

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-97(9) I
Income Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I970821A

On August 21, 1997, a Petition for Advisory Opinion was received from Deloitte & Touche LLP, 2 World Financial Center, 8th Floor, New York, New York 10281-1426.

The issue raised by Petitioner, Deloitte & Touche LLP, is whether lump sum settlements that nonresidents received from their non-qualified supplemental employee retirement arrangements ("SERP Arrangements") claims are exempt from New York State personal income tax because they qualify as either (1) annuities under section 132.4(d)(1) and (2) of the Personal Income Tax Regulations ("Regulations") or (2) "retirement income" as defined by section 114(b)(1)(I)(ii) of Title 4 of the US Code, as added by Public Law 104-95.

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

Individuals who are currently nonresidents of New York State ("Nonresidents") were employed as executive officers of Corporation A at its corporate headquarters in New York City. Following their retirement, the Nonresidents received payments pursuant to SERP Arrangements that were established by Corporation A to provide retirement benefits greater than the amounts payable under Corporation A's qualified pension plans.

In September 1993, Corporation A filed a petition requesting relief under Chapter XI of the US Bankruptcy Code. As a result of the filing, Corporation A ceased all SERP payments to the Nonresidents, and the Nonresidents became unsecured creditors of Corporation A.

The Bankruptcy Court appointed a creditors' committee ("Creditors' Committee") to represent all general unsecured creditors in negotiation with Corporation A. Neither the Nonresidents nor their representatives were members of the Creditors' Committee. Following lengthy and complex negotiations, a Plan of Reorganization ("Plan") was agreed upon by the Creditors' Committee and Corporation A and approved by a vote of the creditors of Corporation A.

Pursuant to the Plan, the Nonresidents' SERP claims were grouped within a class that consisted of all the unsecured claims against Corporation A ("Class of Unsecured Creditors"). In addition to the SERP claims, the Class of Unsecured Creditors included claims in respect of the rejection of executory contracts, as well as the claims of Corporation A's institutional lenders, trade vendors and suppliers.

Under the Plan, the Class of Unsecured Creditors received cash and securities of Corporation A equal to approximately two-thirds of the value of their claims. The cash and securities were paid out to the Class of Unsecured Creditors on April 15, 1997, during the consummation of the Plan. As a result, the Nonresidents' SERP payments, which previously were being paid out as annuities, were settled as lump sum distributions.

Petitioner states that the SERP payments received by the Nonresidents prior to Corporation A's bankruptcy qualified as annuities under section 132.4(d) (1) and (2) of the Regulations, and, as such, were exempt from New York personal income tax and withholding. Additionally, if the Nonresidents' SERP payments had not been suspended as a result of Corporation A's bankruptcy, Petitioner states that any payments received by the Nonresidents after December 31, 1995 would have been exempt from New York personal income tax pursuant to section 114(b) (1) (I) (ii) of Title 4 of the US Code, as added by Public Law 104-95.

Discussion

With respect to question "1", section 132.4(b) of the Regulations provides that:

[t]he New York [source] income of a nonresident individual rendering personal services as an employee includes the compensation for personal services entering into [the individual's] Federal adjusted gross income, but only if, and to the extent that, [the individual's] services were rendered within New York State...

Section 132.4(d) of the Regulations provides the following:

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 [the individual's] 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....

(2) Definition. To qualify as an **annuity**, a pension or other retirement benefit must meet the following requirements:

(i) It must be paid in money only, not in securities of the employer or other property.

(ii) It must be payable at regular intervals, at least annually, for the life of the individual receiving it, or over a period not less than half of such individual's life expectancy as of the date payments begin....

(iii) It must be payable:

(a) at a rate which remains uniform during such life or period; or

(b) at a rate which varies only with:

(1) the fluctuation in the market value of the assets from which such benefits are payable;

(2) the fluctuation in a specified and generally recognized cost-of-living index; or

(3) the commencement of social security benefits; or

(c) in such a manner that the total of the amounts payable is determinable at the annuity starting date either directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computation, or both, in conjunction with such terms and in accordance with sound actuarial theory...

(iv) The individual's right to receive it must be evidenced by a written instrument executed by [the individual's] employer, or by a plan established and maintained by the employer in the form of a definite written program communicated to [the employer's] employees.

(v) In the case of a pension or other similar benefit paid to a nonresident beneficiary of a deceased employee:

(a) where the employee died after retirement, if the pension or other retirement benefit [the individual] was receiving constituted an annuity, payments to [the individual's] beneficiary, even though they do not meet the requirements of subparagraphs (i), (ii) and (iii) of this paragraph, will constitute an annuity

Section 607(a) of the Tax Law provides that any term used in Article 22 of the Tax Law shall have the same meaning as when used in a comparable context in the Internal Revenue Code, unless a different meaning is clearly required.

