STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
KEMRAN S. LEWIS	:	SMALL CLAIMS DETERMINATION DTA NO. 820779
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2000, 2001, 2002 and 2003.	:	

Petitioner, Kemran S. Lewis, 3 Duxbury Heights, Fairport, New York 14450, filed a petition for redetermination of deficiencies or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2000, 2001, 2002 and 2003.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, 340 East Main Street, Rochester, New York, on June 14, 2006 at 1:15 P.M. Petitioner appeared by Gary J. Young, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (Charles A. Denardo).

Since neither party elected to reserve time to file a post-hearing brief, the three-month period for the issuance of this determination commenced as of the date the hearing was held.

ISSUE

Whether annuity income petitioner received from the College Retirement Equities Fund qualifies for the pension and annuity income exclusion provided for in Tax Law § 612(c)(3-a) where the annuity which produced the income was awarded to petitioner pursuant to a Qualified Domestic Relations Order issued as the result of the dissolution of her marriage.

FINDINGS OF FACT

1. Petitioner, Kemran S. Lewis, filed timely New York State resident personal income tax returns for the years 2000, 2001, 2002 and 2003. In computing New York adjusted gross income for all four years in question, petitioner claimed the Tax Law § 612(c)(3-a) pension and annuity income exclusion subtraction modification, thereby reducing Federal adjusted gross income by $10,000.00 for 2000, $17,000.00 for both 2001 and 2002 and $15,000.00 for 2003.

2. The Division of Taxation ("Division") issued statements of proposed audit changes to petitioner wherein it disallowed the pension and annuity income exclusion claimed for each year in dispute. The statements of proposed audit changes contained the following explanation for the disallowance:

> Our records show that you claimed a pension modification at line 28 of your New York State Income Tax Return for pension income received from the Teacher's [sic] Insurance and Annuity Association and/or the College Retirement Equities Fund. Information available indicates these payments are received as a result of a divorce settlement.
>
> Payments received from a pension plan as a result of a divorce agreement are considered alimony payments for New York State and Federal tax purposes, rather than pension or annuity payments. As such, they do not qualify for the pension and annuity income exclusion. In addition, the support payments cannot qualify for the pension and annuity income exclusion because they do not arise from an employer-employee relationship and do not arise from contributions made to a retirement plan. Therefore, the support payments received must be included in your Federal and New York adjusted gross income and do not qualify for the pension and annuity income exclusion provided by Section 612(c)(3-a) of the Tax Law.

3. Based on its statements of proposed audit changes, the Division issued four notices of deficiency to petitioner, one for each year in dispute, dated April 5, 2004, January 31, 2005 and March 21, 2005, asserting that $629.00, $952.00, $1,108.00 and $997.00 of additional New York State personal income was due for the 2000, 2001, 2002 and 2003 tax years, respectively.

Petitioner disagreed with the Division's disallowance of the claimed pension and annuity income exclusions and this proceeding ultimately ensued.

4. Petitioner and her former spouse entered into a separation agreement on November 27, 1996, and a final judgement of divorce was subsequently issued in 1998. As part of the divorce proceeding, a Qualified Domestic Relations Order ("QDRO") was issued on April 21, 1998 by Supreme Court, County of Monroe, which directed the equitable distribution of petitioner's former spouse's interest in two Teachers Insurance and Annuity Association - College Retirement Equities Fund ("TIAA - CREF") retirement annuities.[1] The QDRO provided that the two TIAA - CREF retirement annuities were marital property; that 83.44% of the TIAA annuity and 13.57% of the CREF annuity were to be awarded to petitioner; that all ownership and interest in the portion of the annuities awarded to petitioner belonged to petitioner and that her former spouse retained all ownership and interest in the balance of the two TIAA - CREF retirement annuities not awarded to petitioner.

5. On July 27, 1998, TIAA - CREF issued a letter to petitioner stating that:

> [T]he Marital Property Division of your former spouse's Retirement Annuity (RA), and Transfer Pay-Out Annuity (TPA) has been completed. We have issued new annuities on your life based on the terms of your Qualified Domestic Relations Order.
>
> Distributions will be made from the TPA Contract to CREF Contract in 10 installments, over a 10-year period. The distributions will be made every year on the anniversary date of the original distribution.
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> Your TIAA TPA to CREF Contract is based on dollar investments and consists of a contractual payment and dividend as declared. The yearly contractual payment is $23,673.13. It is based on annuity rates guaranteed in the contract and will not change.

[1] The TIAA-CREF retirement annuities were Internal Revenue Code § 403(b) tax shelter annuities issued to petitioner's former spouse as the result of his employment at the University of Rochester.

6. For each of the four years in question, the College Retirement Equities Fund ("CREF") issued to petitioner a Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., reporting that taxable distributions had been made to petitioner pursuant to the CREF contract in the sum of $10,000.00 for 2000, $17,000.00 for both 2001 and 2002 and $15,000.00 for 2003. These are the amounts which petitioner claimed on her returns as qualifying for the Tax Law § 612(c)(3-a) pension and annuity income exclusion.

7. There is no dispute in this proceeding that for the years at issue petitioner had attained the age of 59 1/2. There is also no question that the QDRO issued on April 21, 1998 met the conditions set forth in Internal Revenue Code ("IRC") § 414(p) to be considered a qualified domestic relations order.

SUMMARY OF THE PARTIES' POSITIONS

8. Petitioner notes that pursuant to the provisions of IRC § 402(e)(1)(A) an alternate payee who is the former spouse of a plan participant is treated as the distributee if the distribution is made under a QDRO. Furthermore, IRC § 402(e)(1)(B) provides that a distribution received pursuant to a QDRO by an alternate payee who is a former spouse shall qualify for the rollover provisions of IRC § 402(c) "in the same manner as if such alternate payee were the employee." Petitioner asserts that as an alternate payee who receives a distribution pursuant to a QDRO, she "stands in the shoes" of the plan participant in accordance with the above-cited provisions of the IRC, thus establishing that, for Federal income tax purposes, the distributions she received from CREF during the years in question are considered as attributable to personal services performed prior to retirement from employment which arise from an employer-employee relationship. Since New York Tax Law and regulations do not contain a

separate definition of what constitutes pension income attributable to personal services performed prior to retirement from employment which arise from an employer-employee relationship, petitioner maintains that the Federal conformity provisions of Tax Law § 607(a) dictate that the CREF pension income she received be found as attributable to personal services performed prior to retirement from employment which arose from an employer-employee relationship.

9. Petitioner also asserts that she could have avoided any New York State tax liability on the CREF pension had she taken the CREF pension in a lump sum payment and then rolled the funds into an individual retirement account ("IRA"). Under IRC § 402(c), the rollover CREF funds would not be included in gross income for Federal income tax purposes and thus not included in New York income pursuant to Tax Law § 612. When petitioner takes a distribution from the IRA, it would then qualify for the Tax Law § 612(c)(3-a) pension and annuity income exclusion subtraction modification since she was an individual who was at least 59 1/2 years of age.

10. The Division contends that the language of Tax Law § 612(c)(3-a) providing for the pension and annuity income exclusion is clear and unambiguous. In order for petitioner to qualify for the pension and annuity income exclusion, the CREF pension and annuity income she received during the years in dispute must be attributable to personal services petitioner performed prior to her retirement from employment and must arise from an employer-employee relationship. The Division argues that petitioner's receipt of the CREF pension and annuity income was the result of the split of marital property and was clearly not attributable to personal services petitioner performed prior to her retirement from employment nor did it arise from an employer-employee relationship.

CONCLUSIONS OF LAW

A. New York adjusted gross income is computed using Federal adjusted gross income with certain modifications both increasing and decreasing the Federal amount (Tax Law § 612[a]). Tax Law § 612(c) provides, in relevant part, as follows:

> Modifications reducing federal adjusted gross income. There shall be subtracted from federal adjusted gross income:
>
> * * *
>
> (3-a) Pensions and annuities received by an individual who has attained the age of fifty-nine and one-half . . . to the extent includible in gross income for federal income tax purposes, but not in excess of twenty thousand dollars, which are periodic payments attributable to personal services performed by such individual prior to his retirement from employment, which arise (i) from an employer-employee relationship or (ii) from contributions to a retirement plan which are deductible for federal income tax purposes. However, the term "pensions and annuities" shall also include distributions received by an individual who has attained the age of fifty-nine and one-half from an individual retirement account or an individual retirement annuity, as defined in section four hundred eight of the internal revenue code. . . .

B. Tax Law § 607(a) provides that:

> Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute.

C. In ***Matter of Schein*** (Tax Appeals Tribunal, November 6, 2003), the Tribunal addressed the issue of whether certain retirement allowance payments made to a retired partner of a partnership qualified for the Tax Law § 612(c)(3-a) pension and annuity income exclusion. As relevant to this dispute, the Tribunal, in ***Schein***, concluded as follows:

> The Administrative Law Judge, as noted earlier, found that the Tribunal in ***Blue*** was remiss in not delving into the legislative history of Tax Law § 612(c)(3-a) to determine its intent. Specifically, the

Administrative Law Judge opined that we should have examined the bill jacket and the Governor's Memorandum filed with Assembly bill number 4043-A. According to the Administrative Law Judge, the bill jacket reflects no intention that the subtraction modification be applied other than uniformly to pension recipients of qualifying age.

When the meaning of a statute is unclear, there can be no doubt that resort to extraneous sources such as the legislative history found in the bill jacket can be helpful. However, the bill jacket is not a substitute for the statute. While the Administrative Law Judge could find no intent in the legislative history that retirement allowance payments to a partner and pension payments to an employee be treated differently for purposes of the subtraction modification, we do find that intent in the plain language of the statute itself. Statutory rules of construction provide that "[t]he legislative intent is to be ascertained from the words and language used, and the statutory language is generally construed according to its natural and most obvious sense, without resorting to an artificial or forced construction" (McKinney's Cons Laws of NY, Book 1, Statutes § 94). Where, as here, the statute is clear, we must follow the plain meaning of its words, and "there is no occasion for examination into extrinsic evidence to discover legislative intent . . ." (McKinney's Cons Laws of NY, Book 1, Statutes § 120). The bill jacket, although helpful in an appropriate case, is extrinsic to the statute. It is the bill itself that is voted on by members of the Legislature, not the bill jacket. We are not to rely on extrinsic matters when the wording of the statute is unambiguous.

Tax Law § 612(c)(3-a) provides, as relevant here, that to be entitled to the pension exclusion, the payments to the retired taxpayer must be attributable to personal services performed by the taxpayer before his retirement and such payments must "arise (i) from an employer-employee relationship or (ii) from contributions to a retirement plan which are deductible for federal income tax purposes." This language is clear and unambiguous. The Legislature intended the quoted language as words of limitation, limiting the pension exclusion to retirement payments from qualified pension plans or *arising from an employer-employee relationship.* The Administrative Law Judge's interpretation of these words would render the Legislature's qualifying language a nullity.

D. Petitioner's arguments that the provisions of the IRC place her in the shoes of the plan participant and that the Federal conformity provisions of Tax Law § 607(a) mandate that New York State likewise consider her as the plan participant are well reasoned and not without some merit; however, these arguments must be rejected given the Tribunal's decision in the ***Schein***

matter. In ***Schein***, the Tribunal set a precedent, which I must follow, that the pension or annuity income received by a taxpayer must be attributable to personal services performed by that taxpayer before retirement and that such payments are to arise from an employer-employee relationship. Petitioner obtained her interest in the pension and annuity income in question as the result of the dissolution of her marriage to her former husband, the plan participant, and not as the result of personal services she performed before retirement pursuant to an employer-employee relationship. While petitioner as an alternate payee may "stand in the shoes" of the plan participant pursuant to the provisions of the IRC, the language of Tax Law § 612(c)(3-a) and the Tribunal's decision in ***Schein*** leave little doubt that a different meaning is clearly required here, thus making the Federal conformity provisions of Tax Law § 607(a) inapplicable in this matter.

Tax Law § 612(c)(3-a) creates a subtraction modification, an exemption from taxation, where a taxpayer can, under certain circumstances, reduce his or her Federal adjusted gross income in computing New York adjusted gross income. Since petitioner seeks the benefit of an exemption from taxation, which, like all tax exemptions is strictly and narrowly construed, the burden is on petitioner to demonstrate that she comes within the reach of the exemption (***see, Matter of Grace v. New York State Tax Common.,*** 37 NY2d 193, 371 NYS2d 715, ***lv denied*** 37 NY2d 708, 375 NYS2d 1027; ***Dental Society of the State of New York v. New York State Tax Commn.***, 110 AD2d 988, 487 NYS2d 894, ***affd*** 66 NY2d 939, 498 NYS2d 797). As noted above, it simply cannot be found that petitioner has met the provisions of Tax Law § 612(c)(3-a).

Also, it is noted that the Legislature, in enacting Tax Law § 612(c)(3-a), specifically provided that pension and annuity payments received by a deceased individual's beneficiary qualified for the pension and annuity income exclusion. By making a specific provision in the

statute which provided that an interest in pension and annuity income acquired by reason of death was eligible for the exclusion, the inference is warranted that the Legislature intended to exclude all others, including petitioner's acquisition of an interest in pension and annuity income by way of divorce. In my view, legislative action amending the statute is needed to grant petitioner, and all other similarly situated taxpayers, the exemption she seeks.

E. Finally, petitioner may have been able to qualify for the Tax Law § 612(c)(3-a) pension and annuity income exclusion by taking the CREF payment in lump sum followed by a nontaxable rollover of the funds into an IRA. Subsequent distributions of funds to petitioner from the IRA would qualify for the Tax Law § 612(c)(3-a) pension and annuity income exclusion. Unfortunately, petitioner did not choose to structure the transaction in such a manner that would have provided a tax benefit to her. In ***Sverdlow v. Bates*** (283 App Div 487, 129 NYS2d 88, 91), the court rejected the taxpayer's argument that "since the same result could have been obtained without the payment of a tax by use of an instrument of a different form, it is inequitable to require a payment of the tax." The court observed that "If a transaction comes within the form which the statute has made taxable, it is no answer to say that it is indistinguishable in substance from a transaction in a different form which could have accomplished the same result in a non-taxable manner" (***id***.).

F. The petition of Kemran S. Lewis is denied and the notices of deficiency issued on April 5, 2004, January 31, 2005 and March 21, 2005 are hereby sustained.

DATED: Troy, New York
September 14, 2006

/s/ James Hoefer
PRESIDING OFFICER