North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

June 24, 2021

[redacted]

Re: Request for Private Letter Ruling

Dear [redacted]:

This letter is in response to your letter dated February 21, 2021, wherein you requested that the North Carolina Department of Revenue ("Department") issue a private letter ruling. Specifically, you requested a ruling on how the *Bailey* settlement will apply to beneficiaries of your qualifying *Bailey* retirement account.

The statement of facts submitted for the Department's consideration is summarized as follows:

- [redacted] ("Taxpayer") is a retired employee of the State of North Carolina.
- Taxpayer was vested in the State retirement system prior to August 12, 1989.
- Taxpayer qualifies for the deduction under N.C. Gen. Stat. § 105-153.5(b)(5) ("*Bailey* Settlement Deduction") for distributions made from his NC 401(k) Supplemental Retirement Account ("Qualifying *Bailey* Retirement Account").
- Taxpayer has named his spouse ("Spouse") as the sole beneficiary on his Qualifying *Bailey* Retirement Account.
- Upon the death of Taxpayer, the account will be moved into the name of Spouse as the sole beneficiary.
- Spouse will then be able to name a new beneficiary ("Spouse Beneficiary").
- Upon the death of Spouse, the account will be moved into the name of Spouse Beneficiary.
- Future beneficiaries of the Qualifying *Bailey* Retirement Account, including Spouse and Spouse Beneficiary, will not be able to transfer or roll additional funds into the Qualifying *Bailey* Retirement Account.

Rulings Requested

1. After the death of Taxpayer, will distributions made from the Qualifying *Bailey* Retirement Account to Spouse, as a beneficiary of the account, be excludable from North Carolina individual income tax?

2. After the death of Spouse, will distributions made from the Qualifying *Bailey* Retirement Account to Spouse Beneficiary, as a beneficiary of the account, be excludable from North Carolina individual income tax?

3. If multiple beneficiaries are named by Taxpayer or Spouse, will distributions made from the Qualifying *Bailey* Retirement Account to the beneficiaries be excludable from North Carolina individual income tax?

4. Will retirement benefits paid from the Qualifying *Bailey* Retirement Account remain exempt from North Carolina individual income tax regardless of whom the beneficiaries may be going forward?

5. Will beneficiaries be eligible to transfer funds into the Qualifying *Bailey* Retirement Account from other retirement accounts that were their own outright or from beneficiary accounts they inherited and have those funds also covered by the North Carolina state tax exemption?

Relevant Information from the North Carolina General Statutes and Department of Revenue Publications

N.C. Gen. Stat. § 105-153.5(b)(5) provides that in calculating North Carolina taxable income, a taxpayer may deduct from the taxpayer's adjusted gross income "the amount received during the taxable year from one or more State, local, or federal government retirement plans to the extent the amount is exempt from tax under this Part pursuant to a court order in settlement of any of the following cases:

a. Bailey v. State, 92 CVS 10221, 94 CVS 6904, 95 CVS 6625, 95 CVS 8230.
b. Emory v. State, 98 CVS 0738.
c. Patton v. State, 95 CVS 04346."

Directive PD-99-1 provides "Retirement benefits paid to a retiree who is vested for purposes of the [*Bailey*] settlement are exempt from future State income tax, including benefits paid to survivor beneficiaries."

The 2020 Personal Taxes Division Bulletins provide that "[a]s a result of the North Carolina Supreme Court's decision in *Bailey v. State of North Carolina* and the settlement subsequently reached in that case, North Carolina may not tax retirement benefits received by a retiree (or by a beneficiary of a retiree) from qualifying State, local, or federal retirement systems if the retiree was vested in the retirement system as of August 12, 1989."

Furthermore, the 2020 Personal Taxes Division Bulletins state that "[p]articipants in the State's Supplemental Retirement Income Plan (Internal Revenue Code § 401(k)) or the State's Deferred Compensation Plan (Code § 457) are vested in the plan as of August 12, 1989, if they contributed or contracted to contribute to the plan by August 12, 1989. If the participant contributed any money to a plan before August 12, 1989, all future withdrawals from that plan are excludable from tax."

Department's Responses

1. After the death of Taxpayer, will distributions made from the Qualifying *Bailey* Retirement Account to Spouse, as a beneficiary of the account, be excludable from North Carolina individual income tax?

   Response: Yes. Retirement benefits paid from the Qualifying *Bailey* Retirement Account to the surviving beneficiary are excludable from North Carolina individual income tax.

   2. After the death of Spouse, will distributions made from the Qualifying *Bailey* Retirement Account to Spouse Beneficiary, as a beneficiary of the account, be excludable from North Carolina individual income tax?

   Response: Yes. Retirement benefits paid from the Qualifying *Bailey* Retirement Account to the beneficiary of a surviving beneficiary are excludable from North Carolina individual income tax.

   3. If multiple beneficiaries are named by Taxpayer or Spouse, will distributions made from the Qualifying *Bailey* Retirement Account to the beneficiaries be excludable from North Carolina individual income tax?

   Response: Yes. Retirement benefits paid from the Qualifying *Bailey* Retirement Account to the beneficiaries of the account are excludable from North Carolina individual income tax even if there are multiple beneficiaries.

   4. Will retirement benefits paid from the Qualifying *Bailey* Retirement Account remain exempt from North Carolina individual income tax regardless of whom the beneficiaries may be going forward?

   Response: Yes. Retirement benefits paid from a Qualifying *Bailey* Retirement Account to the beneficiaries of the account are excludable from North Carolina individual income tax.

   5. Will beneficiaries be eligible to transfer funds into the Qualifying *Bailey* Retirement Account from other retirement accounts that were their own outright or from beneficiary accounts they inherited and have those funds also covered by the North Carolina state tax exemption?

   Response: Pursuant to the Department's Written Determination Policy, "[a] taxpayer must inquire about matters affecting its own tax liability or reporting requirements." Because future beneficiaries of the Qualifying *Bailey* Retirement Account will not be able to transfer additional funds into the account, the requested ruling is not applicable to Taxpayer's account. Consequently, the Department cannot provide a ruling on this request because it does not relate to matters affecting Taxpayer's liability or reporting requirements.

Should you have any questions, please contact me using the information provided below.

Sincerely,

[redacted]

[redacted]
Personal Taxes Division
[redacted]
[redacted]