

**Changes to New York Tax Treatment of Certain Retirement Payments
Made to Nonresident and Part-Year Resident Partners**

On August 3, 2006, President Bush signed into law Public Law 109-264 (House Bill HR-4019). The new federal law amended section 114 of Title 4 of the US Code, which prohibits states from taxing certain retirement income of nonresidents, in relation to certain retirement payments made to retired partners. As a result of the new law, described below, the department's previous position described in TSB-M-06(3)I, *New York Tax Treatment of Certain Retirement Payments Made to Nonresident and Part-Year Resident Partners*, is now obsolete.

Under the new federal law, retirement payments that are made under a nonqualified plan maintained by a partnership and that meet certain criteria are taxable only by a state where the retired partner is a resident or where the retired partner is domiciled at the time the payments are received. To qualify for this treatment, the retirement payments must meet **all** of the following criteria:

- The payments must be provided for in a written plan, program, or arrangement that was in effect prior to the partner's retirement.
- The payments must be in recognition of prior service performed by the partner for the partnership.
- The payments must be made over the life or life expectancy of the recipient or over a period of at least 10 years, must be paid at least annually, and must be paid in substantially equal periodic payments. For this purpose, the nonqualified portion of any retirement payment may be coupled with payments to the retired partner from any qualified arrangements described in section 114 of Title 4 in determining whether the *substantially equal periodic payments* test is met. In addition, the fact that payments may be adjusted from time to time pursuant to the written plan, program, or arrangement to limit total disbursements under a predetermined formula or to provide a cost-of-living increase will not cause the payments made under a nonqualified partnership retirement plan to fail the *substantially equal periodic payments* test.

The new law does not apply to payments from a partnership to a retired nonresident partner that represent payments for the partner's capital interest or other interest in partnership property, unrealized receivables, inventory, or goodwill. It should be noted that although the new law also does not apply to any gain on the sale of the partner's partnership interest, that gain is not New York source income to a nonresident taxpayer under existing New York law unless the partnership interest is employed in some other business, trade, profession, or occupation carried on by the partner in New York State (see TSB-M-92(2)I).

The New York application of this new federal law to partnership retirement payments received by nonresident and part-year resident individuals and trusts and nonresident estates from those plans covered by the new federal law (hereinafter, "payments received from these plans") is described below.

New York State nonresident individuals

Section 601(e) of the New York State Tax Law imposes a personal income tax on the portion of a nonresident individual's taxable income that is derived from New York sources. 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, multiplied by the income percentage.

The numerator of the fraction used to compute the income percentage is the individual's New York source income. The New York source income of a nonresident individual is the sum of the items of income, gain, loss, and deduction entering into the individual's federal adjusted gross income derived from or connected with New York sources and any New York addition and subtraction modifications under sections 612(b) and 612(c)¹ of the Tax Law that relate to the income derived from New York sources (i.e., New York adjusted gross income from New York sources). The denominator of the fraction used to compute the income percentage is the nonresident individual's New York adjusted gross income from all sources for the entire year.

Since the starting point for computing New York adjusted gross income is federal adjusted gross income, the amount of the payments received from these plans by a nonresident individual partner is included in computing the partner's New York State tax as if he or she were a resident and the partner's New York adjusted gross income from all sources for the entire year (the denominator of the income percentage). However, under the new federal law, the amount of the payments received from these plans is **not** included in New York source income (the numerator of the income percentage).

New York State nonresident estates and trusts

A nonresident estate or trust computes its New York State personal income tax in the same manner as a nonresident individual. Accordingly, if a partner's retirement payments are paid to an estate or trust, the rules applicable to a nonresident individual also apply to a nonresident estate or trust in computing its New York source income, New York adjusted gross income from all sources, and New York State tax as if a resident for the entire year.

Yonkers nonresidents

The Yonkers nonresident earnings tax is imposed on wages and net earnings from self-employment derived from Yonkers sources. Under the new federal law, payments received from these plans are not subject to the Yonkers nonresident earnings tax even if the payments are considered net earnings from self-employment for federal income tax purposes.

