposes of this allocation, the compensation for services performed within New York State must be determined separately for each taxable year or portion of a year. Petitioner may, but is not required to, determine the portion of severance payments attributable to New York sources based on a period of time greater than the period described above if Petitioner establishes to the satisfaction of the Tax Department the amount of Petitioner's yearly compensation for these years as well as the amount allocable to New York in each year.

In issue 4, pursuant to sections 601(e)(2) and 611(b)(2) of the Tax Law, if Petitioner files a joint federal income tax return for taxable year 2003 and both spouses are nonresidents but only one has New York source income, Petitioner must file a joint New York State income tax return for 2003 using filing status *married filing joint return* and include in the federal column the income of both spouses, including taxable refunds received from Connecticut, as reported on Petitioner's federal income tax return.

DATED: April 4, 2005

/s/
Jonathan Pessen
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Technical Services Division

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