STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PETER AND MARGUERITE KANE	:	DETERMINATION ON REMAND
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.	:	DTA NO. 824767

Petitioners, Peter and Marguerite Kane,[1] 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.

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. Upon review of the entire record, Catherine M. Bennett, Administrative Law Judge, rendered a determination on March 20, 2014, which denied the petition and sustained the Notice of Deficiency dated January 18, 2011.

Petitioners, Peter and Marguerite Kane, filed an exception to the determination and in a decision dated January 29, 2015, the Tax Appeals Tribunal remanded this matter to the Administrative Law Judge for further analysis of the issue set forth below. The Tax Appeals Tribunal further recommend that the Administrative Law Judge request supplemental briefs from

[1] Marguerite Kane is a petitioner in this matter solely due to the parties having filed a joint personal income tax return for tax year 2007. Accordingly, for simplicity, any reference to petitioner herein refers to Peter Kane.

the parties addressing the issue of the change in nature of the SUNY pension, before issuing the supplemental determination. Petitioners submitted correspondence on March 16, 2015, referring only the documents previously submitted, with no supplemental information. The Division of Taxation submitted a supplemental memorandum of law on May 1, 2015. Petitioner submitted no reply by their due date of June 3, 2015, the date which commenced the six-month period for the issuance of a determination in this matter. In accordance with Tax Law § 2010(3), for good cause shown, the due date was extended an additional three months upon notice to the parties. After review of the evidence and arguments, and upon further research, Catherine M. Bennett, Administrative Law Judge, renders the following determination.

ISSUE

Whether the liquidation, distribution and rollover of a lump sum of petitioner's SUNY ORP, managed by TIAA-CREF, into an Individual Retirement Account managed by National Financial Services, LLC of Fidelity Investments, changed the nature of the pension to the extent that once the amount attributed to the rollover was recovered as exempt pursuant to Tax Law § 612 (c) (3) (i), the amount in excess could no longer be considered as related to petitioner's State employment, and therefore was not exempt under the same provision of the law.

FINDINGS OF FACT

The following findings of fact are incorporated herein from the decision of the Tax Appeals Tribunal in ***Matter of Peter and Marguerite Kane*** (Tax Appeals Tribunal, January 29, 2015). In addition, in its brief on remand, the Division submitted a series of seven additional facts, six of which reference petitioner's SUNY pension, referred to as the SUNY ORP, which specific terminology is also referenced by the Tax Appeals Tribunal in its decision in this matter. Such facts merely clarify and add edification to the SUNY ORP provisions and have been added to the existing findings of fact, and incorporated where their reference would be most useful.[2] The last statement offered by the Division in its brief, regarding an IRA, is a definition also founded in law, and will be incorporated in the conclusions of law.

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. According to petitioner, 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 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," which was part of the

[2] The State Administrative Procedure Act § 306(4) permits the taking of official notice in administrative proceedings if judicial notice could be taken. A court may only take judicial notice of particular facts if the items are of common knowledge or are determinable by referring to a source of indisputable accuracy (***Matter of Crater Club v. Adirondack Park Agency***, 86 AD2d 714, 446 NYS2d 565 [1982], ***affd*** 57 NY2d 990, 457 NYS2d 244 [1982]). Courts today will often judicially notice matters of public record (Fisch on New York Evidence, § 1063 at 600 [2d ed]). Judicial notice is taken of the Education Law, New York case law and Internal Revenue Code references as sources of indisputable accuracy of the information set forth in the additional facts.

SUNY Optional Retirement program (SUNY ORP).[3] The SUNY ORP is a defined contribution plan for SUNY employees who elect to participate rather than join the NYS Teachers' Retirement System, a defined benefit pension plan.[4] Both SUNY and the employee make contributions to the SUNY Optional Retirement program.[5]

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.[6] The Board is authorized to provide for the administration of the ORP, and to perform or authorize the performance of necessary functions. [7] The Board designated TIAA/CREF to administer its ORP, which was established by Article 8-B of the Education Law.[8]

6. In December 1995, Mr. Kane elected to take a distribution of $528,808.00 in complete liquidation of his SUNY ORP[9] 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 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

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[3] The Division's citation reference was to New York State Education Law §§ 390 through 397 and ***Young v. State of N.Y.*** (179 Misc2d 879, 880-881).

