

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

ELIZABETH F. MONTFORT

DECISION

for Redetermination **of** a Deficiency or for
Refund of New York State Personal Income Tax
under Article 22 of the Tax Law for the Years
1980 and 1981.

Petitioner, Elizabeth F. Montfort, Box 240, RD #3 Route 9S, Fishkill, New York 12524, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law **for** the years 1980 and 1981 (File Nos. 52362 and 56542).

A formal hearing was held before Brian L. Friedman, Hearing Officer, at the offices of the State Tax Commission, Building #9, State Campus, Albany, New York, on May 21, 1985 at 1:15 P.M. Petitioner appeared by Paul A. Baldovin, CPA. The Audit Division appeared by John P. Dugan, Esq. (Thomas Sacca, **Esq.**, of counsel).

ISSUE

Whether petitioner may properly treat alimony received as personal service income subject to the maximum tax rate on New York personal service income.

FINDINGS OF FACT

1. Petitioner, Elizabeth F. Montfort, timely filed New York State income tax resident returns for 1980 and 1981. In computing her personal income tax for each of these years, petitioner utilized Form IT-250, New York State

said amount representing alimony received which was listed on line 32 of her New York State Income Tax Resident Return. For the year 1981, petitioner listed as personal service income on line 1 of Form IT-250 the amount of \$38,589.00, said amount representing alimony received which was listed on line 31 of her New York State Income Tax Resident Return.

2. On March 1, 1984, the Audit Division issued to petitioner a Statement of Audit Changes for the year 1980 which stated:

"Alimony is not considered Personal Service Income. The maximum tax benefit of \$390.22 claimed has been disallowed."

On April 4, 1984, the Audit Division issued to petitioner a Notice of Deficiency for the year 1980 asserting additional tax due of \$390.22, plus interest of \$139.67, for a total due of \$529.89.

3. On July 13, 1984, the Audit Division issued to petitioner a Statement of Audit Changes for the year 1981 which stated:

"Interest income, alimony, tax refunds, and unemployment insurance compensation are not included as personal service income. (Section 603-A(B)) of the New York State Tax Law.

	1981 NYS SINGLE
Total income reported/adj'd.	64113.00
Item'd ded's claimed/adj'd.	2510.00
Exemption(s) claimed/adj'd.	750.00
Taxable income corrected	60853.00
Tax on above	7079.42
Less: maximum tax benefit	.00
Minimum Income tax	.00
Balance	7079.42
Tax previously stated/adj'd.	-6414.00
Personal income tax due	665.42
Total interest	175.29
Total due	840.71

On October 10, 1984, the Audit Division issued to petitioner a Notice of Deficiency for the year 1981 asserting additional tax due of \$665.42, plus interest of \$196.04, for a total due of \$861.46.

4. Petitioner was married for approximately 35 years. Petitioner cites section 603-A of the Tax Law which defines New York personal service income as "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered...". Petitioner contends that alimony is compensation for past services during a marriage, is not expressly excluded by law and is, therefore, subject to the maximum tax rate on personal service income.

CONCLUSIONS OF LAW

A. That for the years at issue, for purposes of determining the maximum tax rate on New York personal service income, section 603-A(b)(1) provided, in pertinent part:

"(b)(1) For purposes of this section the term 'New York personal service income' means items of income includible as personal service income for purposes of section one thousand three hundred forty-eight of the internal revenue code, to the extent such items of income are includible in New York adjusted gross income, plus the amount of the modifications which must be added to federal adjusted gross income pursuant to paragraphs seven, eight and nine of subsection (b) of section six hundred twelve;...",

B. That the position of the State Tax Commission regarding the definition of the term "personal service income" is set forth in 20 NYCRR 100.4(c)(2)(1) which provides, in pertinent part:

"(2) Personal service income. (i) For purposes of section 1348 of the Internal Revenue Code, personal service income generally includes wages, salaries, professional fees, bonuses, commissions on sales or on insurance premiums, tips and other amounts received as compensation for personal services actually rendered. It also includes prizes and awards that are not gambling winnings, taxable pensions or annuities if connected with income earned from past personal services, and group term life insurance purchased by

included in gross income. It also includes property received by the taxpayer for the performance of services which has been transferred to another individual." (Emphasis added.)