For federal income tax purposes, Rev Rul 76-171, 1976-1 CB 18, held that a lump-sum payment received in settlement of a claim brought by the taxpayer under a non-qualified, noncontributory pension plan was taxed as ordinary income. The ruling cited Hort v Commissioner, 313 US 28 (1941), (85 L Ed 1168), in which the Supreme Court of the United States held that in order to determine the nature and extent to which settlement amounts received by compromise or judgement are to be included in gross income, it is necessary to look to the nature of the item that the settlement is a substitute for. In that case, the Court determined that

the amount paid for cancellation of a lease was a substitute for rent that would have been ordinary income to the recipient, and therefore, the settlement amount was taxable as ordinary income.

In this case, Petitioner states that the Nonresidents' SERP payments received prior to Corporation A's bankruptcy filing qualified as annuities under section 132.4(d)(1) and (2) of the Regulations. In this case, Corporation A's bankruptcy prevented it from fulfilling the terms of its SERP contracts with the Nonresidents. As a result of Corporation A's filing for bankruptcy under Chapter XI of the US Bankruptcy Code, it ceased all SERP payments to the Nonresidents, and the Nonresidents became unsecured creditors of Corporation A. The modifications to the Nonresidents' SERP payments were imposed by order of the US Bankruptcy Court. Under the Plan of Reorganization, the Nonresidents' SERP payments, which previously were being paid out as annuities, were settled as lump sum distributions.

Pursuant to section 132.4(d)(2)(v)(a) of the Regulations, where an individual was receiving payments that constituted annuities under section 132.4(d)(2) of the Regulations, the death of the individual does not change the taxability of future annuity payments even if the beneficiary receives a lump sum payment for the remaining value of the annuity. Likewise, following Hort, supra, to determine the nature of settlement amounts received by compromise or judgement, it is necessary to look to the nature of the item that the settlement is a substitute for. That is, the settlement amount received is treated the same as the underlying item that was the basis for the settlement. In both of these situations an involuntary act forces a change in the term of an annuity such that it may no longer meet the requirements of section 132.4(d)(2) of the Regulations. However, the lump sum payment or the settlement amount are treated the same as the underlying annuity that was the basis of the lump sum payment or settlement amount.

Similarly, Corporation A's unforeseen and involuntary act of filing for bankruptcy under Chapter XI of the US Bankruptcy Code should not change the treatment of the Nonresidents' SERP Arrangements as constituting nontaxable annuities under section 132.4(d)(1) and (2) of the Regulations.

Accordingly, assuming that the Nonresidents' SERP payments received prior to Corporation A's bankruptcy filing qualified as annuities under section 132.4(d)(1) and (2) of the Regulations, the lump sum payments received by the Nonresidents pursuant to the Plan in settlement of the Nonresidents' SERP claims against Corporation A will be treated as annuities under section 132.4(d)(1) and (2) of the Regulations.

With respect to question "2", section 114(a) of Title 4 of the US Code, as added by Public Law 104-95, applicable to amounts received after December 31, 1995, provides that "[n]o State may impose an income tax on any retirement income

of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State)." Section 114(b)(1)(I) of Title 4 of the US Code defines the term "retirement income" as any income from

any plan, program, or arrangement described in section 3121(v)(2)(C) of such Code, if such income--

(i) is part of a series of substantially equal periodic payments ... or

(ii) is a payment received after termination of employment and under a plan, program, or arrangement (to which such employment relates) maintained solely for the purpose of providing retirement benefits for employees in excess of the limitations imposed by 1 or more of sections 401(a)(17), 401(k), 401(m), 402(g), 403(b), 408(k), or 415 of such Code or any other limitation on contributions or benefits in such Code on plans to which any of such sections apply.

Pursuant to section 114 of Title 4 of the US Code, New York State may not impose personal income tax under Article 22 of the Tax Law on the retirement income of a nonresident or nondomiciliary individual after December 31, 1995. Following Hort, supra, to determine the nature of settlement amounts received by compromise or judgement, it is necessary to look to the nature of the item that the settlement is a substitute for. Therefore, for the reasons discussed in question "1", a lump sum payment or settlement amount received in settlement of payments that constituted retirement income under section 114 of the US Code prior to a bankruptcy proceeding is treated the same as the underlying retirement income that was the basis of the lump sum payment or settlement amount.

In this case, it is assumed that the Nonresidents' SERP Arrangements were arrangements as described in section 3121(v)(2)(C) of the Code and that the Nonresidents' SERP payments would have met the requirements of section 114(b)(1)(I)(ii) and would have constituted retirement income if Corporation A had not commenced the bankruptcy proceeding. Accordingly, for New York State personal income tax purposes, the lump sum payments received by the Nonresidents pursuant to the Plan in settlement of the Nonresidents' SERP claims against Corporation A will be treated as retirement income under section 114(b)(1)(I)(ii) of the US Code.

DATED: October 28, 1997

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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