[4] The Division's citation reference was to New York State Education Law §§ 391, 393, 501 through 539 and ***Young***.

[5] The Division's citation reference was to New York State Education Law §§ 391.1 and 392.

[6] The Division's citation reference was to New York State Education Law § 391 (2).

[7] The Division's citation reference was to New York State Education Law §§ 391 (3).

[8] The Division's citation reference was to New York State Education Law §§ 390 through 397 and ***Young***.

[9] ORP has been substituted for 'pension' to more accurately reflect the record.

§ 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 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.

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.

13. The Division maintains that petitioner's position that the distribution from his IRA in excess of the rollover lump-sum contribution should be excluded from tax as a SUNY pension is not a plausible interpretation of the law. If even this position was deemed plausible, the Division argues that it is not the only reasonable interpretation of the law.

CONCLUSIONS OF LAW

A. This matter was remanded to the Administrative Law Judge for a supplemental determination to address the issue of whether the rollover of petitioner's SUNY ORP into an IRA that was thereafter managed by a different entity (NFS), fundamentally changed the nature of that pension plan, to the extent that the Division no longer considered it as related to his State employment.

B. 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."

C. 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 . . . ."

D. 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 petitioner the $20,000.00 pension and annuity subtraction modification pursuant to Tax Law § 612 (c) (3-a).

E. The subtraction modification of Tax Law § 612 (c) (3) (i) constitutes a statutory exemption from taxation. That is, New York State employee pension income, which is subject to Federal income taxation, would be subject to State income taxation but for this subtraction modification. Statutory exemptions are strictly construed against the taxpayer, since an exemption is not a matter of right, but is allowed only as a matter of legislative grace (***see, Matter of Grace v. New York State Tax Commn***., 37 NY2d 193 [1975], ***lv denied*** 37 NY2d 708 [1975]). Nevertheless, such interpretation "should not be so narrow and literal as to defeat [the] settled purpose" of the exemption (***Id.***). It is the taxpayer who bears the burden of proving entitlement to the exemption, and the taxpayer must establish not only that his interpretation of the law is a plausible one, but that his interpretation of the law is the only reasonable construction, in order to prevail over the construction made by the administrative agency charged with its enforcement (***Blue Spruce Farms v. NYS Tax Commn.***, 99 AD2d 867 [1984], ***affd***, 64 NY2d 682 [1984]).

F. The specific issue that must be addressed is whether distributions from petitioner's IRA funded by a rollover from petitioner's ORP, should be treated for tax purposes in the same manner as distributions directly from his SUNY ORP, including the funds earned by the IRA after liquidation of the ORP and its rollover into the IRA, and qualify for the subtraction modification of Tax Law § 612 (c) (3) (i).

An IRA is a trust created for the exclusive benefit of an individual or his beneficiaries (IRC § 408 [a]). IRAs were intended to be used as retirement savings vehicles by individuals who are not covered by a pension plan, and are most commonly created by an individual, not the individual's employer (***CCH Tax Research Consultant, PLANRET***: 6052.10, *Traditional and Roth Individual Retirement Accounts*, [2016]).[10] When an IRA is created, assets are held in a trust in a custodial account. The account is not required to comply with the same participation, nondiscrimination, and other requirements with which qualified plans are required to comply (***Id***.). IRAs must comply with contribution limitations, minimum and maximum ages for distribution, nontransferability rules, and rules regarding deductibility of contributions (***Id.***). A traditional IRA must meet several requirements. The IRA must be a trust created by a written instrument and established and maintained in the United States (***Id.*** citing IRC § 408 [a]; Reg. § 1.408-2 [b]). The trustee must be a bank or other person who established the ability to act as a fiduciary and is IRS-approved (***Id.*** citing IRC § 408 [a] [2]; Reg. §§ 1.408-2 [b] [2], [e]). A custodial account may be created instead of a trust and the custodian must meet the qualifications of a trustee (IRC § 408 [h]). The written instrument creating the account must set forth the requirements and restrictions regarding contributions, investments, nonforfeitability, and distributions (***Id.***). IRAs allow maximum control and flexibility for the participant in terms of

