STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PETER AND MARGUERITE KANE	:	DETERMINATION DTA NO. 824767
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Year 2007.	:	

Petitioners, Peter and Marguerite Kane, 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 year 2007.[1]

On May 21, 2013 and May 30, 2013, respectively, petitioners, Peter and Marguerite Kane, appearing pro se, and the Division of Taxation, appearing by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel) consented to have the controversy determined on submission without a hearing. All documentary evidence and briefs were due by September 25, 2013, which date commenced the six-month period for the issuance of a determination in this matter. Upon review of the entire record, Catherine M. Bennett, Administrative Law Judge, renders the following determination.

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[1] Petitioners requested that all claims for state personal income tax due against them for 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.

ISSUE

Whether the distribution of $108,000.00 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 were properly entitled to exclude such payments from their New York adjusted gross income pursuant to Tax Law § 612(c)(3)(i).

FINDINGS OF FACT

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 (NFS) of Fidelity Investments, 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 59 ½ 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" (SUNY pension).

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

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

7. 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.

8. 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 a least 59 ½ 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.

9. 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.

10. Petitioners requested a conciliation conference before the Bureau of Mediation and Conciliation Services (BCMS), 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.

11. 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.

12. The parties stipulated to 15 findings of fact that have been incorporated above as either a statement of the issue or the findings of fact, with the exception of petitioners' address, which was excluded for privacy.

SUMMARY OF THE PARTIES' POSITIONS

13. Petitioners maintain that the distribution received from Mr. Kane's IRA, funded by a rollover of his defined contribution plan upon his retirement from SUNY, retains its character as the pension of an employee of New York State, and as such constitutes a pension or retirement benefit exempt from New York personal income tax pursuant to Tax Law § 612(c)(3)(i).

14. The Division states that an important factor in this case is that TIAA/CREF, not Fidelity, was given the duty to manage the pension plans of New York State officers and employees, and asserts that Mr. Kane's pension ceased to be a New York State pension when he liquidated it and rolled the proceeds over to an IRA with Fidelity. The Division believes that proper treatment of these funds is to classify the amount received from the rollover IRA, representing a return of the pension contribution, as not subject to New York personal income tax (as a pension received by an employee of the State of New York), but interest or any other gain earned after the rollover by the IRA as subject to tax.

CONCLUSIONS OF LAW

A. Tax Law § 612(a) provides that the adjusted gross income of a resident individual is his federal adjusted gross income with certain addition and subtraction modifications provided for in subsections (b) and (c) of Tax Law § 612. The specific subtraction modification at issue in this matter is set forth at Tax Law § 612(c)(3)(i), which provides that a taxpayer's federal adjusted gross income is to be reduced for:

> Pensions to officers and employees of this state, its subdivisions and agencies, to the extent includible in gross income for federal income tax purposes.

For pensions and annuities that are not excluded pursuant to Tax Law § 612(c)(3)(i), Tax Law § 612(c)(3-a) provides a subtraction modification from federal adjusted gross income, in pertinent part, for:

> Pensions and annuities received by an individual who has attained the age of fifty-nine and one-half, not otherwise excluded pursuant to paragraph three of this subsection, 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, . . . whether or not the payments are periodic in nature (emphasis supplied).

The Division disallowed the pension exclusion for the 2007 distribution of $128,000.00 under Tax Law § 612(c)(3)(i), but allowed the $20,000.00 pension and annuity exclusion to petitioners pursuant to Tax Law § 612(c)(3-a), leaving $108,000.00 subject to personal income tax.

B. The Commissioner's regulations at 20 NYCRR 112.3(c)(1) contain the following provisions with respect to the pension exclusion:

> Pensions and other retirement benefits paid to public officers and public employees of New York State, its political subdivisions or agencies or the Federal government (Tax Law § 612[c][3]).
>
> (i) Retirement benefits provided for in clauses (*a*) and (*b*) of this subparagraph which are included in Federal adjusted gross income, relate to services performed as public officers or public employees and all or a portion of which are actually contributed to (rather than merely being deemed contributed to) by New York State, its political subdivision or agencies or the Federal government, shall be subtracted in computing New York adjusted gross income:
>
> (*a*) pensions and other retirement benefits (including, but not limited to, annuities, interest and lump sum payments) paid to a public officer or public employee or the beneficiary of a deceased public officer or deceased public employee of New York State, its political subdivisions or agencies . . . .

C. Petitioners assert that the Division justified its position in this matter by its reliance upon several advisory opinions, the earliest of which was 2002, seven years after the rollover of Mr. Kane's defined contribution pension to his IRA, amounting to an improper retroactive application of tax theory to a nonreversible financial event. Petitioner is mistaken in this regard.

The Division explains its theory of taxation in this case in a manner consistent with numerous advisory opinions it has published over the past 34 years, beginning with Joseph W. Martiney (TSB-H-80[523]I, November 24, 1980), where the same issue is addressed. In that opinion, the State Tax Commission addressed the personal income tax treatment of distributions from an IRA established by means of a tax-free rollover of amounts received in the form of a pension from the State of New York or a subdivision or agency thereof. There was no dispute that the Internal Revenue Code permits a tax-free rollover of certain payments made from a qualified trust to an employee that are transferred to an eligible retirement plan such an IRA. The opinion stated the following, in pertinent part:

> Article 16, §5 of the New York State Constitution provides that 'All 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.' Thus, the receipt of a distribution from a qualified trust which constitutes such a pension is not subject to tax under the Personal Income Tax. The act of 'rolling over' the pension into an Individual Retirement Account is not itself a taxable event, and a subsequent distribution from such an account would represent a nontaxable return of principal to the extent that the distribution represented a return of funds 'rolled over' into the account. *To the extent that the distribution represented interest, or any other type of gain, earned in the account such portion would be subject to tax* (emphasis supplied).

Subsequent advisory opinions, TSB-A-10(6)I (July 13, 2010), TSB-A-03(4)I (November 19, 2003), TSB-A-02(5)I (July 24, 2002), and TSB-A-98(4)I (March 24, 1998), with near identical facts to Martiney, provided the same tax guidance. In 1981, Tax Law § 612(c)(3-a) was enacted for tax years after January 1, 1982, and provided that pension and annuity income not subject to the exclusion under Tax Law § 612(c)(3)(i), and not in excess of $20,000.00, may be subtracted in determining New York adjusted gross income. The advisory opinions issued after its enactment additionally addressed the applicability of the subtraction modification of Tax Law § 612(c)(3-a) to the amounts in excess of the return of pension contributions, up to $20,000.00,

provided the conditions of the law are met. The opinions concluded that any excess thereafter would be subject to tax and not allowed as a subtraction from federal adjusted gross income when computing New York adjusted gross income.

D. Petitioners also maintain that the tax exempt character of Mr. Kane's pension does not change when it is moved from one management company to another, and relies upon ***Matter of Bourns*** (Division of Tax Appeals, February 21, 2008). The Division accurately argues that notwithstanding the fact that administrative law judge determinations are not considered precedent, the ***Bourns*** determination is not on point. There, the petitioner was a retired employee of Eastman Kodak, whose pension administration was taken over by a different company, where the pension distributions formerly reported on Form 1099-R were subsequently reported to them as wages on Form W-2, raising the question of whether such distributions still qualified for the pension and annuity exclusion of Tax Law § 612(c)(3-a). In his consideration of whether the change in the reporting of the distribution affected taxability (not whether the change in plan administrators had such an effect), the administrative law judge held that the distributions, although reported as wages, were still pension or annuity payments qualifying for the income exclusion. The ***Bourns*** case has no bearing on the issues in this matter.

E. As a former employee of SUNY, the portion of Mr. Kane's distribution from the rollover IRA that represented the amount of the pension benefit that was rolled into the IRA was considered a return of the pension contribution and was exempt from New York State income tax pursuant to Tax Law § 612(c)(3)(i) and 20 NYCRR 112.3(c)(1)(i)(a). With respect to distributions of any gain or income earned from the rollover IRA account, since those earnings are not attributable to Mr. Kane's retirement plan connected to his employment with SUNY, the interest, gain or income earned is not exempt pursuant to Article 16, section 5 of the New York

State Constitution and section 612(c)(3)(i) of the Tax Law. The reasoning applied in this determination is similar to the reasoning consistently applied by the Division in the previously mentioned advisory opinions. An advisory opinion is a written statement issued on behalf of the Commissioner of Taxation and Finance (Commissioner) regarding the application of the Tax Law to a specific set of facts. Advisory opinions are not binding on the Commissioner except with respect to the person to whom the opinion is issued (Tax Law § 171[24]). Although it has no precedential value, the advisory opinions issued to Martiney, Green, Zelony and others contain analysis and reasoning that are similar to the analysis and reasoning of this determination, and I find the reasoning persuasive as well as consistent with and supported by the statute and regulations governing this transaction. The Division determined that by tax year 2006, the entire amount of Mr. Kane's original liquidated pension amount of $528,808.00 was returned to him through distributions. As a result, once the full amount of the pension contribution that became the IRA rollover was returned to petitioners tax free, distributions thereafter represented accumulated earnings that were no longer connected to Mr. Kane's SUNY employment-related retirement, and were subject only to the subtraction modification of $20,000.00.

Accordingly, when Mr. Kane elected to withdraw $128,000.00 from his IRA in 2007, having recovered his pension rollover amount of $528,808.00 between 1995 and 2006, his distribution was not eligible for the entire exclusion pursuant to Tax Law § 612(c)(3)(i). However, since Mr. Kane was over age 59 ½, the IRA distribution did qualify for the subtraction modification in the amount of $20,000.00 pursuant to Tax Law § 612(c)(3-a). The Division properly determined that the remaining $108,000.00 was taxable to petitioners in 2007.

F. The petition of Peter and Marguerite Kane is denied and the Notice of Deficiency, dated January 18, 2011, is sustained.

DATED: Albany, New York
March 20, 2014

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE