STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CHARLES F. AND LOIS L. BARBER	:	DECISION DTA No. 810515
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Personal Income Tax under the Administrative Code of the City of New York for the Years 1986 and 1987.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 16, 1993 with respect to the petition of Charles F. and Lois L. Barber, 66 Glenwood Drive, Greenwich, Connecticut 06830. Petitioners appeared by Whitman, Breed, Abbott & Morgan, Esqs. (Edward H. Hein, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception and petitioners filed a brief in opposition. Oral argument was heard on September 22, 1994 and began the six-month period for the issuance of this decision.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether certain payments received by petitioner Charles F. Barber, a nonresident of New York, from his former New York employer, were annuity payments so as to be properly excluded from petitioners' New York source income.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "9" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioner's proposed findings of fact are included herein.

Petitioners, Charles F. and Lois L. Barber, timely filed New York State income tax returns for 1986 and 1987 (Form IT-203) as full-yearnonresidents. The returns were filed jointly by petitioners[1] and, at line 10 (1986) and line 9 (1987), reported for Federal purposes taxable pensions, IRA distributions and annuities in the amount of $256,038.00. This figure is comprised of amounts paid to petitioner by his former employer as follows: the amount of $126,088.00 was reported on a Statement of Annuities, Pensions, Retired Pay or IRA Payments (Form W-2P) and the amount of $129,950.00 was reported on a Wage and Tax Statement (Form W-2). The amount reported and the method of reporting were the same for both years. Petitioner reported none of these payments as New York source income subject to New York State and City taxation, contending that the full amount of these payments constituted an annuity, which was not New York source income.

On May 2, 1990, following an audit, the Division of Taxation ("Division") issued to petitioner two statements of personal income tax audit changes for the years 1986 and 1987. For the year 1986, the statement asserted additional tax due in the amount of $6,644.19, consisting of New York State tax in the amount of $6,015.59 and New York City tax in the amount of $628.59. For the year 1987, the statement asserted additional tax due in the amount of $7,120.09, consisting of New York State tax in the amount of $6,476.01 and New York City tax in the amount of $644.08. The calculation of the additional tax was premised primarily upon the Division's position that the amount of $129,950.00 reported as an annuity in both years

[1]Petitioner Lois L. Barber's name appears in this proceeding solely by virtue of the fact that petitioners filed joint returns. There is no claim that Mrs. Barber received compensation subject to New York State or City taxes. Hence, all references to "petitioner" shall be references to petitioner Charles F. Barber only.

was New York source income properly subject to New York State and City of New York taxation. Other adjustments made by the Division are not at issue in this matter.

On July 23, 1990, the Division issued to petitioner two notices of deficiency asserting, in the aggregate, additional personal income tax due for 1986 and 1987 in the amount of $13,764.28, plus interest. The notices of deficiency followed and were issued upon the same basis as the above-described statements of personal income tax audit changes.

On November 22, 1991, the Bureau of Conciliation and Mediation Services ("BCMS") issued a Conciliation Order to petitioner indicating tax due for the year 1986 of $5,518.10, consisting of New York State personal income tax of $4,949.43 and City of New York personal income tax of $568.67. For the year 1987, the Conciliation Order indicated tax due of $6,047.22, consisting of New York State personal income tax of $5,465.03 and City of New York personal income tax of $582.19. The reduction in the personal income tax due was based upon an adjustment to the average ratio employed for pensions and other retirement benefits received by employees whose services were performed partly within and partly without New York State.

Petitioner was a nonresident of New York, being a resident of Connecticut during the years at issue. Petitioner holds a Bachelor of Sciences Degree from Northwestern University, a Bachelor of Law Degree from Harvard University and a Masters of Philosophy (Rhodes Scholar) from Oxford University. On April 1, 1956, petitioner joined ASARCO, Inc. ("ASARCO") as its chief legal officer (general counsel), and became its vice-president in 1959. He moved into general management as ASARCO's executive vice-president in 1963, its president in 1968 and finally its chairman and chief executive officer in 1971, a position in which he remained until his retirement at the age of 65 on April 30, 1982.