[10] References to Roth IRAs are omitted as not relevant to this matter. The references herein are only to traditional IRAs.

choice of investment as opposed to those often offered by a qualified plan (***American Law Institute-American Bar Association Continuing Legal Education***, *Taxation of Distributions*, SE75 ALI-ABA 427, 447 [2000]). However, generally, IRAs will not be afforded protection from the reach of creditors, as is available to most qualified plans (***Id.***)

In ***Matter of Iacona*** (120 BR 691 [1990], overruled on other grounds by ***In re Dubroff***, 119 F3d 75 [1997]), the United States Bankruptcy Court held that funds in IRAs were not exempt property from the bankrupt's estate under the New York exemption for Chapter 7 bankruptcy debtors that addressed funds in these and other retirement vehicles. In the context of that decision, the primary issues of which are unrelated to this matter, the Court provided a relevant historical perspective and discussion of IRAs, in pertinent part, as follows:

> "IRAs were originally established to ease the tax burden of employees that were not covered by a qualified pension plan as well as to encourage savings for retirement (citation omitted). IRA's [sic] were later extended to employees who were actively participating in an employer sponsored pension, profit sharing, savings, or other qualified plan. IRA's [sic] were established under Title II of ERISA[11] and are not qualified pension plans which are governed by Title I of ERISA because they are created by an employee, not an employer.
>
> There are several other fundamental characteristics of an IRA that distinguish it from a qualified pension plan. An IRA is not a plan but rather it is a savings account with tax benefits and is created by gratuitous contributions from the debtor as opposed to contributions made by an employer. It is not established by a corporation or any other entity other than the individual for his own benefit. The Debtors' [sic] arrangement with the depository institution is contractual in nature and the Debtor deals directly with that institution although there may be a nominal 'Trustee' appointed by the institution. The Debtors have complete control over the funds and can withdraw the funds at any time, albeit with a tax or institutional penalty, and can control the amount, time and mode of distribution.
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> * * *

[11] Employment Retirement Income Security Act of 1974, Pub. L. No 93-406, 88 Stat. 829 (codified at 29 U.S. C. §§ 1001-1461 (1988)).

> The most compelling distinction [between an IRA and a qualified pension plan] is the Debtors' [sic] ability to exercise complete control over the funds deposited in an IRA. At any time and for any reason the Debtors' [sic] can simply withdraw the funds by simply paying a ten percent penalty. This element of total control by the Debtors, which is clearly inapposite to the underlying policy of preserving the pension funds until retirement distinguishes an IRA from the traditional pension plan . . . ."

G. The SUNY ORP was established in 1964 as an alternative to the New York State Employees' Retirement System and the New York State Teachers' Retirement System, in accordance with the New York State Education Law, Article 8-B (*The State University of New York Optional Retirement Program Summary Plan Description*, January 2005). Beginning in 1990, the ORP became a qualified plan under IRC § 401 (a) (***Id.***). The original funding choice for the ORP was TIAA-CREF. In 1994, three alternate investment providers were designated, i.e., MetLife, VALIC and Voya, and in 2014, Fidelity was also authorized as an ORP investment provider (***Id.***).

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 F-2). Retirement benefits depend on the value upon distribution of individually owned annuity contracts purchased on behalf of electing employees through employer and required employee contributions from one or more of the currently authorized investment providers for the SUNY ORP, including: TIAA-CREF, Fidelity, MetLife, VALIC and Voya (*The State University of New York, Retirement Plans/SUNY Optional Retirement Program [ORP]*, www.suny.edu/retirement/orp/ [2016]). The ORP defines the rate of contributions by both employees and the employer, and with regard to distributions, the program states that, "As a New York State Public Retirement Plan, distributions from the SUNY

