

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
PETER AND MARGUERITE KANE : DECISION
for Redetermination of a Deficiency or for Refund : DTA NO. 824767
of New York State Personal Income Tax under :
Article 22 of the Tax Law for the Year 2007.¹ :

Petitioners, Peter and Marguerite Kane, filed an exception to the determination of the Administrative Law Judge issued on March 20, 2014. Petitioners appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq. of counsel).

Petitioners filed a letter brief in support of their exception. The Division of Taxation filed a letter brief in opposition. Petitioners filed a letter brief in reply. Oral argument was not requested. By decision dated January 29, 2015, this matter was remanded to the Administrative Law Judge for the issuance of a supplemental determination to more thoroughly address an issue raised by petitioners on exception. The Tax Appeals Tribunal retained jurisdiction over petitioners' original exception during this process.

A determination on remand was issued on March 3, 2016. Petitioners filed a letter brief in response to the determination on remand. The Division of Taxation filed an additional brief in opposition to petitioners' exception. Petitioners filed a letter brief in reply. The six-month date for the issuance of this decision began on June 21, 2016, the date that petitioners' letter brief in reply was received.

¹ Petitioners requested that all claims for state personal income tax due against them for the tax years 2007, 2008, 2009, 2010 and 2011 be consolidated and determined at one time. However, only tax year 2007 is challenged by this petition, and no other petitions for tax years 2008 through 2011 exist with the Division of Tax Appeals. Accordingly, only tax year 2007 will be addressed herein.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the distribution received by petitioners during 2007 from National Financial Services, LLC of Fidelity Investments constituted pension payments to an officer or employee of New York State such that petitioners properly subtracted such payments from their federal adjusted gross income in determining their New York adjusted gross income pursuant to Tax Law § 612 (c) (3) (i).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge in the determination on remand except for finding of fact 1, which has been modified by replacing it with finding of fact 1 from the original determination, and finding of fact 4, which has been modified to more fully reflect the record. The Administrative Law Judge's findings of fact from the determination on remand and the modified findings of fact are set forth below. Finding of fact 13 from the determination on remand has not been included as it merely sets forth the Division's position.

1. Petitioners jointly filed their 2007 New York State Resident Income Tax Return, reporting, among other amounts, a pension and annuity income exclusion in the amount of \$128,000.00. This amount represented a distribution from National Financial Services, LLC of Fidelity Investments (NFS), made to Peter Kane in 2007, in relation to a New York State pension attributable to Mr. Kane.

2. Mr. Kane had attained the age of 59½ prior to the year 2007.

3. Upon review of petitioners' 2007 return and, in particular, the New York State pension exclusion, the Division of Taxation (Division) determined that \$108,000.00 should not be

excluded from taxable income as a New York State government pension, but otherwise allowed \$20,000.00 of the distribution as a tax-free exclusion under Tax Law § 612 (c) (3-a).

4. Peter Kane was employed from 1965 to 1995 by the State University of New York (SUNY) where he participated in a pension plan managed by Teacher Insurance and Annuity Association - College Retirement Equities Fund, known as "TIAA/CREF," which was part of the SUNY Optional Retirement Program (SUNY ORP) (*see* Education Law §§ 390-397; *Young v State of New York* (179 Misc 2d 879, 880-881 [1999])). The SUNY ORP is a defined contribution plan for SUNY employees who elect to participate rather than join the New York State Teachers' Retirement System or the New York State Employees' Retirement System, which are defined benefit pension plans (*see* Education Law §§ 391, 393; *Young v State of New York*). Both SUNY and the employee make contributions to the SUNY ORP (*see* Education Law §§ 391 [1], 392).

5. SUNY'S Board of Trustees (Board) must designate the insurer to which payments of contributions are made and must approve the form and content of such contracts (*see* Education Law § 391 [2]). The Board is authorized to provide for the administration of the ORP, and to perform or authorize the performance of necessary functions (*see* Education Law § 391 [3]). The Board designated TIAA/CREF to administer its ORP, which was established by Article 8-B of the Education Law (Education Law §§ 390-397; *Young v State of New York*).

6. In December 1995, Mr. Kane elected to take a distribution of \$528,808.00 in complete liquidation of his SUNY ORP² and rolled it over to an individual retirement account (IRA) managed by NFS.

7. The Division determined that by the end of the year 2006, Mr. Kane had received all

² ORP has been substituted for 'pension' to more accurately reflect the record.

the distributions that would qualify as the return of contributions to the pension of an employee of SUNY that could be excluded from petitioners' adjusted gross income under Tax Law § 612 (c) (3) (i).