At the time of petitioner's retirement, ASARCO was one of the world's leading producers of nonferrous metals, principally silver, copper, lead and zinc. It operated mines in the United States, Canada, Peru and Bolivia, while its associated companies operated mines in Australia, Peru and Mexico. In addition to mining and treating ore from its own mines, ASARCO was a

custom smelter and refiner of nonferrous metal ores mined by others. ASARCO also produced nonmetallic minerals, such as asbestos, coal and limestone, from mines in the United States and Canada.

A proxy statement dated March 10, 1981 was forwarded to all stockholders entitled to vote at an annual meeting scheduled for April 22, 1981. It was also sent to salaried employees participating in the savings plan of ASARCO. Approximately 83% of all salaried employees participated in such plan. The statement indicated, under the heading "Retirement Plan", that ASARCO had two different plans which covered substantially all employees including all executive officers; a qualified Retirement Benefit Plan for Salaried Employees ("Pension Plan") and an unfunded Supplemental Retirement Plan ("SRP") in connection with the qualified Pension Plan.

The statement also indicated that petitioner, upon retirement, would be deemed to have had 40 years of credited service with ASARCO.

ASARCO's qualified (pursuant to Internal Revenue Code § 401[a]) Retirement Benefit Plan for Salaried Employees is a defined benefit plan with a final average earnings formula, integrated with Social Security by the offset method. The formula provided 1½% of final average earnings (i.e., average of the highest consecutive 60 months of the last 120 months worked) minus 1¼% of primary unreduced Social Security benefit payable at age 65 multiplied by years and months of credited service. The Pension Plan provided that benefits payable would not exceed the limitation prescribed in Internal Revenue Code § 415, added by ERISA. The Pension Plan was established and maintained by ASARCO in a written document during the time of petitioner's employment. ASARCO maintained the Pension Plan as far back as April 30, 1962. Under the Pension Plan, employees had a vested and nonforfeitable right to retirement benefit payments after ten years of service. The Pension Plan was communicated to salaried ASARCO employees eligible to participate. For instance, a Summary Plan Description explaining the Pension Plan and the complete text of such plan were provided, in booklet form, to active employees who participated in the Pension Plan, to those who were eligible to

participate and to retired employees. The Summary Plan Description included amendments through November 2, 1977. On February 2, 1981, an addendum to the Summary Plan Description was issued to all salaried employees of ASARCO describing the amendments to the Pension Plan through July 1, 1980. One of the amendments, effective November 30, 1978, eliminated the optional lump sum form of benefit payment. Subsequently, a revised copy of the Pension Plan was provided which included amendments through April 1, 1982.

We modify the Administrative Law Judge's finding of fact "9" to read as follows:

> Under ERISA, limits are imposed on the amount of annual retirement benefits payable to employees under a qualified pension plan such as ASARCO's Plan. In response, ASARCO amended the Pension Plan to conform to the ERISA limitations. However, the amendment reduced the benefits which certain employees, their surviving spouses and beneficiaries would otherwise be entitled to receive under the Pension Plan. Since ERISA allowed for the establishment of an "excess benefit plan" for the purpose of providing benefits for such employees in excess of the ERISA limitations, ASARCO established a plan so that all employees would receive total retirement benefits of the amount they would have received under the Pension Plan but for the amendment conforming the Pension Plan to ERISA.
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> In a document created February 27, 1976 and signed by its then chief financial officer and attested to by its then general counsel, ASARCO created the Supplemental Retirement Plan of ASARCO, Inc. ("SRP"). The purpose of the SRP was to pay to any employee the benefits otherwise payable under the Pension Plan except for the imposition of the limitations imposed by ERISA (Internal Revenue Code § 415).
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> The SRP provided, in part, as follows:
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> "NOW, THEREFORE, in consideration of past and future services of the affected employees, Asarco hereby establishes such an excess benefit plan to be known as its Supplemental Retirement Plan ('SRP') as follows:
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> "1. All salaried employees of Asarco or of any subsidiary specifically designated by Asarco, whose retirement benefits payable under the Asarco Retirement Benefit Plan for Salaried Employees are limited by ERISA and the Benefit Amendment to an amount which is below the amount which would have been payable under the Plan without such Benefit Amendment ("Employee"), shall be eligible for benefits under this SRP, and no other employee shall be eligible for any such benefits.
>
> "2. Asarco will pay or cause to be paid to each Employee or surviving spouse or other beneficiary of the Employee ("recipient"),

as the case may be, who receives payments under the Pension Plan, an amount which is equivalent to the excess, if any, of

> (1) the amount such recipient would have received under the Pension Plan for each calendar year, taking into account all provisions of the Pension Plan in effect and applicable from time to time to the recipient, except for the Benefit Amendment, over
>
> (2) the amount the recipient was entitled to receive under the Pension Plan for such year, taking into account the Benefit Amendment.

