

Service Award Program Payments to Volunteer Firefighters

This memorandum sets forth the Department's position regarding New York's personal income tax treatment of service award program payments to volunteer firefighters.

Volunteer firefighters may receive payments each year from service award programs. These service award payments are based on service as a volunteer firefighter and are authorized under Article 11-A of the General Municipal Law. At the end of the year, the service award programs mail to each volunteer firefighter a federal Form 1099 indicating the total amount that the volunteer firefighter received during the year.

The starting point in determining an individual's New York taxable income is his or her federal adjusted gross income, subject to the modifications set forth in section 612¹ of the Tax Law. Therefore, a review of the Internal Revenue Code (IRC) characterization of service award payments is necessary to determine New York's treatment of these payments.

Section 457(e)(11)(A) of the IRC provides that if the requirements of section 457(e)(11)(B) are met the service award payments received by a taxpayer will not be treated as deferred compensation. For a service award program to qualify under section 457(e)(11)(B), the program must meet the following requirements. First, the service award recipient must be a bona fide volunteer providing qualified services (firefighting, emergency medical or ambulance services). Second, the recipient can only be reimbursed for reasonable expenses incurred in the performance of such services or reasonable benefits (length of service awards) and nominal fees for such services, customarily paid by eligible employers to volunteers for such services. Third, the amount of the length of service award that can accrue with respect to any year for any volunteer can not exceed \$3,000. Additionally, if these requirements are met and the service award payments are from an eligible employer, the payments will not be classified as wages (IRC section 3121(a)(5)(I)).²

While service award payments that satisfy IRC section 457(e)(11)(B)'s requirements are not treated as deferred compensation or subject to wage withholding, the payments are, however, included in the taxpayer's federal gross income when received (*See* IRC section 61(a) and (b) defining gross income as income from whatever source derived, unless specifically excluded). Therefore, because the service award program payments a volunteer firefighter receives are

¹ § 612(a) of the Tax Law "New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year, with modifications specified in this section."

² IRC § 457(e)(1) Eligible Employer - (A) a State, political subdivision of a State, any agency or instrumentality of a State or political subdivision of a State.

included in his or her federal gross income, the service award payments will also be included in his or her New York adjusted gross income, unless the income modifications under section 612(c) of the Tax Law provide for the payment's subtraction.

The income subtraction provisions in section 612(c) of the Tax Law do not specifically address the subtraction of service award program payments from a taxpayer's federal adjusted gross income. However, as sections 218(e) and 219(f) of the General Municipal Law designate the service award program as a retirement income plan and provided that the service award plan satisfies IRC sections 457(e)(11) and 3121(a)(5)(I)'s requirements, the payments can be subtracted from the taxpayer's federal adjusted gross income if the service award payments **also** satisfy the requirements of section 612(c)(3-a) of the Tax Law, regarding pensions and annuities.

Section 612(c)(3-a) of the Tax Law allows a taxpayer who has attained the age of fifty-nine and one-half to subtract pensions and annuities payments up to a total of \$20,000 from his or her federal adjusted gross income. However, section 612(c)(3-a) of the Tax Law has several requirements for pensions and annuities to be eligible for its \$20,000 income exclusion. First, the payments must be from a pension or annuity. Second, the distributions a taxpayer receives must be periodic payments attributable to personal services performed prior to retirement. These two requirements are mandatory. If the service award payments satisfy the first two requirements, they only need to meet one of the following two remaining requirements: (1) the payments the taxpayer receives from the plan arise from an employer-employee relationship, or (2) the payments arise from contributions to a retirement plan which were deductible for federal income tax purposes.

Applying these requirements to General Municipal Law Article 11-A's service award payments results in the following conclusions. First, provided that the service award program satisfies IRC sections 457(e)(11) and 3121(a)(5)(I)'s requirements, the payments will not be considered deferred compensation or wages. Second, as mentioned earlier, since the General Municipal Law identifies the program as a retirement income plan, the service award payments are from a pension or annuity. Third, section 217(h) of the General Municipal Law provides that the service award program can designate that the service award payments be paid as a lump sum, as an annuity or any other form provided under the program. Thus, as long as the program does not designate that the service award be distributed in a lump sum or the volunteer firefighter does not elect to receive his or her service award as a lump sum, the plan distributions will satisfy Tax Law section 612(c)(3-a)'s periodic distribution requirements. Fourth, section 214 of the General Municipal Law states that the relationship between the volunteer fire district and a volunteer firefighter is that of an employer-employee, therefore, satisfying Tax Law section 612(c)(3-a)'s requirement that the payments received by the taxpayer must arise from an employer-employee relationship. Finally, section 215(4) of the General Municipal Law provides that a volunteer firefighter's earliest age of entitlement is age fifty-five, although he or she must start receiving payments by age seventy and one-half. Therefore, as a taxpayer must be at least age fifty-nine and one-half to be eligible for Tax Law section 612(c)(3-a)'s \$20,000 income subtraction, any service award payments received by a volunteer firefighter before age fifty-nine and one-half is included in his or her New York taxable income.

A service award program, however, that does not meet the requirements of IRC sections 457(e)(11)(B) and 3121(a)(5)(I) will not qualify for Tax Law section 612(c)(3-a)'s \$20,000 income exclusion. This result occurs because the IRC treats these non-qualified payments as wages and subject to wage withholding under IRC section 3401(a). Therefore, if the service award payments are deemed to be wages and subject to wage withholding, the service award payments are not regarded as payments from a pension or annuity. As such, the non-qualified payments are not eligible for Tax Law section 612(c)(3-a)'s \$20,000 pension and annuity income exclusion.

Accordingly, provided that the taxpayer is age fifty-nine and one-half or older and the service award plan satisfies IRC sections 457(e)(11)(B) and 3121(a)(5)(I)'s requirements, New York will allow him or her to subtract the service award program payments, to the extent includible in gross income for federal income tax and in accordance with the provisions of Tax Law section 612(c)(3-a).