

Professional Service Corporations
Taxability of
Employee Trusts, Annuities,
Deferred Payment Plans, and
Lump Sum Distributions

U.S. Internal Revenue Code, section 404(a) prescribes limitations upon deductions for amounts contributed by an employer under a pension, annuity, stock bonus, or profit-sharing plan, or under any plan of deferred compensation.

U.S. Internal Revenue Code, section 402(e) imposes a separate tax on the ordinary income portion of a lump sum distribution to a beneficiary of an employee trust.

New York State Personal Income Tax Law (Article 22), section 601-C, in a similar manner imposes a separate tax on the ordinary income portion of lump sum distributions received.

A clarification was requested on the application of New York State Personal Income Tax Law section 601-C to retirement plan benefits related to professional service corporations.

In general, section 612(b)(7) requires an addition to the federal adjusted gross income of a shareholder-employee for amounts contributed by a professional service corporation on behalf of the shareholder employee to a retirement plan which is in excess of what the shareholder could have deducted under a Keogh plan.

In addition, when benefits are received from the plan, section 612(c)(12) authorizes a reduction in federal adjusted gross income, to prevent the taxation of amounts properly included in New York adjusted gross income in prior years in accordance with section 612(b)(7), (above).

A question arises, in instances whereby a shareholder-employee of a professional service corporation receives a lump sum distribution, and some portion thereof was included in New York adjusted gross income in prior years under a section 612(b)(7) modification. The lump sum distribution would not be shown in reported federal adjusted gross income, since a separate tax is imposed thereon.

Is the relief permitted by section 612(c)(12) applicable?

The provisions of section 612(c)(12) were included in Chapter 974 of the Laws of 1970, whose principal purpose was to amend the business corporation law to enable members of professions to form corporations.

As stated in the Governor's message of approval, one of the accomplishments of this measure was "to make available to (professionals) and to their employees Federal tax benefits now accorded to executives and employees in all other business endeavors "and"... that it would have no net effect on State tax revenues."

Insofar as the computation of the separate tax on lump sum distributions is concerned, the intended relief is not clearly defined under Article 22 of the Tax Law. However, it is our position that the portion of the lump sum distribution attributable to ordinary income may be reduced by an amount necessary to prevent the taxation of amounts properly included in New York adjusted gross income in prior years in accordance with section 612(b)(7) above.

It is also our position that similar treatment is appropriate under the parallel provisions of Articles 22 and 30 of the Tax Law and Title T of the Administrative Code of the City of New York.