Payments under the SRP shall be made at approximately the same times as payments are made to the recipient under the Pension Plan.

"3. Upon application by an Employee to receive his distribution from the Pension Plan in a lump sum to which Asarco consents, Asarco may make or cause to be made to such Employee a payment or a series of payments under the SRP in lieu of any lump sum otherwise payable, in accordance with the last sentence of paragraph 2. Such payment or series of payments shall be the equivalent actuarial value of such lump sum amount otherwise payable based on such tables and interest rates as may be adopted from time to time for the purposes of lump sum payments under the Pension Plan.

"4. Asarco's obligation to make payments to the recipient when due shall be contractual in nature only, and the amounts of such payments shall not be held in trust for the recipient.

* * *

"6. Asarco expects to continue this SRP indefinitely but reserves the right to amend or discontinue it, if in its sole discretion, such a change is deemed necessary and desirable.

"7. No right or interest of the recipient under this Plan shall be subject to voluntary or involuntary alienation, assignment or transfer of any kind.

"8. The administration of this Plan shall be the responsibility of Asarco, and decisions of Asarco shall be final and binding upon any recipient.

"9. If any payment under this SRP is to be made to a recipient on account of an Employee's service for a subsidiary of Asarco, the cost of such payment shall be borne in such proportions as Asarco and such subsidiary shall determine.

"10. This Plan shall be construed, regulated and administered for all purposes according to the laws of the State of New York.

"11. The effective date of this Plan is January 1, 1976."[2]

On March 16, 1981, ASARCO entered into a written agreement ("Agreement") with petitioner which assured petitioner a retirement benefit in an amount substantially the same as the amount which would be provided by the Pension Plan had petitioner been employed by ASARCO for a period of 40 years upon retirement. The Agreement further stated that payments would be paid at such times and in such form as benefits were allowable under the Pension Plan, but the form would not be limited to the form of benefits elected by petitioner under such plan, and such payments would be subject to all other terms and conditions of the Pension Plan as in existence on the date of petitioner's retirement. The Agreement was authorized by ASARCO's board of directors and executed on behalf of ASARCO by its president.

Petitioner made a written election pursuant to the Pension Plan, the SRP and the Agreement to receive his benefits in the form of an annuity payable for his life and thereafter continuing for the life of his spouse in an amount equal to half the amount payable during their joint lives. The election by petitioner of the spousal joint and survivor annuity form of benefit was made prior to his retirement, was irrevocable once he retired and covered his entire pension as determined under the Pension Plan, the SRP and the Agreement.

The benefits manager of the personnel and employee benefits department of ASARCO testified that petitioner's monthly and yearly benefits were computed prior to his retirement and were based upon the Pension Plan, the SRP and the Agreement. Upon retirement, petitioner began to receive uniform and fixed monthly payments in the amount of $21,336.00, payable in money only. Of this monthly total, $10,507.00 represents payments based upon the Pension Plan and $10,829.00 represents payments based upon the SRP and the Agreement.

The vice-president of industrial relations and personnel testified that once an individual retires and receives benefits under the Pension Plan and the SRP (and in this case the

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[2] We modified the Administrative Law Judge's finding of fact "9" to include paragraphs 1, 2 and 7 through 11 of the SRP.

Agreement), the retiree has the absolute right to continue to receive the same payments in the same amount. The rights of the retiree are not subject to discontinuance. In addition, according to the vice-president, paragraph 6 of the SRP contains a prospective modification, which would have an effect upon benefits or provisions in the SRP only from the date of modification, with no effect on retirees. Addressing the introductory paragraph of the SRP which states, in part, "in consideration of past and future services of the affected employees", the vice-president stated that the SRP is available as a method of benefit calculation for services rendered prior to the effective date of the SRP, as well as services rendered after the effective date of the SRP. The terms "past services" and "future services" are measured from the date of the SRP, not the date of retirement. No services are required of a retired employee after retirement.

