TAX SECTION

New York State Bar Association

March 28, 1986

The Honorable Mario Cuomo
Executive Chamber
State Capital
Albany, NY 12224

Dear Governor Cuomo:

The Tax Section of the New York State Bar Association has over 3,000 members, all of whom are lawyers with a professional interest in taxation. They include practicing lawyers, law faculty members, corporate counsel, and government officials.

The Tax Section supports legislation that would allow shareholders of New York professional service corporations to pay State income taxes on the same basis as unincorporated professionals and other residents of New York. Presently, shareholders of professional corporations are subject to a $15,000 limitation on deductible retirement contributions, a limitation that does not apply to other New York taxpayers. This results in unfair and discriminatory income tax liability for incorporated professionals.

1. The source of the problem.

In 1970, when New York became the 48th state to permit the incorporation of professionals, the Tax Law was changed to save the State from any revenue loss resulting from the incorporation of professionals. One of these provisions required shareholders of professional corporations to "add back" to their personal income, and pay State

income tax on, corporate retirement contributions in excess of the amounts deductible by unincorporated professionals (who were then subject to the less-generous Keogh plan limitations). This provision was intended to preserve state tax parity among professionals and was generally regarded as equitable.

In 1981, the Tax Law was amended to substitute a $15,000 limit for the limit applicable to self-employed individuals which had been in the law since 1970. The purpose of this amendment (which the Tax Section objected to) was to ease administrative problems; it was not intended to subject professional corporation shareholders to lower limits than the limits applicable to unincorporated professionals with Keogh plans. The $15,000 limit was then the maximum amount deductible under federal law for all individuals with Keogh plans.

In 1982, the Internal Revenue Code was again amended. The principal change was to increase to $30,000 the maximum deduction allowed unincorporated persons with defined contribution plans (and possibly greater amounts for unincorporated persons with defined benefit plans) and to reduce to the same level the deduction allowed for employees of corporations. This change in federal law was automatically incorporated in the New York Tax Law for all residents -- except for shareholders of professional corporations who continued to be subject to the $15,000 limit.

2. <u>The Tax Section position</u>.

The inequity of discriminating between shareholders of professional corporations and all other professionals is apparent. Commissioner Chu has stated that this discrimination should be terminated. There is also general agreement among both private and New York State tax professionals that this discrimination should not continue; that the only appropriate tax costs for choosing the corporate form should be the imposition of a corporate tax.

The present inequity is an unintended development traceable to a series of changes in State and Federal tax laws. It does not reflect an established New York State tax policy. Quite the contrary, termination of this discriminatory provision is fully consistent with the procedure started by the legislature to keep the "add back" provision both fair and consistent with Federal legislation. The State acted quickly to conform to the 1982 Federal tax changes, which increased State revenues, and in fairness the $15,000 limit should also have been removed at that time.

The only objection to removing the inequity is the revenue impact. That impact is such that removal of the discrimination will not be of value only to the wealthy. Even if a $15,000 annual contribution is considered to result in generous retirement payments for younger professionals, in reality the fruits of that benefit will not be available for everyone. Many professionals have not had this opportunity in their earlier earning years (when limits on qualified retirement plan contributions ranged as low as $2,500 per year). Moreover, many professionals are not financially able to make significant contributions to their retirement plans until their children are out of school. Consequently, they can only begin to fund their retirement benefits in their later working years.

This year may be an ideal time to end this discrimination without impacting the State's ability to finance its programs. For this reason, the Tax Section of the New York State Bar Association supports the passage in 1986 of legislation that will conform the limits on qualified retirement plan contributions for professional corporation shareholders to that of other New York State residents.

Respectfully yours,

Richard G. Cohen

cc: The Honorable Roderick Chu
Charles E. Heming, Esq.