C. That for the years at issue, section 1348 of the Internal Revenue Code (repealed by P.L. 97-34 for tax years beginning after 1981) provided, in pertinent part:

"(b) Definitions. -- For purposes of this section --

(1) Personal service income. --

(A) In general. -- The term 'personal service income' means any income which is earned income within the meaning of section 401(c) (2)(C) or section 911(b) or which **is** an amount received as a pension or annuity which arises from an employer-employee relationship **or** from tax-deductible contributions to a retirement plan. For purposes of this subparagraph, section 911(b) shall be applied without regard to the phrase ', not in excess of 30 percent of his share of net profits of such trade or business,'.

(B) Exceptions. -- The term 'personal service income' does not include any amount --

(i) to which section 72(m)(5), 402(a)(2), 402(e), 403(a)(2), 408(e)(2), 408(e)(3), 408(e)(4), 408(e)(5), 408(f), or 409(c) applies; or

(ii) Which **is** includible in gross income under section 409(b) because of the redemption of a bond which was not tendered before the close of the taxable year in which the registered owner attained age 70½."

D. That Treasury Regulations §1.1348-3(a)(1)(i), in effect for the years at issue, defined 'learned income' as follows:

"(a) Earned income -- (1) In general. (i) For purposes of section 1348 and the regulations thereunder, the term 'earned income' means any item of gross income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b) unless the item constitutes deferred compensation as defined in paragraph (b) of this section or is otherwise excluded by application of this paragraph. Thus, subject to such exceptions, the term includes --

(A) Wages, salaries, professional fees, bonuses, amounts includible in gross income under section 83, commissions on sales or on insurance premiums, tips, and other amounts received by an individual for services rendered by him or her."

(B) Compensatory payments for personal services made prior to the time such services are actually rendered, provided such advance payments are not made for a purpose of minimizing Federal income taxes by reason of the application of section 1348, and are either customary in the particular profession, trade, or business, or are made for a bona fide business purpose.

(C) Prizes and awards in recognition of personal services includible in gross income under section 74, amounts, includible in gross income under section 79 (relating to group-term life insurance purchased for employees), and amounts includible in gross income under section 1379(b) (relating to contributions to qualified pensions plans in the case of certain shareholder-employees); and

(D) Gains (other than gain which is treated as capital gain under any provision of chapter 1) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created such property.

The term does not include such income as dividends (including an amount treated as a dividend by reason of section 1373(b) and §1.1373-1), other distributions of corporate earnings and profits, gambling gains, or gains which are treated as capital gains under any provision of chapter 1. The term also does not include amounts received for refraining from rendering personal services or engaging in competitive activity or amounts received as consideration for the cancellation of an employment contract."

E. That Treasury Regulation §1.1348-3(a)(5), in effect for the years at issue, set forth the exceptions to "earned income" as follows:

"(5) Exceptions to definition of earned income. For purposes of section 1348 and the regulations thereunder, the term 'earned income' does not include:

(i) Any distribution to which section 72(m)(5), relating to certain amounts received by owner-employees from a trust described in section 401(a) or under a plan described in section 403(a), applies,

(ii) Any distribution to which section 402(e), relating to the treatment of certain total distributions from a trust described in section 401(a) or under a plan described in section 403(a), applies,

(iii) Any distribution to which section 402(a)(2), relating to capital gains treatment of certain total distributions from a trust described in section 401(a), applies,

(iv) Any distribution to which section 403(a)(2)(A), relating to capital gains treatment for certain distributions,

(v) Any deferred compensation within the meaning of paragraph (b) of this section."

F. That subdivision 1 of Part A of section 236 of the Domestic Relations Law, effective July 19, 1980, which incorporates essentially the same language as contained in the prior section 236 sets forth the factors to be considered in the awarding of alimony, stating, in pertinent part:

"...the court may direct either spouse to provide suitably for the support of the other as, in the court's discretion, justice requires, having regard to the length of time of the marriage, the ability of each spouse to be self-supporting, the circumstances of the case and of the respective parties."

G. That section 71(a)(1) of the Internal Revenue Code, in effect for the years at issue, provided:

"(1) Decree of divorce or separate maintenance. -- If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation."

H. That alimony is not compensation for personal services actually rendered but is, instead, support received in discharge of a legal obligation by the former spouse imposed on or incurred by the former spouse under the divorce decree or under a written instrument incident to the divorce. Alimony received by petitioner is not personal service income and is, therefore, not includible in the maximum tax rate provisions of section 603-A of the Tax Law.

I. That the petition of Elizabeth F. Montfort is denied and the notices of deficiency dated April 4, 1984 and October 10, 1984 are sustained in full

together with such additional interest as may be lawfully due and owing.

DATED: Albany, New York

STATE TAX COMMISSION

JAN 28 1986


PRESIDENT


COMMISSIONER


COMMISSIONER