¹ The Tax Appeals Tribunal, in Matter of Blue, held that retirement payments made to partners under a nonqualified plan do not qualify for the pension and annuity exclusion under section 612(c)(3-a) of the Tax Law. Accordingly, that modification is not an issue here.

New York State part-year resident individuals

A New York State part-year resident individual computes his or her New York State tax in the same manner as a nonresident individual. However, the New York source income of a part-year resident individual (the numerator of the income percentage) is the sum of:

1. the individual's New York adjusted gross income from all sources for the resident period, determined as if the individual's tax year for federal income tax purposes were limited to the resident period;
2. the individual's New York adjusted gross income derived from or connected with New York sources for the nonresident period, determined as if the individual's tax year for federal income tax purposes were limited to the nonresident period; and
3. the special accruals required under section 639 of the Tax Law that relate to adjusted gross income.

Accordingly, a part-year resident partner computes the amount of the payments received from these plans that is includable in New York source income as follows.

- If the partner's interest in the partnership is not totally liquidated during the year and, therefore, the payments received from these plans are treated by the partnership as payments under section 736(a) of the Internal Revenue Code, the partner must first apply the *proration method* or *direct accounting* method under section 639(f) of the Tax Law to determine the amount of the payments included in federal adjusted gross income that are attributable to the resident and nonresident periods. The amount attributable to the resident period is includable in New York source income; the amount attributable to the nonresident period is **not** includable.
- If the partner's interest in the partnership is totally liquidated during the year and, therefore, the payments received from these plans are not treated as payments under section 736(a) of the Internal Revenue Code, the portion of the payments included in federal adjusted gross income that is actually received during the resident period is includable in New York source income; the portion of the payments actually received during the nonresident period is **not** includable.

Part-year New York State resident trusts

A part-year resident trust computes its New York State tax in the same manner as a part-year resident individual. Accordingly, if a partner's payments received from these plans are paid to a trust and the trust changes resident status, the amount of the payments includable in the trust's New York source income is computed using the same methods that apply to part-year resident individuals.

Part-year New York City residents

A New York City part-year resident individual or trust is subject to the New York City personal income tax on all income attributable to the resident period. The methods used to determine the amount

of the payments received from these plans attributable to the resident period in the case of a part-year New York City resident individual or trust are the same as those for a New York State part-year resident individual or trust.

Part-year Yonkers residents

A part-year Yonkers resident individual or trust is subject to the Yonkers income tax surcharge for the resident period and, if applicable, the Yonkers nonresident earnings tax for the nonresident period. The Yonkers income tax surcharge is equal to the allocated net New York State tax for the resident period multiplied by the Yonkers income tax surcharge rate. The allocated net New York State tax for the resident period is equal to the net New York State tax for the entire year (the sum of all state taxes imposed by Article 22 of the Tax Law on the individual or trust, reduced by any allowable state credits) multiplied by a fraction. The numerator of the fraction is the individual's or trust's New York adjusted gross income for the period of Yonkers residence. The denominator of the fraction is the individual's or trust's New York adjusted gross income for the entire year. The nonresident earnings tax, if applicable, is based on wages or net earnings from self-employment derived from Yonkers sources for the nonresident period.

Accordingly, a Yonkers part-year resident will use the same methods as a New York State part-year resident (see *New York State part-year resident individuals* on page 3) to determine the portion of payments received from these plans includable in New York adjusted gross income for the entire year that is attributable to the Yonkers resident and nonresident periods. The total amount attributable to the resident period is includable in the numerator of the fraction used to compute the allocated net New York State tax. The amount attributable to the nonresident period is not subject to the Yonkers nonresident earnings tax even if the payments are considered net earnings from self-employment for federal income tax purposes.

Effective date

The new federal law applies to payments received from these plans after December 31, 1995. However, the committee report for HR 4019 provides that refunds will be allowed based on the statute of limitations applicable in each state.

Accordingly, taxpayers who previously filed New York State nonresident or part-year resident income tax returns and included in New York source income the retirement payments that are now excluded by the new federal law may file an amended return within the statute of limitations and claim a refund. Generally, an amended return must be filed within three years of the date that the original return was filed or within two years of the date the tax was paid, whichever is later. A return filed before the original due date (determined without regard to any extension of time) is treated as being filed on the original due date.