BOARD OF TAX APPEALS
STATE OF LOUISIANA

JUDITH AND STEPHEN SMITH
PETITIONERS

VERSUS **DOCKET NO. 9437C**

SECRETARY,
DEPARTMENT OF REVENUE,
STATE OF LOUISIANA
RESPONDENT

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ORDER WITH WRITTEN REASONS
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This is an appeal from the denial of a refund claim by the Secretary of the Louisiana Department of Revenue and Taxation (the "Department"). A hearing on the merits of this case was held before the Board on August 9, 2016 with Judge Tony Graphia (Ret.), Chairman; Board Members Cade R. Cole Francis J. "Jay" Lobrano present, and no member absent. Participating in the hearing was: Stephen Smith, representing himself and his wife, Judith Smith (the "Taxpayers") and Miranda Y. Conner, attorney for the Department. After the hearing, the Board ordered the parties to file post trial memoranda. The Board subsequently ordered that the record be supplemented with an additional document. The Board now renders its unanimous ruling for the following written reasons.

The facts of this case are undisputed.[1] Mr. Stephen Smith ("Smith") and his wife were long-time residents of Louisiana. Smith was an employee of Wm. B.

[1] At the hearing of the matter, the Taxpayers testified that they had moved to Texas and had intended to remain there permanently. The Department has not argued nor did it present any evidence to establish that the Taxpayers were Louisiana residents at the time of the receipt of the income in dispute in this matter. This Board finds that the Taxpayers were residents of Texas at the time of the receipt of the income in dispute.

Reily & Company, Inc. ("Reily Foods") headquartered in New Orleans. Smith formally retired from Reily Foods in January of 2014. In anticipation of his retirement, the Smiths moved to Austin, Texas in September of 2013. For the balance of 2013 and for a short period in January, 2014, Smith commuted from Austin to New Orleans to work his final months for Reily Foods. While still an employee of Reily Foods, Smith received compensation and a bonus in January, 2014. Reily Foods withheld Louisiana state income tax on both items of compensation. There is no dispute that these payments to Smith for his final weeks of working for Reily Foods in January 2014 are subject to Louisiana income tax.

However, Smith received two lump sum payments following his retirement from Reily Foods that are the basis of the dispute in this case. Reily Foods made the first lump sum payment of $127,096.24 to Smith in late January, 2014 pursuant to terms of the Reily Foods Supplemental Executive Retirement Plan ("SERP"). Reily Foods made the second lump sum payment of $266,676.00 to Smith in September, 2014 pursuant to the terms of the Reily Foods Long Term Incentive Compensation Plan ("LTICP").

At the time of both payments, Smith was fully retired and a resident of Texas. Reily Foods withheld and remitted Louisiana income tax of $16,366 attributable to these two payments. With the filing of their 2014 Louisiana state income tax return, Taxpayers claimed a refund of the Louisiana taxes attributable to the SERP and LTICP on the basis that these two payments constituted "retirement income" as defined in 4 U.S.C. §114, and thus were not taxable as Louisiana source income.[2]

[2] 4 U.S.C. §114 is a federal statute prohibiting states from taxing retirement income (as defined by the statute) of non-residents.

The Department denied the Taxpayers' refund claim on June 17, 2015. Taxpayers timely filed an appeal of that denial with this Board on August 4, 2015.

The sole issue presented in the Taxpayers' appeal is whether the SERP payment and the LTICP payment made to Smith are "retirement income" within the meaning of 4 U.S.C. §114. If these payments are not "retirement income" for purposes of 4 U.S.C. §114, then the payments are properly included in Taxpayers' income as Louisiana source revenue as the payments were attributable to Smith's services rendered in Louisiana while an employee of Reily Foods. If these payment are "retirement income" under 4 U.S.C. §114, then the Taxpayers' are entitled to a refund of the taxes paid attributable to these payments.

4 U.S.C. §114 provides in part:

4 U.S. Code § 114 - Limitation on State income taxation of certain pension income

(a) No 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).

(b) For purposes of this section-

(1) The term "retirement income" means any income from-

(A) a qualified trust under section 401(a) of the Internal Revenue Code of 1986 that is exempt under section 501(a) from taxation;

(B) a simplified employee pension as defined in section 408(k) of such Code;

(C) an annuity plan described in section 403(a) of such Code;

(D) an annuity contract described in section 403(b) of such Code;
(E) an individual retirement plan described in section 7701(a)(37) of such Code;

(F) an eligible deferred compensation plan (as defined in section 457 of such Code);

(G) a governmental plan (as defined in section 414(d) of such Code);

(H) a trust described in section 501(c)(18) of such Code; or

(I) any plan, program, or arrangement described in section 3121(v)(2)(C) of such Code (or any plan, program, or arrangement that is in writing, that provides for retirement payments in recognition of prior service to be made to a retired partner, and that is in effect immediately before retirement begins), if such income-

(i) is part of a series of substantially equal periodic payments (not less frequently than annually which may include income described in subparagraphs (A) through (H)) made for-

(I) the life or life expectancy of the recipient (or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient), or

(II) a period of not less than 10 years, or

(ii) is a payment received after termination of employment and under a plan, program, or arrangement (to which such employment relates) maintained solely for the purpose of providing retirement benefits for employees in excess of the limitations imposed by 1 or more of sections 401(a)(17), 401(k), 401(m), 402(g), 403(b), 408(k), or 415 of such Code or any other limitation on contributions or benefits in such Code on plans to which any of such sections apply.

The fact that payments may be adjusted from time to time pursuant to such plan, program, or arrangement to limit total disbursements under a predetermined formula, or to provide cost of living or similar adjustments, will not cause the periodic payments provided under such plan, program, or arrangement to fail the "substantially equal periodic payments" test.

Such term includes any retired or retainer pay of a member or former member of a uniform service computed under chapter 71 of title 10, United States Code.

4 U.S.C. §114 generally divides "retirement income" into two categories: (1) income from qualified deferred compensation plans (4 U.S.C. §§114(b)(1)(A)-(H); and (2) income from non-qualified deferred compensation plans (4 U.S.C.

§114(b)(1)(I)).[3] Essential to the determination of whether payments to a taxpayer constitute "retirement income" as defined in 4 U.S.C. §114 are the terms and conditions of the specific plan or agreement pursuant to which the payments are made. For example, distributions made to a taxpayer from a qualified individual retirement account (IRA) where the IRA is established pursuant to a written trust instrument satisfying the requirements under 26 U.S.C. §408(a) would be "retirement income" under 4 U.S.C. §114(b)(1)(E).

In support of their appeal, Taxpayers produced the SERP and LTICP agreements between Reily Foods and Smith. While each one contains specific terms and conditions that will ultimately determine whether the payments to Smith are taxable in Louisiana, as an initial matter, neither the SERP nor the LTICP fall within the defined categories of plans identified in 4 U.S.C. §§114(b)(1)(A)-(H). As such, the only possible category of retirement plan that can result in the lump sum payments from the SERP and LTICP being exempt from taxation in Louisiana is the category of plan identified in 4 U.S.C. §114(b)(1)(I)(ii).

The analysis of whether income received after termination of service by an employee is "retirement income" under 4 U.S.C. §114(b)(1)(I) is as follows:

(1) Is the payment received from any plan, program, or arrangement described in section 26 U.S.C. § 3121(v)(2)(C)[4] (or any plan, program, or arrangement that

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[3] Typically, though not in every case, qualified deferred compensation plans are plans where contributions are deductible to the employer when made and not included in the income of the employee until distributed. Non-qualified deferred compensation plans are plans where contributions are not deductible to the employer until distributed and not included in the income of the employee until distributed. Exceptions are the ROTH IRA.

[4] 26 U.S.C. §3121(v)(2)(C) provides:

> (C) Nonqualified deferred compensation plan
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> For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (a)(5).

is in writing, that provides for retirement payments in recognition of prior service to be made to a retired partner, and that is in effect immediately before retirement begins);

(2) is such income

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

(i) the life or life expectancy of the recipient (or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient), or a period of not less than 10 years, or

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26 U.S.C. §3121(a)(5) provides:

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust,

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise),

(E) under or to an exempt governmental deferred compensation plan (as defined in subsection (v)(3)),

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974,

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received,

(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof, or

(I) under a plan described in section 457(e)(11)(A)(ii) and maintained by an eligible employer (as defined in section 457(e)(1))

> (ii) is a payment received after termination of employment and under a plan, program, or arrangement (to which such employment relates) maintained solely for the purpose of providing retirement benefits for employees in excess of the limitations imposed by 1 or more of sections 401(a)(17), 401(k), 401(m), 402(g), 403(b), 408(k), or 415 of such Code or any other limitation on contributions or benefits in such Code on plans to which any of such sections apply.

With the above statutory framework, we now turn to an analysis of the SERP and the LTICP to determine whether the payments made by Reily to Smith are in fact retirement income as defined in 4 U.S.C. §114.

SERP

The SERP agreement is a non-qualified deferred compensation agreement. The SERP agreement contains recitals which identify Smith as a key employee, state that he participates in the Reily "Retirement Savings Plan," and that the purpose of the SERP is to "protect certain key Employees from reductions in Employee's contributions and benefits under the Qualified Plan attributable to certain limitations of the Internal Revenue Code of 1986".

Pursuant to the SERP agreement, Smith deferred a percentage of his compensation (Section 1) and was entitled to a limited matching contribution by Reily and further was entitled to a lump sum payment upon termination from employment with the Company (Section 2). Section 3 of the SERP agreement provides for a formula to calculate the deferred amount based in part on the "maximum amount that could have been contributed to the Qualified Plan....if the limitations of the Code on Employee's compensation and on the amount of such contributions **were not applicable**" (emphasis added). Section 6 of the SERP agreement provides for payment of the deferred amounts upon termination of employment. Section 16 of the SERP Agreement provides that no effect shall be

given to any provision in the agreement that would result in adverse tax consequences under Section 409A of the Code (26 U.S.C. §409A).[5]

We find that the $127,096.24 lump sum payment received by Smith pursuant to the SERP agreement is retirement income as defined in 4 U.S.C. §114(b)(1)(I). First, the SERP is a non-qualified deferred compensation plan described in 26 U.S.C. §3121(v)(2)(C). Second, pursuant to 4 U.S.C. §114(b)(1)(I)(ii), the payment was received after termination of employment pursuant to a plan maintained solely for the purpose of providing retirement benefits for employees in excess of the limitations imposed by 1 or more of the sections of the Internal Revenue Code limiting contributions to qualified deferred compensation plans.

The recitals and other provisions of the SERP agreement make clear the SERP was a retirement plan designed to provide employees the ability to make contributions to the SERP in excess of the limitations otherwise imposed on their contributions to qualified deferred compensation plan. Considering the SERP agreement as a whole and the specific language contained therein, the payment to Smith pursuant to the SERP agreement is not taxable in the State of Louisiana.

LTICP

The LTICP differs significantly from the SERP. Taxpayers submitted the "Long Term Incentive Compensation Plan Information Guide" which contains the substantive provisions of the LTICP. The LTICP is best described as a phantom stock program where certain key employees are given stock appreciation rights ("SAR") in Reily Foods on an annual basis. Unlike the SERP, there is no language in the LTICP which provides that the purpose of the plan is to provide retirement

[5] 26 U.S.C. §409A governs non-qualified deferred compensation plans. Section 16 of the SERP agreement is a savings provision designed to avoid current taxation of the deferred income of the employees participating in the SERP.

benefits for employees in excess of the limitation imposed on qualified retirement plans. In the Section titled "Payout" on page 3 of the information guide, the plan provides that "[P]ayouts will be in cash following the end of the performance period. Under the Plan, as amended, employees may not elect to defer payouts." The "performance period" is defined on page 2 of the information guide as the five year period beginning on the effective date of the grant of the SAR. On page 4 of the information guide, the plan provides that participants may no longer defer payout of their long term incentive shares.

We find that the $266,676.00 lump sum payment received by Smith pursuant to the LTICP agreement is not retirement income as defined in 4 U.S.C. §114(b)(1)(I) and is therefore properly taxable in Louisiana as Louisiana source income. The LTICP is better characterized as a bonus plan as opposed to a retirement plan. While Smith, in this instance, received the payment after termination of employment, the LTICP was not maintained for the purpose of "providing retirement benefits for employees in excess of the limitations imposed by 1 or more of sections 401(a)(17), 401(k), 401(m), 402(g), 403(b), 408(k), or 415 of such Code or any other limitation on contributions or benefits in such Code on plans to which any of such sections apply" as required by 4 U.S.C. §114(b)(1)(I)(ii).

The LTICP called for cash payouts to participating employees every five years from the date of each SAR grant and further provided that the employees could NOT defer payout of their long term incentive shares. In other words, it is a benefit to current employees, that happened to be paid to Smith following his retirement, but would have been payable to him even if he had not retired.

While the LTICP information guide refers to deferral elections made prior to 2006, Taxpayers submitted no evidence in the record before the Board as to when

the SARs were granted to Smith and whether he had a valid deferral election in place for any portion of the lump sum payment he received on account of the LTICP.

The Taxpayer is entitled to a refund on the portion of income tax paid on the SERP payment, but is not entitled to a refund on the portion of income tax paid on the LTICP payment.

For the written reasons stated hereinabove:

IT IS ORDERED AND DECREED that the Taxpayer's Petition for Refund be GRANTED IN PART AND DENIED IN PART.

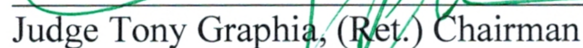
IT IS FURTHER ORDERED AND DECREED that the parties shall calculate the refund due in accordance with these Written Reasons and shall submit a Judgment in accordance therewith within 30 days of the date of this Order.

IT IS FURTHER ORDERED AND DECREED that if the parties cannot agree on a form Judgment, then each party may submit its own proposed Judgment with a Memorandum in support thereof and in opposition to the opposing party's proposed Judgment within 45 days of the date of this Order.

This Order does not constitute a final appealable Judgment as contemplated by La. R.S. 47:1410 and 1434.

Baton Rouge, Louisiana, this 11th day of July, 2017.

FOR THE BOARD:



Judge Tony Graphia, (Ret.) Chairman