8. The Division issued correspondence to Mr. Kane, dated January 19, 2010, which cancelled assessment L-032579012-1 (not in issue in this matter), resulting in no tax due for tax year 2006. The explanation provided stated the following, in pertinent part:

“Information provided shows that in 1995, \$528,808 in TIAA/CREF contracts . . . was rolled into Fidelity (National Financial Serv). The TIAA/CREF contracts were 100% publicly funded (SUNY). Since only the rolled over amount retains its character as government pension, not any accumulated earnings, it appears that the 2006 distribution from National Financial Services is the final tax exempt pension amount to be disbursed from the Fidelity account.”

9. The Division issued a statement of proposed audit changes, dated November 1, 2010, to petitioners with the following explanation, in pertinent part:

“The \$128,000 distribution you received from National Financial Services, LLC does not qualify for full exclusion as a New York State government pension.

Information provided in protest to your assessments for previous years shows that in 1995, \$528,808 in TIAA/CREF contracts RA A182364-8 and RA P102425-1 was rolled into Fidelity (National Financial Services). The TIAA/CREF contracts were 100% publicly funded (SUNY). Only the rolled over amount retains its character as government pension, not any accumulated earnings.

Our records indicate that you have excluded the maximum \$528,808 as New York State government pension in tax years prior to 2007. Therefore, the remainder of the distributions from National Financial Services cannot be considered distributions from New York State that qualify for full exclusion.

Since you were at least 59½ during 2007 and received qualifying pension income, you have been allowed the appropriate pension and annuity income exclusion of up to \$20,000 in our computation.”

The statement computed tax due in the amount of \$5,349.41 plus interest.

10. The Division issued a notice of deficiency, assessment L-034893475, to petitioners

dated January 18, 2011, asserting additional personal income tax due in the amount of \$5,349.41, plus interest.

11. Petitioners requested a conciliation conference before the Bureau of Mediation and Conciliation Services, for a redetermination of the income tax deficiency, on or about February 1, 2011. Petitioners set forth the following explanation on the request:

“The State constitution clearly states that New York State pensions are not subject to New York State income taxes. Nevertheless, the Department of Taxation has since 2001 sought to tax my New York State pension income even though they have received and acknowledged documentation proving the income source. Year after year the Department has finally admitted that their claim was illegitimate (most recently agreeing in a letter dated 1/25/10 that there was no tax owing for 2006). At this point it seem [sic] fair to describe this behavior as harassment that needs to end now.”

12. A conciliation conference was held on September 20, 2011, and a conciliation order dated November 10, 2011 was issued to petitioners sustaining the notice of deficiency. A timely petition was thereafter filed in protest with the Division of Tax Appeals on December 8, 2011, and timely answered by the Division on February 8, 2012.

THE DETERMINATION ON REMAND OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge initially explained that the New York State adjusted gross income of a resident individual is determined by starting with that individual's federal adjusted gross income and then applying certain New York State addition and subtraction modifications. As relevant to this matter, Tax Law § 612 (c) (3) (i) allows a reduction from income for pensions paid to state employees to the extent such income was included in federal adjusted gross income. The Administrative Law Judge, citing 20 NYCRR 112.3 (c) (1), further explained that the Division's regulations interpret this reduction as only applicable to pensions and other retirement benefits that relate to services performed as a public employee and only where the benefit in question was contributed to by the State. The Administrative Law Judge noted that, for pensions

and annuities not excluded pursuant to Tax Law § 612 (c) (3) (i), Tax Law § 612 (c) (3-a) allows a subtraction modification from federal adjusted gross income for up to \$20,000.00 to the extent such pensions and annuities are (1) included in federal gross income and (2) constitute periodic payments stemming from personal services before retirement from either (a) an employer/employee relationship or (b) contributions to a retirement plan deductible for federal income tax purposes. Also included in such pensions and annuities are distributions to persons 59 ½ years old and older, from an IRA, even where the payments are not periodic in nature.

The Administrative Law Judge then explained that with regard to such subtractions from income, petitioners must establish by clear and convincing evidence that their interpretation of the Tax Law is the only reasonable interpretation of the relevant provisions of the Tax Law.

The Administrative Law Judge provided a detailed explanation of the various elements of what constitutes an IRA, such as the IRA account managed by NFS that Mr. Kane established with the funds from the complete liquidation of his SUNY ORP, and an employer pension plan, such as the SUNY ORP. The Administrative Law Judge summarized such elements and the differences between an IRA and an employer-sponsored retirement plan, utilizing a quote from a bankruptcy case, the primary points of which were as follows:

- An IRA is a savings account with tax benefits, not a pension plan;
- An IRA consists entirely of the employee contributions, whereas a pension plan includes contributions from employers;
- An IRA is created and governed by the employee and established under Title II of ERISA whereas qualified pension plans are created by employers and governed by Title I of ERISA; and
- The employee has complete control over an IRA and can withdraw the funds at anytime, albeit subject to a penalty, which is the antitheses of the purpose of a retirement plan, which is make funds available at the time of retirement (*Matter of Iacono*, 120 BR 691 [1990], overruled on other grounds by *In re Dubroff*, 119 F3d 75 [1997]).

The Administrative Law Judge noted that the SUNY ORP was a defined contribution plan created in 1964 to offer an alternative to the New York State Employees' Retirement System and the New York State Teachers' Retirement System to eligible SUNY employees. The Administrative Law Judge explained that the SUNY ORP was an employer sponsored pension plan funded by contributions from both employers and employees, and that the rate of the contributions was determined by SUNY ORP. The Administrative Law Judge further explained that the retirement benefits paid out under the SUNY ORP depended upon the value of individually owned annuity contracts purchased through an authorized investment provider and that at the time Mr. Kane retired, there were four funding choices available to SUNY ORP participants including TIAA-CREF, Mr. Kane's choice. The Administrative Law Judge noted that SUNY ORP provided various options for how to receive retirement distributions and informed its participants that as a New York State government retirement plan, such distributions were exempt from New York State income taxes. However, SUNY ORP also informed its participants that such exemption applied only to the portion of the distribution that was attributable to their employment with SUNY.

The Administrative Law Judge then concluded, based upon this discussion, that the distribution received by Mr. Kane was not attributable to his SUNY employment, but rather was attributable to his investment choices made after the total liquidation of his SUNY ORP retirement plan and his subsequent rollover of the funds from that plan into an IRA. As further support for the conclusion that the very nature of Mr. Kane's holdings changed when they were distributed from the SUNY ORP and then rolled over into an IRA, the Administrative Law Judge pointed to the different treatment accorded to direct transfers of retirement assets versus rollovers. Citing to 13 *Tax'n for Law* 214, Vol 13, no 4 (1985), the Administrative Law Judge

explained that in direct, or trustee-to-trustee, transfers of retirement assets, there is no distribution of the assets so the employee never takes possession of the assets. Most significantly, “amounts transferred from one plan to another retain their original characteristics as employer or employee contributions” (*id.* at 214). However, in a rollover, a distribution is made to the employee, who therefore has possession of the assets, and the employee then has a certain amount of time within which to complete the rollover transactions. Thus, the Administrative Law Judge reasoned that amounts rolled over did not retain their original characteristics as employer or employee contributions. The Administrative Law Judge noted that at the time of his retirement, Mr. Kane had various options available to him. He chose to liquidate his SUNY ORP, thereby receiving a distribution of his entire pension. Mr. Kane then chose to place the funds in the NFS IRA, an investment vehicle totally unrelated to his SUNY ORP, such investment vehicle being operated solely at the discretion of Mr. Kane. Thus, the Administrative Law Judge concluded that none of the funds used to establish the IRA were actually contributed by New York State as required by 20 NYCRR 112.3 (c) (1) (i). The Administrative Law Judge noted that even if the Division had a policy whereby none of the distribution received by Mr. Kane was allowed to be considered a pension to an employee of New York State, such policy would be required to be upheld.

The Administrative Law Judge then addressed the incongruity between the conclusion that the entire amount of the distribution received by Mr. Kane could no longer be considered a New York State government pension, and the fact that the Division treated the original amount invested in the IRA, \$528,808.00, as retaining its character as a government pension, while only excluding from coverage of Tax Law § 612 (c) (3) (i) the amount that represented Mr. Kane’s return on investment from the date of the establishment of the IRA. The Administrative Law Judge concluded that it was within the Division’s discretion to treat only the \$528,808.00 that

was rolled over as a government pension, and then treat the post-liquidation earnings on the IRA as not covered by Tax Law § 612 (c) (3) (i). In other words, the Division is allowed to interpret the statute and regulations in a manner that allowed petitioners to receive the benefit of having the distribution treated as a New York State government pension, although the Division could have asserted that even this amount lost its character as a government pension under the above analysis. The Administrative Law Judge noted that this has been the Division's consistent policy for over 35 years.

Accordingly, the Administrative Law Judge concluded that the Division's interpretation of the statute and regulations in this instance were indeed reasonable, and that, therefore, petitioners could not meet their burden to show by clear and convincing evidence that their interpretation of the statute was the only reasonable interpretation.

SUMMARY OF ARGUMENTS ON EXCEPTION

In response to the determination on remand, petitioners argue that neither the determination on remand, nor the arguments of the Division, have adequately answered their logical assertion that the nature of Mr. Kane's retirement account did not change from a New York State government pension to something else, merely because he received a distribution of his SUNY ORP and rolled it over into an IRA. Petitioners' point is that the money in the account was originally related to Mr. Kane's work as a SUNY employee and that the change in investment vehicle did not change the origin of the funds. Petitioners also assert that the decision in this matter should be governed by the Administrative Law Judge determination in ***Matter of Bourns***, Division of Tax Appeals (February 21, 2008). Finally, Mr. Kane asserts that he is elderly and disabled and does not understand all of the legal terms utilized in the various determinations and decisions, but asserts that the Division's position is based upon a string of

advisory opinions that do nothing to answer this Tribunal's question on remand.

In opposition to petitioners' submission, and in support of the determination on remand of the Administrative Law Judge, the Division argues that Article 16, section 5 of the New York State Constitution, Tax Law § 612 (c) (3) (i) and 20 NYCRR 112.3 (c) (1) (i) all support its longstanding position that IRA distributions are excluded from taxation only to the extent that such distributions consist of funds from the rollover distribution of a New York State government pension.

The Division asserts that petitioners' position should not be considered a plausible interpretation of the law. The basis of the Division's argument was its comparison of the SUNY ORP to IRAs, as follows:

- The SUNY ORP is a defined contribution pension plan; is available as an option for eligible employees; and is overseen by the SUNY Board of Trustees. IRAs are for the exclusive use of the owner of the account or their beneficiaries; are nonqualified plans under ERISA; and are not established or maintained by employers.
- The SUNY ORP is contributed to by employers and employees. IRAs are only contributed to by the owner of the account who may keep contributing until age 70½ as long as the owner has taxable income.

Applied to the present case, the Division asserts that SUNY had oversight of its SUNY ORP, but not the IRA, and that while SUNY and Mr. Kane made contributions to his SUNY ORP account, only Mr. Kane contributed to his IRA. The Division asserts that although there is no evidence in the record regarding any contributions made to the IRA after the initial rollover, Mr. Kane was free to contribute to the IRA, and such contributions clearly would not have been from a New York State government pension. Thus, the Division argues that the Administrative Law Judge correctly found that none of the funds used to set up the IRA were contributed by the State, and that, in any event, the IRA earnings after the rollover were attributable solely to Mr.

Kane's investment choices and cannot in any manner be attributable to the SUNY ORP. The Division agrees with the Administrative Law Judge that the facts in the current case could justify taxation of all the distributions from the IRA, but acknowledged that it has been its policy to tax only those amounts in excess of the rollover amount. The Division asserts that petitioners' reliance on *Matter of Bourn* is misguided in that pursuant to Tax Law § 2010 (5) determinations of Administrative Law Judges are not precedential and, furthermore, such determination is not relevant to the present case.

The Division also reasons that as it originally set forth its interpretation of the statute in a 1980 advisory opinion and, reiterated its position in 10 additional advisory opinions, the last being issued in 2010, the silence of the Legislature on this issue should be interpreted to mean that it acquiesced in the Division's interpretation. Thus, the Division asserts that as petitioners have not shown by clear and convincing evidence that the Division's interpretation of the relevant statute is unreasonable, or that their interpretation of the statute is the only reasonable interpretation, the determination of the Administrative Law Judge should be affirmed.

OPINION

Initially, we address the modifications made to the findings of fact by the Administrative Law Judge on remand, in that the remand was made in order for the Administrative Law Judge to address a question of law. We agree with the Administrative Law Judge that, although not technically facts, the additional information in the findings based upon statutes and case law is useful in assisting the reader to understand the SUNY ORP, and, accordingly, have adopted those findings. We do not, however, find any basis for the modification to finding of fact 1 and have not adopted that modification.

As we held in our previous decision in this matter, Article 16, Section 5 of the New York State Constitution provides that “[a]ll salaries, wages and other compensation, except pensions, paid to officers and employees of the state and its subdivisions and agencies shall be subject to taxation.” In accordance with this constitutional provision, and as relevant hereto, Tax Law § 612 (c) (3) (i) allows for the calculation of New York adjusted gross income by reducing federal adjusted gross income by the amount of pensions paid to employees of New York State to the extent that such income was included in federal adjusted gross income. This reduction is further defined by regulation as only applicable to pensions and other retirement benefits that relate to services performed as a public employee and only where the benefit in question was actually contributed to, at least in part, by the State (20 NYCRR 112.3 [c] [1]).

Optional retirement programs available for certain SUNY employees are defined contribution plans to which both SUNY and the employees contribute (*see* Education Law Article 8-B; Opp Atty Gen 2004 F2). Mr. Kane participated in this program during his 30 years of employment with SUNY and, upon his retirement, opted to roll over the entire amount of his SUNY pension into an IRA managed by NFS.

Had Mr. Kane left his SUNY pension with TIAA/CREF, the total of the contributions made by SUNY, the contributions made by Mr. Kane and the earnings on those amounts would have been excluded from petitioners’ adjusted gross income pursuant to Tax Law § 612 (c) (3) (i). Indeed, the Division allowed the exclusion from petitioners’ income of the amount of the SUNY pension actually rolled over into the NFS IRA. Therefore, even though the payments came from NFS rather than TIAA/CREF, the Division considered the payments to be pension payments related to Mr. Kane’s state employment and from a pension that was contributed to by SUNY.

The question that was to be addressed by the Administrative Law Judge on remand was how did the rollover of Mr. Kane's SUNY pension into an IRA managed by NFS change the nature of that pension plan to the extent that the Division no longer considered it as related to his state employment. This case was remanded, as we previously found that the Administrative Law Judge's answer to petitioners' question was based on conclusory Advisory Opinions that did not provide an adequate basis for the Administrative Law Judge's determination.

The crux of petitioners' argument is that Mr. Kane's IRA distributions should not be treated any differently than the distributions he would have received had Mr. Kane not taken a complete distribution of his SUNY ORP and used it to establish an IRA, but rather kept his SUNY ORP and received distributions that would have clearly been covered by the subtraction modification of Tax Law § 612 (c) (3) (i). In other words, petitioner questions why the earnings from his investments were treated differently simply because they were in different investment vehicles.

This was the question that this Tribunal asked on remand. We conclude that the Administrative Law Judge did answer this question in the determination on remand. We conclude that an employer sponsored retirement plan, such as the SUNY ORP, is fundamentally different from an IRA, thus allowing for its different treatment for tax purposes. The SUNY ORP is controlled by SUNY and is partially funded by SUNY. An IRA is controlled by the employee creating it and funded solely by that employee. It was Mr. Kane's decision to liquidate his SUNY ORP and roll the funds over into an IRA, thus giving him complete control over the asset and changing its fundamental nature from a New York State government pension. We agree with the Division that once this was done, Mr. Kane was free to make further deposits into the IRA that were completely unrelated to his public employment, and note that the record

contains no indication as to whether the only funds in the IRA were from the liquidated SUNY ORP. We also agree with the Division that petitioners' reliance on *Matter of Bourn* is misplaced, in that Administrative Law Judge determinations may not be relied upon as precedent (*see* Tax Law § 2010 [5]) and, in any event, the circumstances presented in that case are distinguishable from the present case. Finally, we note that we agree with the Administrative Law Judge and the Division that it is within the Division's discretion to adopt a policy that allows for the amounts distributed from a SUNY ORP and rolled over into an IRA to be considered as a New York State government pension that is allowed to be subtracted from federal adjusted gross income in determining New York adjusted gross income pursuant to Tax Law § 612 (c) (3) (i), even though a strict interpretation might result in subjecting even these amounts to taxation.

In summary, as we have concluded that the Division's interpretation of the controlling statutes is reasonable, we find that petitioners have failed to meet their burden of proving that their interpretation of the controlling statute was the only reasonable interpretation (*Matter of Grace v New York State Tax Commn.*, 37 NY2d 193 [1975], *rearg denied* 37 NY2d 816 [1975], *lv denied* 338 NE2d 330 [1975]; *Matter of Marriott Family Rests. v Tax Appeals Trib. of State of N.Y.*, 174 AD2d 805 [1991], *lv denied* 78 NY2d 863 [1991]).

Thus, other than the additional discussion above, we conclude that the determination on remand of the Administrative Law Judge adequately and correctly addressed the issue in this matter and affirm such determination on remand for the reasons stated therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Peter and Marguerite Kane is denied:
2. The determination on remand of the Administrative Law Judge is affirmed;

3. The petition of Peter and Marguerite Kane is denied; and
4. The notice of deficiency is sustained.

DATED: Albany, New York
December 21, 2016

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner
JAM with permission