0120010115.LOF

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 01-0115
Individual Income Tax—Indiana Source Income
For Tax Years 1997-2000

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Individual Income Tax—Indiana Source Income

Authority:	**IC § 6-3-1-23**	**45 IAC 3.1-1-7(3)**
	IC § 6-3-2-1(a)	**45 IAC 3.1-1-23**
	IC § 6-3-2-2	**45 IAC 3.1-1-25**
	IC § 6-8.1-5-1(b)	**45 IAC 3.1-1-100**

Taxpayer protests the withholding of individual income tax on payments from an employment contract after retirement, on the basis that he was a resident of Florida during the tax years at issue. Because of the withholding tax liability, taxpayer's 2000 refund was reduced.

STATEMENT OF FACTS

Taxpayer protests the reduction of a refund for tax year 2000 and the assessment of individual income tax for tax years 1997-2000. Taxpayer argues that as a full-time resident of Florida, income derived from an employment contract for services performed in Indiana, where payments continued after his retirement, was not subject to Indiana's income tax statutes.

Taxpayer worked for an Indiana insurance company. A Wisconsin insurance company purchased it, and, pursuant to an employment contract, employed taxpayer as a vice-president of data processing. The term of the contract was 5 years, from September of 1995 until the end of August 2000. Taxpayer was to be paid a yearly sum certain, in equal biweekly installments, over the life of the contract. The termination section of the contract provides in pertinent part:

> 9.3 **Compensation Upon Termination.** If the Executive's employment is terminated by the Employer for any reason, or if the Executive voluntarily terminates employment with the Employer subsequent to the completion of at least two (2) years of employment pursuant to this Contract, the Employer shall continue to pay the Executive the salary being paid to the Executive as of the date of termination of employment for the remaining portion of the term of this Contract. . .. The amount of the salary payable to the Executive subsequent to termination of employment shall be reduced by any income or earnings of the

> Executive from employment in the insurance industry or from employment which violates the terms of section 11 of this Agreement.

Section 11 is a typical covenant not to compete pronouncement. The financial arrangement outlined in the above section is not a typical retirement package. Retirement benefits are paid pursuant to whatever retirement plan an employer maintains; amounts are not reduced by income received from employment in the same field, nor by income received by allegedly violating a covenant not to compete. The income taxpayer received from the terms of his employment contract with the Wisconsin insurance company is more properly characterized as compensation for services performed, with an option to terminate after 2 years if taxpayer wished to continue receiving contract payments.

Taxpayer retired in 1997 after working for 2 years under the terms of the contract. Pursuant to the contract terms, taxpayer continued receiving his biweekly installments. Taxpayer filled out and filed his own tax returns for the tax years at issue, and protested assessments for 1997, 1998, and 1999, arguing that his status as a Florida resident relieved him of his duty to pay Indiana income tax. A refund issued to taxpayer in 2000 was reduced by taxpayer's individual income tax liabilities.

DISCUSSION

I. Individual Income Tax—Indiana Source Income

Under IC § 6-8.1-5-1(b), a "notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." The real issue in this taxpayer protest concerns the character of the biweekly installments taxpayer received after exercising the contract option to continue receiving those payments in exchange for 2 years of employment with the Wisconsin insurance company.

First of all, IC § 6-3-1-23 defines "compensation" as "wages, salaries, commissions and any other form of remuneration paid to employees for personal services." Secondly, IC § 6-3-2-1(a) imposes the adjusted gross income tax "upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every non-residential person."
Taxpayer performed personal services under the employment contract for 2 years. After that, taxpayer exercised an option in the contract allowing him to terminate the personal services part of the contract and to continue receiving compensation as if he were still employed. The employment contract treated taxpayer as an employee rendering services for the life of the contract; taxpayer, in exercising the option to terminate his employment services, had to work for 2 years to secure payment for the final 3 years of the contract. As such, the income taxpayer received during those 3 years is 2 years of salary paid out over a 5 year period, a species of deferred compensation.

45 IAC 3-1-1-100 covers aspects of withholding pertinent to characterizing the income taxpayer received pursuant to his employment contract:

> Withholding is not required on pension and annuity payments that meet certain qualifications of the Internal Revenue

> Service, unless the recipient requests that federal income tax be withheld. If such a requests is made, the payor must also withhold and remit Indiana adjusted gross income tax.
> Pensions and annuities that do not meet the Internal Revenue qualifications are considered to be deferred compensation and, therefore, require withholding in the same manner as for wages and salaries.

Under a regulation concerning allocation of income among states, taxpayer's income is subject to Indiana's tax statutes: "[d]eferred compensation, other than that from a qualified retirement plan as described above [meeting the qualifications of the Internal Revenue Code], is directly attributable to services performed, and is taxed by the state where the services were performed." (45 IAC 3.1-1-7(3)). Further, 45 IAC 3.1-1-23(2) provides in pertinent part:

> Any person who, on or before the last day of the taxable year, changes his residence or domicile from Indiana to a place without Indiana, with the intent of abiding permanently without Indiana, is subject to adjusted gross income tax on all taxable income earned while an Indiana resident. Indiana will not tax income of a taxpayer who moves from Indiana and becomes an actual domiciliary of another state or country **except that income received from Indiana sources will continue to be taxable.** (**emphasis added**.)

With respect to the tax liability of a nonresident, 45 IAC 3.1-1-25 provides that "[a]ll persons who are not residents of Indiana are required to report that portion of their entire income directly or constructively from or attributable to business, activities or any other source within Indiana…" The income taxpayer received from the final 3 years of the employment contract derived from services performed in Indiana. Therefore, taxpayer's income is taxable and a refund reduced to cover an outstanding tax liability is legal.

FINDING

Taxpayer's protest is denied.

DF/JM/MR 010612