

Cafeteria Plans and Section 401(k) Plans

Numerous inquiries have been received concerning the tax treatment by New York State of contributions to or benefits received from cafeteria plans which meet the requirements of Internal Revenue Code Section 125 or from qualified cash or deferred arrangements which are available pursuant to Internal Revenue Code Section 401(k).

Under Internal Revenue Code Section 125, a cafeteria plan allows each eligible employee to select benefits from a variety of taxable and nontaxable benefits.

Under Internal Revenue Code Section 401(k), a qualified cash or deferred salary arrangement is permitted under which an employee may elect to have his employer make payments of his wages as contributions to a trust on behalf of the employee, or to pay the wages to the employee in cash. For federal income tax purposes, the deferred wages, and the interest earned thereon, is not taxed until actually distributed to the employee by the trust.

The New York State and City of New York income taxes conform, generally, to the Internal Revenue Code with respect to items of income which are includible in adjusted gross income. Contributions to a qualified cash or deferred salary profit-sharing or stock bonus plan which are excluded from an employee's income for federal income tax purposes are also excluded from income for New York State and City of New York income tax purposes. Accordingly, such contributions are not subject to New York State or City of New York income tax withholding.

Distributions of benefits pursuant to a cafeteria plan or a qualified cash or deferred profit-sharing or stock bonus plan are subject to the New York State and City of New York income taxes in the same taxable years and to the same extent as for federal income tax purposes. However, if the recipient of such benefits is 59½ years of age or older and the distribution he receives is a pension or annuity consisting of periodic payments attributable to his personal services prior to retirement, he may exclude up to \$20,000 each year of such pension or annuity income, to the extent that it has been included for the taxable year in his federal adjusted gross income.

A nonresident is taxed only on that portion of his benefits derived from or connected with New York State sources, unless the distribution qualifies as an annuity under New York State Income Tax Regulation Section 131.4(d)(2), in which case, such distribution is not taxable. If benefits are excluded from computation of New York State income tax by reason of their constituting an annuity, such amounts are also excluded from the computation of the New York City income tax.

Cross Reference

See TSB-M-83-(7)-I, Deferred Compensation Plans for Public Employees of New York State, for the tax treatment of Section 457 Plans for public employees of New York State.