

ATTORNEY GENERAL

January 9, 1976

SIDNEY GLASER, *Director*  
Division of Taxation  
State and Willow Streets  
Trenton, New Jersey 08625

FORMAL OPINION NO. 1-1976

Dear Director Glaser:

You have asked for an opinion as to whether a lump sum pension distribution to an employee on his retirement from a retirement fund qualified under section 401(a) of the Internal Revenue Code is taxable to him as unearned income under the New Jersey Capital Gains and other Unearned Income Act. Laws of 1975, c. 172. Unearned income is defined by the Act to mean and include income from an interest in an estate or trust pursuant to regulations promulgated by the Director of the Division of Taxation and gains from the sale or exchange of capital assets. Your specific inquiry then is whether such a lump sum pension distribution is either income from a trust or estate or gain from the sale or exchange of a capital asset within the meaning of the statutory definitions set forth in the Act. For the following reasons, it is our conclusion that a lump sum pension distribution is neither income from an interest in an estate or trust nor a gain from the exchange of a capital asset and would not thereby be taxable as unearned income under the Act.

In the statutory definition of unearned income to include income from an interest in an estate or trust, the Legislature has authorized the Director to promulgate regulations which shall be consistent with comparable provisions of the Internal Revenue Code and regulations issued thereunder. Sections 2, 19. In the Internal Revenue Code, pension plans are treated in a different manner from estates or trusts. Section 61 of the Code sets forth pensions and income from an interest in an estate or trust as separate categories of gross income. Taxation of employee retirement plans is treated generally in Sections 72, 402 and 403 of the Code, whereas income from interest in an estate or trust are taxed pursuant to Section 641. It may, therefore, be reasonably concluded that the Internal Revenue Code does not consider a distribution from a pension plan as income from an interest in an estate or trust. Accordingly, it would not appear to have been the legislative purpose to empower the Director to tax these distributions as income from an interest in an estate or trust as unearned income for purposes of this Act.

The second question posed is whether a lump sum distribution of a pension is taxable as a gain from the sale or exchange of capital asset. The Act defines gains from the sale or exchange of capital assets as "net gains as defined by regulation of the Director which shall be consistent with definitions prescribed for Federal income tax purposes, . . ." Section 2. Generally, retirement benefits are taxed, for Federal purposes, as ordinary income to the extent they do not represent employee contributions. Int. Rev. Code of 1954 § 72 (d). However, Section 402(a) (2) of the Internal Revenue Code imposes capital gains treatment on a fraction of lump-sum distributions in cases of pension plans qualifying under Section 401(a) of the Code. The numerator of the fraction reflects the number of years the taxpayer participated in the plan prior to 1974 and the denominator consists of the total number of years of participation. This formula came into effect as a result of a 1974 amendment phasing out the previous preferential capital gains treatment in cases of lump-sum distributions. Act of September 2, 1974, Pub. L. No. 93-406, § 2005(b) (1), 88 St. 829, *amending* Int. Rev. Code of 1954, § 402(a) (2).

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The issue, therefore, remains whether the Director to be consistent with the definition prescribed for federal income tax purposes is obliged to treat a lump sum pension distribution as a capital gain transaction in accordance with section 402 (a) (2) of the Code, or, rather, adopt the generally accepted definition of a pension distribution as a form of ordinary income. It is clear that the treatment of retirement benefits as ordinary income under section 72 of the Code is based upon the realization that these benefits are merely a form of deferred compensation for work previously performed. See *Heard v. C.I.A.*, 326 F. 2d 962 (8th Cir. 1964) *cert. denied* 377 U.S. 978 (1964). The deferral in the distribution of the sum representing the employer's contribution does not change the basic transaction as one involving compensation to an employee. The congressional determination to treat lump sum pension distributions differently is simply based on underlying policy considerations in the administration of the Federal tax laws and not on a strict definition of the transaction involved.

The Act merely requires the Director to be consistent with definitions prescribed for federal income tax purposes. It does not require him to adopt a congressional policy to give this form of transaction capital gains treatment. The employee is simply collecting an obligation from his employer due to him as deferred compensation for previously rendered services. See *Pounds v. U.S.*, 372 F. 2d 342 (5th Cir. 1967). You are accordingly advised that a lump sum distribution from a pension fund does not constitute a sale or exchange of a capital asset under the Act and would not thereby be taxable to its recipient as unearned income.

Very truly yours,

WILLIAM F. HYLAND

*Attorney General of New Jersey*

By: BARRY D. SZAFERMAN

*Deputy Attorney General*

January 19, 1976

HON. PHILLIP ALAMPI  
*Secretary of Agriculture*  
Health & Agriculture Bldg., Rm. 304  
Trenton, New Jersey 08625

FORMAL OPINION NO. 2-1976

Dear Secretary Alampi:

You have asked for our advice on certain questions pertaining to the notification provisions of the newly enacted Open Public Meetings Act, N.J.S.A. 10:4-6 *et seq.* In particular, you have asked whether the State Board of Agriculture is required to promulgate a schedule of its regular meetings for this year as soon as the Act takes effect on January 19, 1976 or whether the Board may delay the promulgation of its schedule of regular meetings until its reorganization meeting to be held in July of 1976.