ORP are exempt from New York State Income Taxes" (***Id.***). The SUNY ORP also includes several flexible options designed to allow participants to plan their retirement income distribution according to their own needs and preferences, and included such options periodic and systematic cash withdrawals, guaranteed lifetime annuity payments, and a variety of blended options and lifetime annuity dependent survivor payment levels (***Id***).[12]

In a publication provided to its participants, entitled "*SUNY Optional Retirement Program, Taxation of Distributions*" (http://www.suny.edu/media/suny/content-assets/documents/benefits/retirement-systems/ORP-Tax-Exemption-NYS----NYS-Tax-Law—612.pdf), it states, in pertinent part: "As a New York State Public Retirement Plan, distributions from SUNY ORP contracts are exempt from New York State Income Taxes." Referencing instructions for a New York State resident income tax return, the publication also states: "Optional Retirement Program members may only subtract that portion attributable to employment with the State or City University of New York or the NYS Education Department" (***Id.***). The distribution in this case was from petitioner's IRA, not his SUNY ORP. The post-retirement rollover earnings by the IRA were not attributable to petitioner's employment with SUNY, but rather to the investment choices he made in a new and separate plan, after the liquidation, distribution, and transformation of his original retirement plan.

H. As previously mentioned, petitioner effected a rollover upon receipt of a lump sum distribution from his SUNY ORP. A rollover is a transfer of a distribution received from an IRA or other retirement plan by the recipient to the recipient's IRA or another type of retirement plan

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[12] It is noted that the SUNY ORP information referenced here is current information. However, it is presumed that some or all of the choices noted were available to petitioner when planning his distribution in 1995.

(CCH Tax Research Consultant, RETIRE: 66,700). Rollovers, which are distributions, must be distinguished from trustee-to-trustee or "direct" transfers, which are not distributions (***Id.***). The direct transfer of assets between qualified plans is often contrasted to a rollover of the same funds, and if permitted, may be more advantageous than an IRA rollover (***see 13 Tax'n for Law. 214***, Vol 13, No 4, [1985]). In order to transfer assets from one plan to another, both the transferring plan and the receiving plan must specifically permit the direct transfer or acceptance, respectively. Though often applied in situations of corporate plan mergers, an employer's termination of one plan followed by the adoption of another, or a transfer that follows an employee transfer to another related company, as applicable in this case, these provisions are distinguished from the more common plan provisions accepting rollover contributions from either a qualified plan or from an IRA. In a direct plan-to-plan transfer, the participant does not have possession of the plan assets, and employees (in addition to employers) generally benefit by a direct plan to plan transfer. One author states, "In contrast with a distribution upon termination of a plan, which is either taxable as ordinary income (unless the employee is over 59 ½) or eligible for rollover to an IRA, a transfer of an employee's benefit to another qualified plan allows the employee to retain all of the favorable tax characteristics applicable to distributions from such qualified plans," such as favorable ten-year forward averaging and favorable capital gains rates, if qualified for such treatment (***Id.*** at 215). Perhaps even more significant, as noted by the author, is that the "amounts transferred from one plan to another retain their original characteristics as employer or employee contributions (***Id.*** at 214)." The author further points out that "significantly, amounts transferred directly will not be considered employee contributions" for purposes of exceeding the limits on employee contributions under other provisions of the

IRC, or in determining the amounts allocated to a participants account (***Id.*** at 214). Whether petitioner could have made a direct transfer between his qualified plan and his IRA, or whether the plans even permitted a direct transfer, is unknown. What is important is that beneficial attributes of a direct transfer, as a contrasted significantly to the characteristics, and perhaps lesser benefits, of the liquidation, distribution and rollover employed by petitioner, support the conclusion that the rollover results in fundamental changes to the funds that cannot be ignored.

I. Prior to the 1994 regulatory amendment to 20 NYCRR 112.3 (c) (1), the existing rule relating to the subtraction modification, was that the exemption only applied to pension payments paid by a New York State or municipal retirement system (***NYS Register***, Notice of Adoption, August 17, 1994). Under the revised rule, that which is being applied in this case, effective August 17, 1994, the year before petitioner retired, a pension payment would qualify for the subtraction modification if it related to services performed as a public officer or public employee and included amounts actually contributed by the applicable public employer, which includes the federal government (***Id.***).

