STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LAWRENCE E. WALSH AND MARY P. WALSH	:	DECISION DTA No. 806133
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1982 and 1983.	:	

Petitioners Lawrence E. Walsh and Mary P. Walsh, 1902 Bedford, Oklahoma City, Oklahoma 73116 filed an exception to the determination of the Administrative Law Judge issued on January 23, 1992 with respect to their petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1982 and 1983. Petitioners appeared by DeGraff, Foy, Holt-Harris & Mealey, Esqs. (James H. Tully, Jr., Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

Both parties filed briefs on exception. Petitioners' request for oral argument was denied.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.[1]

ISSUES

I. Whether petitioners' filing of an application for tax amnesty precludes a subsequent claim for a refund of the same taxes.

II. Whether the Division of Taxation is estopped from denying petitioners' claim for a refund of personal income taxes.

III. Whether the retirement benefits received by petitioners during the years in issue constituted a taxable annuity.

[1]President John P. Dugan took no part in deciding the case herein.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "2" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Prior to the years in issue, petitioner Lawrence E. Walsh was a partner in the law firm of Davis, Polk & Wardell which was located in New York City. In June 1981, Mr. Walsh retired from the firm, and, during the years in issue, was a nonresident of New York.

We modify finding of fact "2" of the Administrative Law Judge's determination to read as follows:

> Under the terms of the Davis, Polk & Wardell Partnership Agreement ("Partnership Agreement") dated January 1, 1981, Mr. Walsh was entitled to certain payments from the law firm as a retired partner. Section 9(e) of the Partnership Agreement provided as follows:
>
> > "(9) Provisions with respect to Death, Withdrawal and Retirement Payments.
> >
> > "(e) Payments Constitute Full Payments. The payments provided for above in Sections 7[2] and 8[3] hereof shall be in full for the share of the Former Partner for all services performed prior to his . . . retirement."
>
> The agreement further provided for alternative methods of calculating the amount that he would receive. Under section 8(b)(i) of the Partnership Agreement, Mr. Walsh would receive annual payments based on his interest in the net profits of the firm during the year he retired. The agreement provided that the payments would be adjusted annually depending on the increase in the compensation paid to the ten highest paid partners of the firm in the years after Mr. Walsh's retirement. The retirement payments were limited to an amount no greater than the change in the Consumer Price Index (all urban) for the New York City area. If the change in the average compensation paid to the ten highest paid partners of the firm was less than the change in the consumer price index, section 9(a) of the Partnership Agreement provided that the shortfall would be made up in later years. The same section of the Partnership Agreement provided that

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[2] Section seven of the Agreement is titled "Payments in Event of Death, Withdrawal and Retirement of Partners."

[3] Section eight of the Agreement is titled "Provisions with Respect to Retirement of Partners."

> "any reduction which has accrued for five years and has not been paid shall be cancelled."
>
> Under section 8(b)(ii) of the Partnership Agreement, the annual payment was based on the partner's age at the time of retirement, a fixed dollar amount and the average compensation paid to the ten highest paid partners of the firm. This alternative did not contain a consumer price index limitation.[4]

Under the "Alternative Retirement Payment Election" a partner could, in general, elect to receive reduced retirement payments during his lifetime and, after his death, have payments made to a spouse or other designee during their lifetime or for a certain term.[5]

Section 8(e) of the Partnership Agreement prohibited former partners from engaging in the practice of law in the United States or Europe, without the consent of the law firm, as a condition to receiving retirement payments.

At the time of his retirement, Mr. Walsh did not maintain a capital account with the law firm. Further, during the years in issue, he did not have an ownership interest in the law firm.

In 1982, Mr. Walsh received $158,839.00 from the law firm as retirement payments pursuant to the law firm's Partnership Agreement. In 1983, he received $136,887.00 in retirement payments from the law firm. Each of these payments was made pursuant to section 8(b)(i) of the Partnership Agreement.

Mr. Walsh did not render any personal services to the law firm during the years 1982 and 1983. Similarly, during the years in issue, petitioners did not employ intangible personal property in any New York business involving the law firm. During the years in issue, Mr. Walsh did not receive a distributive share of the income or losses of the law firm.

In December 1985, petitioners filed Tax Amnesty Applications for the years 1981 through 1983. In conjunction with the Tax Amnesty Applications petitioners filed joint a New York

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[4] Finding of fact "2" was modified by adding the second sentence of the first paragraph to describe the nature of the payments made to petitioner under the Partnership Agreement.

[5] The definition of the terms used in the partnership agreement do not lend themselves to a brief summary. Pertinent provisions of the Partnership Agreement are set forth as an appendix.

State Nonresident Income Tax Return for each of the years in issue. Each return reported the retirement income which Mr. Walsh received from the law firm. Petitioners also paid the tax and interest owed for each of the years in issue.

The returns filed with the Tax Amnesty Applications for the years 1982 and 1983 included cover letters signed by Mr. Walsh which stated:

> "I wish to take advantage of the Amnesty Program, but I do not wish to waive my right to claim a refund of this disputed income as stated in the protest attached to the return. We intend to claim a refund, and if that should be denied, we reserve the right to bring an appropriate court action to compel it."

In August 1986, petitioners filed claims for a refund of the $12,147.00 in income taxes paid in 1982 and the $11,690.00 in income taxes paid in 1983. The refund claims were premised on petitioners' position that the pension payments constituted an exempt annuity pursuant to 20 NYCRR 131.4(d). Petitioners did not mention their prior application for tax amnesty in their refund claims.

On or about August 28, 1986, petitioners' representative sent a letter to the Deputy Commissioner and Counsel for the Department of Taxation and Finance which enclosed the refund claims and argued that the then recent decision of Matter of Pidot v. State Tax Commn. (118 AD2d 915) was distinguishable from the situation involving petitioners. This letter did not state that an amnesty application had been filed.

In a letter dated September 22, 1986, Counsel responded that Mr. Walsh's pension payments did not constitute an exempt annuity. The letter noted that the opinion stated therein was based on a limited set of facts and recommended that petitioners present all of the relevant facts regarding the refund claim to the State Tax Commission through the administrative process.

On November 18, 1986, the Division of Taxation (hereinafter the "Division") granted petitioners' application for amnesty for the tax years in issue.

In a letter dated April 22, 1987, the Division denied petitioners' claims for refund for three reasons. First, petitioners were advised that 20 NYCRR 131.4(d), which governs tax

exempt annuities, applies to former employees only and not to Mr. Walsh, who was a partner. Second, the letter stated that the pension was not an exempt annuity under 20 NYCRR 131.4(d). Lastly, petitioners were told that they waived their appeal rights when they filed their returns under the Amnesty Program.

In a letter dated May 18, 1987 to Counsel for the Division, petitioners' representative noted the denial of the refund claims and suggested that a conference would be beneficial because petitioners allegedly stood an excellent chance of success.

In a letter dated June 24, 1987, petitioners' representative presented a legal argument to the Director of the Law Bureau of the Division of Taxation that this would be a proper case for the State Tax Commission to allow the refunds because the pension payments were exempt from tax.

In a letter dated July 15, 1987, the Director of the Law Bureau of the Division advised petitioners' representative that he agreed with the prior position of the Division that the pension payments did not constitute a nontaxable annuity which is exempt under the personal income tax regulations. The letter concluded with the following qualification:

> "[b]ecause the Walsh payments do not meet the requirements of the regulation, as was the case in Pidot, I cannot recommend that the Tax Commission grant a refund on the basis of Pidot under the Amnesty process. Pursuit of the refund claim is, of course, an available avenue. In the event of a denial, review by the Administrative Law Judge and even the Tax Appeals Tribunal is also available. As I had emphasized earlier, we have not seen the documentation in this matter and it is quite possible that other bases may exist for rejection of the claim that your client is receiving an annuity exempt from New York income tax. The regular administrative process is available, but not in conjunction with the benefits of Amnesty."

On October 14, 1988, the Division of Tax Appeals received the petition in this matter. The petition did not make any reference to the prior amnesty application. The answer of the Division also did not make any reference to the prior amnesty application.

In a letter dated November 29, 1990, petitioners' representative advised the Deputy Commissioner and Counsel of the Department of Taxation and Finance as follows:

> "[i]n accordance with the correspondence had with Terrence Boyle, Director of the Law Bureau, and with you, copies of which are enclosed, and also the petition seeking administrative review, we hereby withdraw any claims to amnesty for the years in question, for the above-captioned taxpayers, and seek the administrative review process in effect in the Tax Department.
>
> "I also enclose copies of the original amnesty application with an accompanying letter from Judge Walsh stating that he specifically does not waive any rights to claim a refund, and specifically reserves his right to bring an appropriate court action to compel it, if such is required."

At the beginning of the hearing, the Division raised the issue of whether petitioners' application for tax amnesty precludes a subsequent claim for a refund of the same taxes. Petitioners' counsel did not object to the Division's raising the issue.

OPINION

In the determination below, the Administrative Law Judge held that petitioner[6] was prohibited from claiming a refund for taxes paid under amnesty. Specifically, it was held that because petitioner sought the benefits of the Amnesty Program, he was prohibited by statute from obtaining a refund of the same taxes. In addition, the Administrative Law Judge rejected petitioner's estoppel argument, finding that the Division did not mislead petitioner into withdrawing his Amnesty application. Addressing the merits, the Administrative Law Judge held that the income at issue is employee compensation constituting income derived from a business, trade, profession or occupation carried on in New York pursuant to former Tax Law § 632(b)(1)(B) and, thus, taxable to New York. The Administrative Law Judge also held that the retirement funds received by petitioner did not constitute a nontaxable annuity under former 20 NYCRR 131.4(d).

On exception, petitioner contends that he was prejudiced by his reliance on a letter from the Division issued to him eighteen months after filing his tax Amnesty application. Petitioner

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[6] Lawrence E. Walsh's wife, Mary P. Walsh, is a named party in this proceeding because a joint tax return was filed. However, Lawrence E. Walsh is the individual receiving the income at issue and he will be referred to as petitioner throughout the remainder of this opinion.

contends that because the letter indicated that pursuit of a refund claim, as well as subsequent administrative remedies, were still available to him, the Division should now be estopped from asserting that petitioner is foreclosed from the avenue of administrative review. Secondly, petitioner argues that his filing of the refund claim, which occurred prior to the Division's grant of amnesty, was an effective withdrawal of his Amnesty application. Thus, he argues that because the preclusive effects of amnesty do not occur until amnesty is granted, he should be afforded the opportunity for administrative review. As to the merits, petitioner argues that the income at issue is not taxable under former Tax Law § 632, as it does not constitute income from a business, trade, profession or occupation carried on in New York. Petitioner also contends that the subject income is not subject to tax on the separate ground that the payments received were from a nontaxable annuity under former 20 NYCRR 131.4(d).

In response, the Division argues that: 1) petitioner's estoppel argument was properly rejected below because petitioner did not detrimentally rely on any communications from the Division; and 2) the amnesty statute makes clear that all administrative remedies are barred once a qualified taxpayer applies for amnesty. As to the merits of petitioner's claim, the Division asserts that the Administrative Law Judge was correct in finding petitioner's retirement payments to be New York source income from a business, trade, profession or occupation carried on in this State and, thus, taxable under former section 632(a). In addition, the Division asserts that because the retirement payments did not change to match changes in the consumer price index, the income cannot be classified as a nontaxable annuity under former 20 NYCRR 131.4(d).

We affirm the determination of the Administrative Law Judge.

Effective April 17, 1985, the New York State Legislature enacted an Amnesty Program (L 1985, ch 66). Under this program, the Legislature directed that upon the written application of a taxpayer and the payment of all designated taxes plus interest, the State Tax Commission shall waive all applicable penalties (L 1985, ch 66, § 1[b]). Where these requirements were

met, the legislation provided that no civil, administrative, or criminal actions or proceedings could be brought against the taxpayer relating to the designated taxes plus interest (L 1985, ch 66, § 1[b]).

The Amnesty Program legislation further provided:

> "[u]nless such tax commission on its own motion redetermines the amount of designated taxes plus interest, no refund or credit shall be granted of any designated taxes plus interest paid under this program." (L 1985, ch 66, § 1[e]).

The Division asserts, on the authority of Matter of Mon Paris Operating Corp. v. Commissioner of Taxation & Fin. (151 AD2d 822, 542 NYS2d 61), that a taxpayer who seeks protection under the Amnesty Program is barred from filing claims for refund of taxes and interest paid thereunder. The Appellate Division in Mon Paris stated:

> "[p]etitioner, having taken advantage of the Amnesty Program and received the benefits therefrom, is bound by the course it elected to follow. By paying the tax due as defined in 20 NYCRR 2500.5(d)(1), petitioner made an admission that it owed the amount of tax which it paid. Petitioner thereupon was not obligated to pay any penalty arising from such admission and, by the tax amnesty provision and the regulations, the taxes were finally and irrevocably assessed (L. 1985, ch. 66 § 1[e]; 20 NYCRR 2500.8[b]). Consequently, petitioner may not maintain this proceeding to claim a refund of the tax paid or seek damages for the payment. Supreme Court properly dismissed the proceeding" (Matter of Mon Paris Operating Corp. v. Commissioner of Taxation & Fin., supra, 542 NYS2d 61, 62, emphasis added).

Petitioner argues that Mon Paris is not controlling here because, unlike the taxpayer in that case, petitioner attached to his Amnesty application a letter expressly reserving his right to a refund or to the appeals process.

We reject petitioner's argument and hold, based on the Amnesty statute and interpretive regulations, that petitioner was properly denied a refund and is foreclosed from seeking a return of the taxes and interest paid through the administrative process.

As the Amnesty statute and regulations make clear, the Amnesty Program offered a delinquent taxpayer the benefit of avoiding the imposition of penalties by submitting an application and paying all designated taxes and interest (L 1985, ch 66, § 1[b]). In exchange for

this benefit, the Legislature decreed that payments made as a result of the taxpayer's participation in this program shall not be refunded (L 1985, ch 66, § 1[e]).

The regulations, which were authorized by statute,[7] expound on this legislative command, stating:

> "[a]ll payments made in connection with an amnesty application are final and will not be returned upon a denial or revocation of amnesty. However, in the case of an application that is denied because of a pending criminal investigation, the application, payment and returns will be returned to the applicant" (20 NYCRR 2500.9[b][1], emphasis added).

Despite these authoritative rules, petitioner, as expressed in the letter submitted with his Amnesty application, sought to alter this statutory scheme by attempting to receive the benefits of amnesty while preserving his right to contest the correctness of the tax as applied to him. However, as the statute and accompanying regulations make clear, the terms under which a taxpayer participated under the Amnesty Program were non-negotiable. We agree with the Administrative Law Judge that, viewing the Amnesty Program as a whole, it was the obvious intent of the legislative drafters to preclude any additional disputes regarding those taxes which the taxpayers voluntarily paid under the auspices of the Amnesty Program (L 1985, ch 66, § 1[b],[e]). Petitioner's payment of the taxes and interest at issue with his Amnesty application forecloses any further review otherwise available to petitioner to determine whether the tax is actually owed (20 NYCRR 2500.9[b][1]).

Petitioner asserts that the administrative remedies of a taxpayer opting for tax amnesty are not waived until amnesty is granted (citing, 20 NYCRR 2500.6[a][1]). Petitioner further asserts that because no formal procedure for revoking an Amnesty application exists, his filing of a refund claim on August 19, 1986 effectively withdrew his Amnesty application before amnesty

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[7] The Legislature empowered the State Tax Commission to promulgate regulations necessary to implement the provisions of the Act (L 1985, ch 66, § 1[f]).

was granted on November 18, 1986. This argument must fail. Petitioner simply misinterprets the meaning of 20 NYCRR 2500.6(a)(1), which states:

> "[o]nce amnesty is granted, all penalties (as defined in section 2500.2 of this Part) are waived and any civil, administrative or criminal proceeding is barred relating to the designated tax. (Laws of 1985, chap. 66, § 1[b]).

Section (1)(b) of Chapter 66 of the Laws of 1985, which 20 NYCRR 2500.6(a)(1) interprets, states in relevant part:

> "[s]uch amnesty program shall provide that upon written application by any taxpayer, and upon evidence of payment to the state of New York by such taxpayer of all designated taxes plus interest, such tax commission shall waive any penalties which may be applicable and no civil, administrative or criminal action or proceeding shall be brought against the taxpayer relating to the designated taxes plus interest" (L 1985, ch 66, § 1[b], emphasis added).

Based on this statutory language, it is clear that the actual granting of amnesty is relevant for purposes of 20 NYCRR 2500.6(a)(1) only in that the granting of amnesty prohibits the Division from using the administrative process to collect the tax at issue.

In light of our holding above, petitioner's estoppel argument must also fail. Petitioner claims that the Division is estopped from asserting that petitioner is foreclosed from administrative review of his refund claim. Petitioner points to the letter sent to petitioner's attorney by the Director of the Law Bureau, dated July 15, 1987. This letter was in response to a letter from petitioner dated June 24, 1987, asking the Tax Commission to grant a refund on its own motion pursuant to the Amnesty statute. After explaining the legal grounds for denying petitioner's request, the Director stated the following:

> "[p]ursuit of the refund claim is, of course, an available avenue. In the event of a denial, review by the Administrative Law Judge and even the Tax Appeals Tribunal is also available. As I have emphasized earlier, we have not seen the documentation in this matter and it is quite possible that other bases may exist for rejection of the claim that your client is receiving the annuity exempt from New York income tax. The regular administrative process is available, but not in conjunction with the benefits of amnesty" (Exhibit "I," emphasis added).

Petitioner contends that in light of these statements, he had a basis to believe that the administrative review process remained available to him, he had availed himself of those rights and, by doing so, had withdrawn his Amnesty application, subjecting him to the possibility of the payment of penalties (Petitioner's brief, p. 8).

In order to determine whether estoppel should be invoked, three requirements must be met. The party seeking estoppel must show: that there was a right to rely on the representation, whether there was such reliance, and whether the reliance was to the detriment of the party who relied upon the representation (Matter of Harry's Exxon Serv. Sta., Tax Appeals Tribunal, December 6, 1988). As we have established above, the issue of whether the tax was actually owed became moot on December 17, 1985, the date that the designated taxes and interest were paid (L 1985, ch 66, § 1[e]; see, 20 NYCRR 2500.9[b][1]). Therefore, any detrimental reliance on Division personnel regarding petitioner's rights under the Amnesty Program must have occurred before this date. Because the Division's correspondence was dated July 15, 1987, or roughly 18 months after payment of the taxes and interest, it is clear that petitioner was not harmed by any reliance he may have placed on the letter.

Petitioner also makes the argument that because in Mon Paris the taxpayer's action was dismissed by the Supreme Court for failure to exhaust its administrative remedies, it is inherent in this holding that the taxpayer had a right to an administrative remedy. However, before the Tax Commission could have reached the merits of the appeal in Mon Paris (i.e., whether the taxpayer actually owed sales tax under Article 28), it would first have been required to determine whether the taxpayer's decision to pay the tax under the Amnesty Program rendered this question moot. As the subsequent decision by the Appellate Division makes clear, the taxpayer would not have been entitled to a review of the merits of its tax liability if the case were brought before the Tax Commission in the first instance (Matter of Mon Paris Operating Corp. v. Commissioner of Taxation & Fin., supra, 542 NYS2d 61, 62). Because petitioner here

paid the tax and interest under the Amnesty Program, we hold that he is not entitled to an administrative review to determine the tax legitimately owed under the Tax Law.

If we were to reach the merits of petitioner's refund claim, he would not prevail. The applicable statute in making this determination is former Tax Law § 632(a), which states:

> "[t]he New York source income of a nonresident individual shall be the sum of the net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources. . . ."

Former section 632(b)(1)(B) defines income or gain "derived from or connected with New York sources" in relevant part as "those items attributable to a business, trade, profession or occupation carried on in this state." Former 20 NYCRR 131.4(d) addresses the tax treatment of retirement benefits, stating in relevant part:

> "[w]here a pension or other retirement benefit does not constitute an annuity, it is compensation for personal services and, if the individual receiving it is a nonresident, it is taxable for New York State personal income tax purposes to the extent that services were performed in New York State."

Petitioner claims that the payments received in 1982 and 1983 from his former law firm, Davis, Polk & Wardell, while he was a nonresident of New York are not taxable under former section 632(a). Petitioner's right to receive retirement payments is governed by the "Davis, Polk & Wardell Partnership Agreement" dated January 1, 1981 (Exhibit "1"). The pertinent portion of this agreement is as follows:

> "(9) Provisions with respect to Death, Withdrawal and Retirement Payments. (e) Payments Constitute Full Payments. The payments provided for above in Sections 7 and 8 hereof shall be in full for the share of the Former Partner <u>for all services performed prior to his . . . retirement</u>" (emphasis added).

Because the partnership agreement makes clear that the payments petitioner received from Davis, Polk in 1982 and 1983 were attributable to his services on behalf of that firm prior to his retirement in 1981, these payments constituted income attributable to a business, trade,

profession or occupation carried on in New York State (former Tax Law § 632[b][1][B]; see, former 20 NYCRR 131.4[d]).

Petitioner asserts that his retirement income cannot fall within the above definition because he was not engaged in a business, trade, profession or occupation in New York State at any time subsequent to his retirement from Davis, Polk & Wardell in 1981. This argument is without merit. We have held that in attributing the source of a nonresident's income under former section 632(a)(1), the year in which the income was received is not controlling. Rather, the words "derived from or connected with New York sources" require an examination of the nonresident's activities from which the income was secured or earned, not when the benefit was received or realized (Matter of Halloran, Tax Appeals Tribunal, August 2, 1990, citing Howkins v. Commissioner, 49 TC 689). It is clear from the contract conferring upon petitioner the right to the payments at issue that the payments represented compensation for services provided to the firm prior to petitioner's retirement in 1981. Thus, we conclude that the payments constitute income "derived from or connected with New York sources" within the meaning of former section 632(a) (see, Matter of Michaelsen v. New York State Tax Commn., 67 NY2d 579, 505 NYS2d 585; Matter of Norris v. State Tax Commn., 140 AD2d 876, 528 NYS2d 694).

Petitioner cites Matter of Pardee v. State Tax Commn. (89 AD2d 294, 456 NYS2d 459) in support of his position. In Pardee, the issue was whether, upon a lump-sum distribution to a nonresident of his share of an employee profit-sharing plan, the income and gains generated from his New York employer's contribution to the plan were taxable under former section 632(a). The Appellate Division, Third Department held that the income and gains from the employer's contribution did not constitute income or gain from a business, trade, profession, or occupation carried on in this state within the meaning of former section 632(b)(1)(B) because they were not compensation for personal services rendered in New York State, as required under former 20 NYCRR 131.4(b).

We find Pardee to be inapplicable to this case. In contrast to Pardee, the issue here is whether the payments made to petitioner, a nonresident, are themselves taxable by New York. Thus, the payments received by petitioner here are more akin to the employer contributions to the profit-sharing plan in Pardee, which the taxpayer in Pardee conceded to be taxable as compensation for services provided in New York (Matter of Pardee v. State Tax Commn., supra, 456 NYS2d 459, 460) than they are to the payments at issue in Pardee.

Petitioner contends that Matter of Michaelsen v. New York State Tax Commn. (supra), which was the basis for the Administrative Law Judge's determination, is distinguishable from the present case. In Michaelsen, the petitioner, an executive with Avon Products, Inc. in New York City, was granted options under a stock option plan to purchase Avon stock at a set price. After the options became exercisable, the petitioner eventually exercised his option, purchasing 6,000 shares from Avon. The petitioner, then a resident of Connecticut, sold the shares in 1973 for a gain of $179,761.00. The petitioner reported the gain from the sale of the stock as ordinary income on his 1973 Federal income tax return, but did not report any portion of this gain on his New York nonresident income tax return for that year. The issue before the Court of Appeals was whether the appreciation of the stock from the time the option was exercisable to the time it was exercised represented compensation from the employer and, thus, was taxable by New York under former section 632(b)(1)(B). The Court held that the appreciation was taxable as compensation from Avon, stating that "[t]he employee's compensation comes from the employer's willingness to let the employee benefit from the market appreciation in the stock without risk to its own capital" (Matter of Michaelsen v. New York State Tax Commn., supra, 505 NYS2d 585, 588).

Petitioner states that:

> "[i]n Michaelsen, there was no evidence indicating the stock options were issued other than as a form of compensation for service to the employer and, thus, there was a rational basis for determining that the gain on sale of the stock was connected with New York sources within the meaning of former section 632. There is no question that payments to Judge Walsh were not compensation for services to Davis Polk" (Petitioner's brief, p. 15).

Because, as stated above, we have concluded that the payments received by petitioner in 1982 and 1983 did represent compensation for prior services rendered to the firm, this argument is without merit.[8]

We will now address whether the payments received by petitioner constitute an annuity under former 20 NYCRR 131.4(d) and are, therefore, not taxable to New York under former section 632. The pertinent provisions of this regulation provide that in order for an annuity to be nontaxable, it must meet the following requirements:

"(iii) It must be payable:

(a) at a rate which remains uniform during such life or period; or

(b) at a rate which varies with:

(1) the fluctuation in the market value of the assets from which such benefits are payable;

(2) the fluctuation in a specified and generally recognized cost-of-living index; or

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[8]We note our disagreement with the Administrative Law Judge's inference that the Court of Appeals decision in Michaelsen undermines the holding of Pardee. To the contrary, we find the Michaelsen decision to reinforce the result reached in Pardee. In Michaelsen, the amount attributed to New York was the difference between the option price paid by petitioner for the stock and the value of the stock at the time the option was exercised -- a benefit created as a direct result of the terms granted by petitioner's employer. In its opinion, the Court of Appeals addressed the Tax Commission's erroneous attempt to impose as well a tax on the stock's increase in value between the time it was purchased by the petitioner and the time it was sold. The Court stated:

> "[t]his treatment mirrors the tax consequences imposed under Federal law, but results in the taxation of personal property not derived from a New York source (Tax Law § 632[b][2]). Any gain petitioner realized from an increase in the market value of the Avon stock between the time the option was exercised and the time the stock was sold is clearly investment income rather than compensation and, as a nonresident, petitioner cannot be taxed on this amount" (Matter of Michaelsen v. New York State Tax Commn., supra, 505 NYS2d 585, 589).

The petitioner's exercise of his stock option in Michaelsen had the same effect as the employer's contribution of property to the profit sharing plan in Pardee -- it signaled the point at which any further growth or income arising from the transferred property ceased to be attributable to the recipient's New York employment. Therefore, the holdings in Michaelsen and Pardee appear to be entirely consistent.

(3) the commencement of social security benefits" (former 20 NYCRR 131.4[d][2][iii]).

Under the pertinent terms of the Davis, Polk & Wardell Partnership Agreement, the annual increase in the annual payment to petitioner could not exceed the increase in the consumer price index for that year. The fluctuation in the annual payments, however, is not governed by this index, but rather is principally determined by the compensation paid to the 10 highest paid active partners. If the change in the active partner index was less than the change in the consumer price index, the agreement provided that the shortfall would be made up in later years. Section 9(a) of the agreement also provided that "any reduction which has accrued for five years and has not been paid shall be cancelled" (Exhibit "1").

Petitioner argues that the holding in Matter of Pidot v. State Tax Commn. (118 AD2d 915, 499 NYS2d 482, affd 69 NY2d 837, 513 NYS2d 965) should govern in this case. In Pidot, the agreement governing the payments to the petitioner, a retired law partner, stated that all such payments "would be reduced in any year in which the partnership's net income failed to exceed certain qualifying criteria . . ." (Matter of Pidot v. State Tax Commn., supra, 499 NYS2d 482, 483). The agreement further stated that "the unpaid amounts remained due and owing, to be paid in subsequent years . . ." (Matter of Pidot v. State Tax Commn., supra). The Appellate Division held that this partial deferral to later years did not provide a rational basis for the Tax Commission to conclude that the payment at issue was not an annuity.

In attempting to align this case with the facts of Pidot, petitioner fails to address the cancellation provision contained in section 9(a) of the agreement. Because this cancellation provision represents a deviation from the requirements of a qualified payment plan, we reject petitioner's argument that the annuity is payable "at a rate which varies only with the fluctuation in a specified and generally recognized cost-of-living index" (former 20 NYCRR 131.4[d][2][iii][b][2], emphasis added). Further, petitioner has failed to distinguish his case from the facts of Matter of Norris v. State Tax Commn. (supra), where it was concluded that

payments that varied based on partnership profits were not part of a nontaxable annuity. Because petitioner has not established that the payment terms conform with one of the other qualified methods under former 20 NYCRR 131.4, we hold that petitioner has failed to prove that the payments at issue were part of a nontaxable annuity.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners Lawrence E. and Mary P. Walsh is denied;

2. The determination of the Administrative Law Judge is sustained; and

3. The petition of Lawrence E. and Mary P. Walsh is denied.

DATED: Troy, New York
November 19, 1992

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner