

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

TSB-M-78-(14)I (Rev)  
Income Tax  
January 22, 1980

This Memorandum Supersedes Memorandum numbered TSB-M-78-(14)-I Dated August 31, 1978, which should be destroyed.

Maximum Tax

Section 603-A was added to the New York State Tax Law to provide a 12% maximum tax rate on "personal service income". This is applicable for tax years commencing after December 31, 1977. In 1979 this law was amended changing the maximum tax rate on personal service income to 11% for tax years beginning on or after January 1, 1980 and 10% for tax years beginning on or after January 1, 1981. The Maximum Tax Computation will not result in a tax benefit unless Personal Service Taxable Income is more than \$21,000.00 for 1978 and 1979, more than \$19,000.00 for 1980 and more than \$17,000.00 for 1981.

"New York personal service income" means items of income includible as personal service income for purposes of section 1348 of the Internal Revenue Code and includes earned income or pensions or annuities resulting from past personal services. Earned income includes wages, salaries, professional fees, bonuses, commissions, tips, amounts received as compensation for personal services rendered, advance payments for personal services, prizes and awards in recognition of personal services, income attributable to group-term life insurance premiums paid by an employer on employee's behalf, contributions to qualified pension plans for certain shareholder-employees (if there is a connection with personal services), net earnings (other than gains subject to capital gain treatment) from the sale, transfer, or licensing of property (other than goodwill) if personal efforts created the property, and amounts received for professional services such as services performed by a doctor, dentist, lawyer, architect or accountant. If engaged in a noncorporate trade or business in which both personal services and capital are material income - producing factors, the earned income will be based on a reasonable allowance for the personal service actually performed but may not exceed 30% of an individual's share of the net profits from the business. Based on the Federal Revenue Act of 1978, for taxable years beginning on or after January 1, 1979, the 30% limitation is no longer applicable. Pensions, annuities, and deferred compensation received on account of personal services rendered generally are personal service income.

In computing deductions against personal service income, the following rule applies in the case of a trade or business. When the expenses of a business exceed the income from that business, and both personal services and capital are material income producing factors, only a portion of the expenses are deductible against personal service income. To determine the allowable deductions, multiply the total business expenses of that business by the ratio of the reasonable value of the taxpayer's services to the business over the gross receipts of that business. For application of the above paragraph and examples, see I.R.C. Regulation Section 1.1348-2(d)(4), examples 5, 6 & 7. Caution: This regulation does not reflect changes made by the Revenue Act of 1978 but the examples do illustrate how the deduction for expenses can be computed even disregarding the 30% limitation.

The ordinary income realized from the sale of stock, under a statutory stock option, before the end of the required holding period is considered to be realized from personal services.

For nonstatutory stock options, personal service income will result upon exercise, sale, or other disposition equal to the difference between the fair market value of the property received and

the amount paid for it if the option cannot be exercised more than 3 months after the termination of employment with the grantor (other than by death). Transfer to a related corporation is not considered termination of employment.

Earned Income does not include:

1. That portion of compensation from a corporation that represents a distribution of earnings or profits rather than a reasonable allowance for services actually rendered.
2. Amounts received for refraining from rendering services or engaging in competition or for cancellation of any employment contract.
3. Lump-Sum distributions from employee's trusts or annuity plans, which are eligible for capital gains treatment or for the limitation of tax provided by special averaging rule.
4. Premature or excess distributions from qualified employee's pension plans, redemption of retirement bonds, or certain distributions from Individual Retirement Accounts (including distributions before age 59 1/2 and amounts includible in income because of prohibited transactions with the account).

"Personal service net income" is personal service income less any adjustments that are properly allocable to or chargeable against New York personal service income. These adjustments include items such as: Employee Business Expenses, Moving Expenses and Payments to an IRA or Keogh Plan.

A nonresident computes his maximum tax on personal service income connected with or derived from New York sources.

Personal Service income of estates and trusts includes only amounts which constitute income in respect of a decedent.

"Personal service taxable income" is the result of the following formula, but not more than 100% of New York Taxable income, reduced by the sum of the tax preference items.

$$\frac{\text{New York personal service net income}}{\text{New York adjusted gross income}} = \% \times \text{New York Taxable income}$$

The Revenue Act of 1978 amended the federal maximum tax law to exclude capital gains from items of tax preference used in reducing personal service net income to compute federal personal service taxable income. However, capital gains is still listed in the definition of items of tax preference in section 57 of the Internal Revenue Code, even though it is not used in computing the federal maximum tax. Capital gains, therefore, will continue to be an item of tax preference in computing New York personal service taxable income because current New York law does not have this special limitation in its maximum tax provision. Section 603-A(c)(2) refers to items of tax preference "---as defined in this article ---". Section 622(b) defines New York items of tax preference as Federal items of tax preference "--- as defined in the laws of the United States ---", thus referring to section 57 of the Internal Revenue Code, which includes capital gains.

To compute the maximum tax, Form IT-250, New York Maximum Tax on Personal Service Income, should be completed and attached to the New York State Personal Income Tax Return.

Married taxpayers filing separate returns must compute their maximum tax on separate forms.

The tax rate limit of 12% for 1978 and 1979, 11% for 1980 and 10% for 1981 applies if personal service taxable income of an individual, estate, or trust is more than \$21,000 for 1978 and 1979, more than \$19,000 for 1980 and more than \$17,000 for 1981.

The tax is determined by computing the tax on all taxable income from the tax rate schedule less the tax benefit computed from the tax tables shown below for each year.

Personal Service Taxable Income is:

The amount of Tax Benefit is the Sum of:

1978

<u>At Least</u>	<u>But Less Than</u>	<u>Rate</u>	<u>Amount</u>
\$21,000	\$23,000	\$ 0 plus	1% of excess over \$21,000
23,000	30,000	20 plus	2% of excess over 23,000
30,000	and over	160 plus	3% of excess over 30,000

1979

<u>At Least</u>	<u>But Less Than</u>	<u>Rate</u>	<u>Amount</u>
\$21,000	\$23,000	\$ 0 plus	1% of excess over \$21,000
23,000	and over	20 plus	2% of excess over 23,000

1980

<u>At Least</u>	<u>But Less Than</u>	<u>Rate</u>	<u>Amount</u>
\$19,000	\$21,000	\$ 0 plus	1% of excess over \$19,000
21,000	23,000	20 plus	2% of excess over 21,000
23,000	and over	60 plus	3% of excess over 23,000

1981

<u>At Least</u>	<u>But Less Than</u>	<u>Rate</u>	<u>Amount</u>
\$17,000	\$19,000	\$ 0 plus	1% of excess over \$17,000
19,000	21,000	20 plus	2% of excess over 19,000
21,000	23,000	60 plus	3% of excess over 21,000
23,000	and over	120 plus	4% of excess over 23,000