During that same period, several nonsubstantive changes were made to the regulations, one of which is noteworthy. Example 4 contained in Regulation section 112.2 (c) (1) (iii) was revised to eliminate referenced to the Teacher's Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF) in order the clarify that contribution to an ORP under the Education Law, based on public service, qualifies for the subtraction modification, whether or not the plan is administered by TIAA/CREF (***Id.***). The intention was to clarify the regulation because ORP participants were now permitted to transfer funds from the College Retirement Equities Fund to any of three approved plans with alternative private insurance companies, and not merely TIAA/CREF (***Id.***). Thus, petitioner had a wide variety of additional options for future investment of his SUNY ORP that he did not pursue at the time of his retirement, which did not involve a distribution and rollover of the funds, again, highlighting the separate and distinct aspects of the different plans.

J. Mr. Kane participated in the SUNY ORP during his 30 years of employment with SUNY and, upon his retirement, given various choices, opted to liquidate and receive a distribution of the entire amount of his pension, then managed by TIAA-CREF. Petitioner next placed the funds into an IRA set up by petitioner, managed by a different company (NFS) unrelated to the managers of plans similarly established for SUNY employees, that petitioner would thereafter control until such time he decided to withdraw portions of it, or was required to take minimum distributions. At no time was any portion of the funds used to set up the IRA actually contributed to the trust by New York State, as required by 20 NYCRR 112.3 (c) (1) (i). Petitioner alone made the contribution, having taken possession of the distributed funds. Petitioner's action of liquidation and distribution ended the existence of funds "actually contributed" by the State. Even if the interpretation of the Division or its policy with regard to such distributions resulted in a conclusion that the portion rolled over was contributed by the State and related to petitioner's service as a public employee, as is evidenced by a myriad of agency opinions that preceded this matter, clearly the earnings on the rollover account were neither contributed by the State or related to petitioner's service as a public employee. The earnings on the IRA account, post-rollover, were solely attributable to petitioner's investment choices post retirement, and were not in any way attributable to the ORP.

As an alternative view point, the Division could have maintained that the liquidation, distribution and rollover of the SUNY ORP changed the character of the funds in their entirety, such that distributions, solely from the IRA and contributed only by petitioner individually, and are fully taxable, subject only to the lesser $20,000.00 subtraction modification (Tax Law § 612 [c] [3-a]). In other words, the Division could have simply argued, it's a new plan with new rules, and the entire lump sum is subject to these rules. The law is clear that once any portion of an eligible rollover distribution has been contributed to an IRA and designated as a rollover distribution, taxation of the withdrawal of the contribution from the IRA is determined under IRC § 408 (d) rather than under §§ 402 or 403 (IRC Reg. 1.402 [c]-2, Q-13). Consequently, the eligible rollover distribution is not eligible for capital gains treatment, five-year or ten-year averaging, or the exclusion from gross income for net unrealized appreciation on employer stock (***Id.***). Private Letter Ruling (PLR 9806012 [1998]), not cited for its conclusion, but merely its discussion of relevant IRC provisions, offered the following regarding distributions from IRAs:

> "Section 408 (d) (1) provides that, except as otherwise provided in section 408 (d), any amount paid or distributed from an individual retirement plan is included in gross income by the payee or distributee in the manner provided under section 72. Section 72 provides rules that apply in various situations whereby a taxpayer recovers his 'investment in the contract' within the meaning of section 72 [c] [1] over the course of distributions from various types of annuities and other specified arrangements. A taxpayer has no investment in the contract with respect to an individual retirement account that is funded entirely through deductible contributions, or that is funded entirely through rollover contributions described in section 402 (a) (5) (A); therefore, all distributions from such an individual retirement account are includible in the gross income of the payee or distributee pursuant to the rules of section 72."

For 35 years it has been the Division's generous policy to characterize a rollover distribution as it did here, as a taxpayer's "State pension," and exempt all distributions up to that amount, which in this case was $528,808.00 over a period of approximately 11 years. Once the amount of the original pension distribution was recovered, the Division subjected amounts over and above that amount (i.e., the earnings on the IRA account post retirement) to taxation, subject to the benefit of the $20,000.00 subtraction modification pursuant to Tax Law § 612 (c) (3-a). The Division has remained steadfast and consistent in its position and application of these rules and its policy.

K. There is additional authority that also supports the conclusion that a rollover changes the character of the funds, and often, the resulting tax rules. In a Tax Court case, ***Gee v. Commn.***, (127 TC 1 [2006]), a taxpayer rolled over a distribution from her deceased husband's IRA into her separate IRA in 1998, and as a result of her action, the amount received by the taxpayer from her husband's IRA lost its character as a "distribution to a beneficiary upon a decedent's death," and the source of the funds became irrelevant. When the taxpayer later received an early distribution (under age 59 ½) of $977,887.79 in 2002, from her own IRA, the Court concluded that the distribution was subject to the 10-percent additional tax on early distributions under IRC § 72 (t) (2) (A) (ii), failing to meet the exception for "distributions made to a beneficiary." The Court explained its reasoning:

> "Petitioner rolled over the entire amount received from her deceased husbands's IRA into her own IRA. Petitioner is and was the sole owner of her separately created IRA. The distribution petitioner received was not occasioned by the death of her deceased husband nor made to her in her capacity as beneficiary of his IRA. Petitioner cannot have it both ways. She cannot choose to roll the funds into her own IRA and then later withdraw funds from her IRA without additional tax liability because the funds were originally from her deceased husband's IRA. Accordingly, once petitioner chose to roll the funds over into her own IRA, she lost the ability to qualify for the exception from the 10-percent additional tax on early distributions. The funds became petitioner's own and were no longer from her deceased husband's IRA once petitioner rolled them over into her own IRA. The funds therefore no loner qualify for the exception."

The taxpayer in ***Gee*** received the benefit afforded tax deferral between 1998 and 2002, and could have continued such deferral. The rollover into her own IRA, a retirement savings vehicle, was viewed as an addition to her own retirement funds. Since the IRC § 72 (t) tax discourages premature IRA distributions that frustrate the intention of saving for retirement, petitioner's early distribution ran afoul of the intent (***Dwyer v. Commn.***, 106 TC 337 [1996]), and the tax was imposed. Similarly here, the distribution petitioner received was not occasioned by his receipt of funds from his SUNY ORP or attributed to his public employment. Petitioner received the benefits of investment flexibility, control, and many years of tax deferral by choosing the rollover option. Failing to separate as taxable the earnings on the IRA after the rollover effectively ignores the "burden" of the distribution rules imposed upon IRAs, but allows petitioner all of the benefits. Once petitioner rolled over the funds, the character of the funds changed and the source was irrelevant (***Gee***).

L. Based on the foregoing, it has been shown there are clear fundamental differences between qualified plans and IRAs. Even with the acknowledgment that both are retirement savings vehicles, they must each comply with a different set of stringent rules and are governed by different provisions of the IRC. Petitioner's choice to terminate his interest in the SUNY ORP in favor of a personally controlled IRA came with price. Ignoring the integrity of the IRA as though it did not exist and failing to acknowledge the tax responsibilities associated with the distribution, while allowing petitioner to benefit from the rollover choice for over a decade, is an incongruent application of retirement principles, and a result that cannot be reached. Reading the clear language of the regulation at issue, the post-rollover earnings on the IRA are simply not "actually contributed in whole or part by New York State," and the earnings have no relation to petitioner's services as a public employee (20 NYCRR 112.3 [c] [1]). Given the materials presented, there is clearly an alternative conclusion that one could reach which would result in the Notice of Deficiency being sustained. Given that another plausible conclusion may be reached, petitioner cannot show that his interpretation of the law is the only reasonable construction, and has not met the burden imposed upon him in this matter (***Blue Spruce Farms***). Accordingly, the Division properly denied the subtraction modification of Tax Law § 612 (c) (3) (i) to the portion of the earnings of the IRA after the rollover, and properly allowed only the $20,000.00 subtraction modification of Tax Law § 612 (c) (3-a).

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

DATED: Albany, New York
March 3, 2016

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE