

**New York State Department of Taxation and Finance**  
**Taxpayer Services Division**  
**Technical Services Bureau**

TSB-A-96 (7) I  
Income Tax  
December 24, 1996

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I960828A

On August 28, 1996, a Petition for Advisory Opinion was received from Merrill Lynch & Co., Inc., World Financial Center, South Tower, 7th Floor, New York, New York 10080-6107.

The issue raised by Petitioner, Merrill Lynch & Co., Inc., is whether the payment of deferred compensation to a nonresident or nondomiciliary of New York, who was employed in New York at the time of deferral, will be exempt from personal income tax under Article 22 of the Tax Law pursuant to section 114(b)(1)(I)(i)(II) of Title 4 of the US Code if the payment is one of a series of installments as described below over a period of 10 or more years.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner maintains a deferred compensation plan which provides for payment of deferred cash compensation to certain employees who have elected to participate in the plan. Some of the employees who have elected to participate in the plan are employed in New York. At the time of deferral, the participant designates the amount that will be deferred as well as certain "benchmark return options." By electing one or more benchmark return options, the employee elects to key his or her deferred compensation account balance to the performance of certain employer-sponsored mutual funds. The amount of compensation deferred is credited to the participant's account as a vested but unfunded liability of Petitioner to the participant. The account is adjusted (either positively or negatively) to reflect the investment experience of the selected benchmark return options in the same manner as if such investments had actually been made.

The participant's account balance will generally be paid, at the election of the participant, at or after retirement, either in a single payment or in a number of annual installments (not to exceed 15) selected by the participant. If the annual installment payout is selected, the amount of each annual installment is determined by multiplying the account balance as of the last day of the month immediately preceding the month in which the payment is to be made by a fraction, the numerator of which is one and the denominator of which is the remaining installment payments (including the installment payment to be made). Consequently, the account balance is adjusted by the performance of the benchmark return options each year until the final installment payment is made to the participant. Thus, the amount of the installment payments made over the course of the payout period will not be exactly equal.

Petitioner states that its deferred compensation plan constitutes a plan, program, or arrangement described in section 3121(v)(2)(C) of the Internal Revenue Code ("IRC"). The installment payments will be made to a participant annually for a period of 10 or more (but not to exceed 15) years.

Section 114(a) of Title 4 of the US Code, as added by Public Law 104-95, January 10, 1996, and applicable to amounts received after December 31, 1995, provides that "[n]o State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State)." Section 114(b)(1) of Title 4 of the US Code defines the term "retirement income" as any income from, among other things:

(I) any plan, program, or arrangement described in section 3121(v)(2)(C) of [the IRC], if such income --

(i) is part of a series of substantially equal periodic payments (not less frequently than annually) made for --

(I) ...

(II) a period of not less than 10 years ....

Section 3121(v)(2)(C) of the IRC defines a "nonqualified deferred compensation plan" as any plan or other arrangement for deferral of compensation other than a plan described in section 3121(a)(5) of the IRC (generally, ERISA or "qualified" plans).

Accordingly, pursuant to section 114 of Title 4 of the US Code, New York State may not impose personal income tax under Article 22 of the Tax Law on the retirement income of an individual who is not a resident or domiciliary of New York. An individual's retirement income includes income from a nonqualified deferred compensation plan that is described in section 3121(v)(2)(C) of the IRC if the income is part of a series of substantially equal periodic payments (not less frequently than annually) made for a period of not less than 10 years.

However, the phrase "substantially equal periodic payments" is not defined for purposes of section 114(b)(1)(I)(i) of Title 4 of the US Code and no federal guidance has been issued with respect to this section. However, an analogous provision of the IRC has defined "substantially equal periodic payments" with regard to similar types of installment payments from qualified defined contribution plans. Under section 402(c) of the IRC, any portion of a distribution from a qualified plan that is an eligible rollover distribution described in section 402(c)(4) of the IRC may be rolled over to an eligible retirement plan described in section 402(c)(8)(B) of the IRC. Section 402(c)(4) of the IRC defines an "eligible rollover distribution" as:

any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include --

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made --

(i) ...

(ii) for a specified period of 10 years or more ..."

Section 1.402(c)-2 Q&A 5 of the Treasury Regulations provides that for purposes of determining whether a distribution is an eligible rollover distribution, the determination of whether a series of payments is a series of

substantially equal periodic payments over a period specified in section 402(c)(4)(A) of the IRC, is generally determined at the time payments begin, and by following the principles of section 72(t)(2)(A)(iv) of the IRC, without regard to contingencies or modifications that have not yet occurred. However, with respect to a defined contribution plan, Q&A 5(d) provides that the following rules apply in determining whether a series of payments from a defined contribution plan constitute substantially equal periodic payments for a period described in section 402(c)(4)(A) of the IRC:

(1) *Declining balance of years.* A series of payments from an account balance under a defined contribution plan will be considered substantially equal payments over a period if, for each year, the amount of the distribution is calculated by dividing the account balance by the number of years remaining in the period. For example, a series of payments will be considered substantially equal payments over 10 years if the series is determined as follows. In year 1, the annual payment is the account balance divided by 10; in year 2, the annual payment is the remaining account balance divided by 9; and so on until year 10 when the entire remaining balance is distributed ....

Accordingly, the IRC has interpreted the phrase "substantially equal periodic payments" with respect to a qualified defined contribution plan to mean a series of payments from an account balance over a period if, for each year, the amount of the distribution is calculated by dividing the account balance by the number of years remaining in the period.

Without guidance to the contrary, it would appear that the Internal Revenue Service's interpretation of "substantially equal periodic payments" for purposes a qualified defined contribution plan under section 402(c)(4)(A) of the IRC would also apply to the same phrase in section 114(b)(1)(I)(i) of Title 4 of the US Code with respect to a defined contribution plan that is a non-qualified deferred compensation plan that is described in section 3121(v)(2)(C) of the IRC. Under section 414(i) of the IRC a "defined contribution plan" means "a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account."

In this case, Petitioner states that the deferred compensation plan at issue is a plan described in section 3121(v)(2)(C) of the IRC. Petitioner also states that installment payments will be made to a participant annually for a period of 10 or more (but not to exceed 15) years, and that the annual installments will be determined by multiplying the account balance as of the last day of the month immediately preceding the month in which the payment is to be made by a fraction, the numerator of which is one and the denominator of which is the remaining installment payments (including the installment payment to be made). Assuming those facts, and the fact that it is a defined contribution plan, it appears that, pursuant to section 114(a) of Title 4 of the US Code, the

TSB-A-96 (7) I  
Income Tax  
December 24, 1996

income from the deferred compensation plan received by an individual who is not a resident or domiciliary of New York State would be exempt from New York State's personal income tax under Article 22 of the Tax Law for amounts received from the plan after December 31, 1995.

DATED: December 24, 1996

s/John W. Bartlett  
Deputy Director  
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions  
are limited to the facts set forth therein.