Petitioner testified that he elected the method of pension prior to his retirement date of April 30, 1982, that he receives a monthly payment of $21,336.00, that he expects to receive that amount for life, that the amount cannot be changed by himself or ASARCO and that his retirement benefits are based upon the Pension Plan, the SRP and the Agreement. Petitioner also testified that his rights under the plans and agreement were vested and nonforfeitable.

In two letters dated May 15, 1990 and June 6, 1990, ASARCO, by its controller, addressed the question of the relationship between petitioner and ASARCO following petitioner's retirement. The letters stated that petitioner received payments under two supplemental pension plans (the SRP and the Agreement). The SRP and the Agreement are considered contractual obligations of ASARCO which incorporate the terms of the Pension Plan which, in turn, requires fixed monthly payments for the remainder of petitioner's life.

The letters further stated that ASARCO has retained the right to amend or discontinue both the Pension Plan and the SRP. The right of amendment, however, would affect only accrual of benefits. Since Pension Plan and SRP benefits, which are a function of employee salary, length of service and retirement age, are calculated at retirement, an amendment would have no effect on petitioner's rights under the Pension Plan and the SRP.

As to the Agreement, the letters indicate that it substituted 480 months in place of petitioner's actual service in both the Pension Plan and the SRP. Otherwise, it had no other effect on petitioner's contractual right to fixed payments for life under the plans.

The $129,950.00 yearly amount at issue consists of $10,829.00 in monthly payments and is the result of retirement benefits paid pursuant to the SRP and the Agreement. The remaining monthly ($10,507.00) and yearly ($126,088.00) amounts are based upon the Pension Plan and have been accepted by the Division as an annuity.

OPINION

The Administrative Law Judge concluded that the payments received by petitioner pursuant to the SRP were income from an annuity within the meaning of section 632(a)(2) of the Tax Law and, therefore, were not derived from New York sources. The Administrative Law Judge rejected the Division's contention that paragraph 6 of the SRP, under which ASARCO reserved the right to amend or discontinue the SRP (the "modification clause"), meant that ASARCO was not bound to continue making benefit payments under the SRP to petitioner. Consequently, the Administrative Law Judge found that the modification clause of the SRP did not preclude the SRP from satisfying the condition of 20 NYCRR former 131.4(d)(2)(i)-(v) that an annuity "must be paid in money only, at regular intervals at least annually for the life of the individual receiving it, at a rate which remains uniform during the individual's life or in such manner that the total of the amounts payable is determinable at the annuity starting date" (Division's brief on exception, p. 5).

The Administrative Law Judge stated:

> "It is well settled that pension benefit plans are unilateral contracts which employees accept by appropriate performance (Pratt v. Petroleum Prod. Mgt. Employee Sav. Plan, 920 F2d 651 [10th Cir 1990]). Since a pension is a unilateral contract, it may not be amended or modified retroactively by the sponsor -- after a participant has accepted the plan offer by retiring or other performance specified in the plan -- in a manner that alters or impairs the rights of participants under the term of the plan (Pratt v. Petroleum Prod. Mgt. Employee Sav. Plan, supra; Carr v. First Nationwide Bank, 816 F Supp 1476 [ND Cal 1993]).

> "An employee who performs the acts and completes the services stipulated in the employer's pension plan thereby consummates a unilateral contract vesting in him an indefeasible right to the retirement benefits. Therefore, under established contract principles, vested retirement rights may not be altered without the pensioner's consent (Chemical Workers v. Pittsburgh Glass, 404 US 157, 181, n. 20, 30 L Ed 2d 341, 92 S Ct 383; Silfen v. Whelan, 30 AD2d 523, 290 NYS2d 417; Scoville v. Surface Transit, 39 Misc 2d 991, 242 NYS2d 319)" (Determination, conclusion of law "H").

Based on these principles, the Administrative Law Judge held that because petitioner was already retired and his rights were vested, an amendment of the SRP could not have any effect on his rights under the SRP.

On exception, the Division states that "[t]he characteristics of pension plans and the principles of the law of contracts that apply to plan amendments are well settled, as noted by the ALJ" (Division's brief on exception, p. 10). However, the Division contends that the Administrative Law Judge erred, in part, because "none of the cases relied upon by the ALJ involve plans containing the same broad language found in paragraph '6' of the Supplemental Plan that allowed the change or termination" (Division's brief on exception, p. 10).

One of the cases cited by the Administrative Law Judge, Carr v. First Nationwide Bank (supra), involved a deferred compensation plan that included a clause which stated that the employer could modify or amend the plan in whole or in part at any time. The employer relied on this clause to reduce the interest rate on deferred amounts and the payout schedules with respect to employees who were already entitled to repayment under the terms of the plan. The District Court ultimately held that the employer's reserved power under the plan to amend the plan did not authorize the employer to modify the plan in a manner that infringed the former employees' right with regard to interest or repayment. Although the District Court's decision is not binding precedent, the analysis of the Court is very instructive. Applying the Federal common law of ERISA contract interpretation, the Court concluded that the deferred compensation plan and the right to amend had to be interpreted under the principles that: 1) "the plan should be construed as a whole, and the specific language of each provision should be interpreted in the context of the whole. [citation omitted] Thus, the provision of an ERISA

plan should be construed so as to render none nugatory and to avoid illusory promises" (Carr v. First Nationwide Bank, supra, at 1493) and 2) "an interpretation which gives a reasonable, lawful and effective meaning to all the terms is preferred to one which leaves any part unreasonable or of no effect" (Carr v. First Nationwide Bank, supra, at 1493). Under these principles, the Court found that the amendment provision could not mean what the employer urged because this meaning would render all of the provisions in the plan as to how interest "shall" be computed and how repayment "shall" be made illusory.

The principles of contract construction under the New York common law are similar to those of ERISA contract interpretation. In New York "[a] written contract 'will be read as a whole and every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose.' 3 Williston on Contracts, § 618" (Empire Props. Corp. v. Manufacturers Trust Co., 288 NY 242, 248). Further, in New York "[i]t is a cardinal rule of construction that a court should not 'adopt an interpretation' which will operate to leave a 'provision of a contract . . . without force and effect'" (Corhill Corp. v. S.D. Plants, 9 NY2d 595, 217 NYS2d 1, 3). Under these principles, we do not see how the modification clause can mean what the Division contends it means, for this renders most of the other provisions of the SRP meaningless.

As set forth in the facts, the SRP states that certain employees "shall be eligible for benefits under this SRP" (Exhibit 6, ¶ 1, emphasis added); "Asarco will pay or cause to be paid . . . an amount . . . . Payments under the SRP shall be made at approximately the same times" (Exhibit 6, ¶ 2, emphasis added); "[s]uch payment or series of payments shall be the the equivalent actuarial value" (Exhibit 6, ¶ 3, emphasis added); "Asarco's obligation to make payments to the recipient when due shall be contractual in nature only" (Exhibit 6, ¶ 4, emphasis added); "[n]o right or interest of the recipient under this Plan shall be subject to voluntary or involuntary alienation" (Exhibit 6, ¶ 7, emphasis added); "[t]he administration of this Plan shall be the responsibility of Asarco" (Exhibit 6, ¶ 8, emphasis added). Each of these provisions is meaningless if ASARCO had unfettered discretion to amend or discontinue the

SRP. Accordingly, we, like the District Court in Carr. v. First Nationwide Bank (supra), refuse to adopt an interpretation of the modification clause that nullifies the meaning of the rest of the agreement. Instead, we hold that any authority ASARCO had to modify the SRP did not apply to employees, such as petitioner, whose rights to receive payments under the SRP had already vested. Therefore, we conclude that ASARCO was bound to continue making benefit payments to petitioner and that the requirements of 20 NYCRR former 131.4(d) were satisfied.

Because our decision is based solely on the provisions of the SRP itself, we need not address the Division's contentions that the Administrative Law Judge erred in concluding that the SRP was, in effect, an extension of the Retirement Plan and that the Administrative Law Judge improperly relied on testimony to construe the provisions of the SRP.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Charles F. and Lois L. Barber is granted; and

4. The notices of deficiency dated July 23, 1990 are modified to the extent indicated in paragraph "3" above, but are otherwise sustained.

DATED: Troy, New York
March 9, 1995

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner