STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition

of

DOMINION TEXTILE, (USA) INC., AS SUCCESSOR TO JORIC CORP.

for Redetermination of a Deficiency for for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Year Ended May 31, 1987.

DECISION
DTA No. 812248

The Division of Taxation and petitioner Dominion Textile, (USA) Inc., as successor to Joric Corp., 120 West 45th Street, New York, New York 10036-4003, each filed an exception to the determination of the Administrative Law Judge issued on May 25, 1995. Petitioner appeared by Peter L. Faber, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Vera R. Johnson, Esq. and James Della Porta, Esq., of counsel).

Petitioner filed a brief in support of its exception and in reply to the Division of Taxation's brief in opposition. Oral argument was heard on March 14, 1996. In addition, petitioner filed a motion for reargument which is addressed herein. Petitioner submitted additional written argument on January 15, 1997 to which the Division of Taxation responded on March 6, 1997.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the former regulatory definition of investment capital which included "other securities" covered stock options so that the Division of Taxation incorrectly required petitioner to allocate capital gains received from the sale of certain stock options by use of its business allocation percentage of 100% instead of its investment allocation percentage of 4.8540%.

II. Whether the Division of Taxation's refusal to apply retroactively the current tax regulation which treats stock options as investment capital was improper so that the Division of Taxation

incorrectly required petitioner to allocate capital gains received from the sale of certain stock options by use of its business allocation percentage of 100% instead of its investment allocation percentage of 4.8540%.

III. Whether petitioner's motion for reargument before the Tax Appeals Tribunal should be granted.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "10" and "19" which have been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact are set forth below. The numbers assigned to the findings of fact by the Administrative Law Judge have been retained for ease of reference.

Dominion Textile, Inc. ("Dominion Textile"), which began operations in 1905, was, during the period at issue, the largest Canadian manufacturer of textiles and related products, with worldwide manufacturing and sales activities. In Canada, Dominion Textile designed, produced, finished and marketed a wide range of woven fabrics including: (i) consumer products such as sheets, blankets, towels, knitted sportswear and leisurewear; (ii) spun yarn for knitters and weavers; and (iii) woven and nonwoven industrial products engineered to meet the requirements of many manufacturing and processing industries. In the United States, Dominion Textile, by various subsidiaries, manufactured and sold: (i) denim, polyester/cotton and cotton yarns; (ii) geotechnical products;[1] and (iii) plastic accessories.

Petitioner, Dominion Textile, (USA) Inc. ("Dominion Textile USA"), was the principal United States subsidiary of Dominion Textile, the Canadian parent corporation. In turn, Dominion Textile USA, as a holding company, owned the subsidiary corporations that conducted Dominion Textile's active business operations in the United States.

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[1]The record does not disclose the nature of "geotechnical" products.

In the spring of 1986, Dominion Textile decided to expand and diversify its investments in the United States. It targeted Burlington Industries, Inc. ("Burlington"), whose corporate headquarters were located in North Carolina, for takeover. Burlington, one of the world's largest and most broadly diversified textile companies, operated principally in the United States with additional operations in Canada, Mexico, Ireland and Italy.

Burlington's stock, which was publicly held, traded on several United States exchanges.

Dominion Textile was inexperienced in the takeover mania that was sweeping Wall Street, and anticipating resistance by Burlington to its takeover, Dominion Textile enlisted the assistance of Asher Edelman, who had participated in other takeovers.

Complex Takeover Creations

Dominion Textile USA created a wholly-owned subsidiary, Joric Corp. ("Joric") on December 6, 1986 for the sole purpose of acquiring the outstanding common stock of Burlington. Joric and Grid Partners, L.P. ("Grid Partners"), which was a limited partnership organized under the laws of Delaware controlled by Asher Edelman, formed Samjens Partners I ("Samjens Partners"), a New York general partnership, for the sole purpose of acquiring the stock of Burlington.

Asher Edelman's takeover organization was remarkably complex. His Grid Partners, which served as the general partner of Samjens Partners, was made up of (1) Grid Management Corp. ("Grid Management"), the sole general partner of Grid Partners (i.e., the general partner of a general partner), and (2) five limited partners consisting of three corporations, Canran Corp., Intelogic Trace, Inc., and United Stockyards Corporation, and two limited partnerships, Plaza Securities Company and Valley Partners, L.P. (i.e., limited partnerships which were limited partners).

The partnership agreement of Samjens Partners stated that its business purposes were (i) to acquire, directly or through its subsidiaries, actively traded marketable securities (or rights or options relating thereto) of a <u>specified issuer</u>, and (ii) to hold, sell, dispose, exchange, transfer, vote or otherwise exercise all rights, powers and privileges and other incidents of ownership

with respect to the securities of the specified issuer and other partnership property. Samjens Partners designated Burlington as the specified issuer.

The only activities conducted by Joric and Samjens Partners were activities conducted in connection with the acquisition of Burlington stock. Joric purchased Burlington common stock on the open market over a five-month period, from December 1986 until April 1987. Joric transferred its Burlington stock to Samjens Partners during 1987. Samjens Partners also purchased Burlington stock.

We modify finding of fact "10" of the Administrative Law Judge's determination to read as follows:

> In addition to the purchase of Burlington stock, Joric purchased Burlington stock options. On March 5, 1987, Joric paid a total of $1,299,318.00 to purchase 1,440 June 40 options of Burlington on the New York Stock Exchange[2] in two[3] transactions: (i) 265 options for $268,312.50 and (ii) 1,175 options for $1,028,125.00. Each June 40 option represented the right to purchase 100 shares of Burlington common stock at $40.00 per share, exercisable in June 1987. In other words, Joric had the option to purchase 144,000 shares of Burlington stock at $40.00 per share in June 1987 for a total price of $5,760,000.00. Since the cost of the options totalled $1,299,317.50, if Joric, in fact, exercised its options in June 1987, it would have paid $7,059,317.50 for the 144,000 shares of Burlington ($5,760,000.00 + $1,299,317.50 = $7,059,317.50), or a per-share cost of $49.02.
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> On March 5, 1987, Joric also paid $113,558.00 to purchase 243 June 55 options of Burlington. Each June 55 option represented the right to purchase 100 shares of Burlington common stock at $55.00 per share, exercisable in June 1987. If Joric, in fact, exercised these June 55 options, it would have paid $1,450,058.00 for the 24,300

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[2] The taxpayer's expert witness, Professor Stephen Figlewski, noted that the first exchange trading of options occurred in 1973.

[3] The parties stipulated that such purchase was made in three transactions. However, Exhibit "E" to the stipulation, which is a photocopy of confirmation slips for such purchase from Bear, Stearns & Co., Inc., shows two purchases as follows:

Number of June 40 Options	Price per Option	Principal	Net Commission	Amount
265	10-1/8	$ 268,312.50	$ 530.00	$ 268,842.50
1,175	8-3/4	1,028,125.00	2,350.00	1,030,475.00
1,440		$1,296,437.50	$2,880.00	$1,299,317.50

shares of Burlington ($1,336,500.00 + $113,558.00 = $1,450,058.00), or a per-share cost of $59.67.[4]

Joric's purchase of Burlington stock options was part of a strategy to acquire the outstanding common stock of Burlington. It is noted that the Burlington stock options purchased by Joric were traded on the New York Stock Exchange and were not specifically created for the purpose of enabling Joric to acquire Burlington's common stock.

Takeover Attempt Becomes Public

On April 8, 1987, an article in USA Today reported that a group led by Asher Edelman and Dominion Textile USA had acquired 4.9% of the outstanding Burlington stock. A week later, a competing group led by representatives of Morgan Stanley Group, Inc. ("Morgan Stanley Group") contacted Burlington management and, on April 28, 1987, representatives of the Morgan Stanley Group met with Burlington representatives concerning their possible acquisition of Burlington. This competing group was willing to allow Burlington management to acquire an interest in the Morgan Stanley Group entity that would make the acquisition and would prove to be Burlington's so-called white knight against petitioner's hostile tender offer.

Dominion Textile's Hostile Takeover Attempt Fails

Over a period of a few intense weeks in May 1987, Dominion Textile's attempt to take over Burlington would fail:

(a) On May 6, 1987, Samjens Partners extended a tender offer to Burlington shareholders to purchase all of Burlington's stock for $67.00 per share;

(b) On May 11, 1987, Burlington's board of directors met and rejected the tender offer of Samjens Partners, recommending to Burlington shareholders that they not tender their shares and announcing that Burlington would offer to buy back at a price of $80.00 per share up to 25% of its shares;

(c) On May 14, 1987, Burlington made a tender offer to buy back up to 8,000,000 of

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[4] We modified this finding to reflect the correct principal amount of the 265 June 40 options.

its shares (approximately 25%) at a price of $80.00 per share at a total buy back cost of $640,000,000.00 (8,000,000 x $80.00 = $640,000,000.00);

(d) On May 15, 1987, Samjens Partners amended its tender offer to increase by $5.00 the price per share in its tender offer, from $67.00 to $72.00, and in a letter to Burlington refused to abandon its tender offer;

(e) On May 20, 1987, Burlington's board of directors and the Morgan Stanley Group reached an agreement on an acquisition of Burlington by the Morgan Stanley Group for a price of $76.00 per share with selected members of Burlington's management invited to participate in the Morgan Stanley Group entities that would effect the acquisition;

(f) On May 26, 1987, the Morgan Stanley Group, through controlled entities, extended a tender offer to Burlington shareholders to purchase their Burlington stock for $76.00 per share;

(g) On May 27, 1987, Samjens Partners amended its tender offer by raising the price in its tender offer another $5.00 per share, from $72.00 to $77.00, $1.00 more per share than the competing group's tender offer;

(h) In a matter of days, it became apparent that the Morgan Stanley Group would increase its offer, while Dominion Textile and Asher Edelman concluded that they would not be able to match an offer in excess of $77.00 per share;

(i) On June 10, 1987, the Morgan Stanley Group increased its offer another $2.00 per share, from $76.00 to $78.00, $1.00 per share more than Dominion Textile's tender offer; and

(j) On June 24, 1987, the Morgan Stanley Group announced that 78% of the Burlington shares had been tendered to it.

Joric Dissolves

As noted in Finding of Fact "13", by late May 1987, Dominion Textile's takeover attempt had failed and, consequently, Joric had no reason to continue holding the Burlington stock options described in Finding of Fact "10". On May 29, 1987, Joric sold 970 of its June 40

options for $3,547,656.00, realizing a gain of $2,660,528.00. On the same day, it also sold 240 of its June 55 options for $517,783.00, realizing a gain of $404,225.00. A comparison of these stock options sold to stock options purchased (described in Finding of Fact "10") shows that Joric retained 470 June 40 options and 3 June 55 options.

Subsequently, Samjens Partners and its affiliates sold the Burlington common stock that they held (along with Burlington's other shareholders) pursuant to the tender offer of the Morgan Stanley Group.

On August 10, 1989, Joric filed a certificate of dissolution, and its assets and liabilities were transferred to Dominion Textile USA, its sole shareholder, in liquidation.

The Division of Taxation's Assessment

The Division of Taxation ("Division") issued a Notice of Deficiency[5] dated June 12, 1992 against an entity named in the notice as "Joric Corp. Dominion Textile" asserting additional tax due of $321,379.00, plus penalties[6] and interest, which was allocated as follows:

Tax Period Ended	Additional Corporate Franchise Tax	MCTD Surcharge[7]	Totals
May 31, 1987	$272,922.00	$46,397.00	$319,319.00
May 31, 1989	1,724.00	336.00	2,060.00
Totals	$274,646.00	$46,733.00	$321,379.00

Petitioner has contested only the assertion of additional tax for the period ended May 31, 1987. In the course of the audit, petitioner had argued that New York had no nexus to tax Joric's income for the period at issue, but subsequent to the conciliation conference held in this

[5]A photocopy of the Notice of Deficiency dated June 12, 1992 was included with the taxpayer's petition, which was marked into evidence as the Division's Exhibit "C." This photocopy of the notice, however, appears to be missing a fourth page which apparently would have shown an additional tax asserted due of $336.00 for the period ended May 31, 1989 representing the surcharge imposed on corporations doing business in the Metropolitan Commuter Transportation District ("MCTD surcharge"). An unsigned Form DO-356, Consent to Field Audit Adjustment, included in the Division's Exhibit "F," the field audit report and attachments, indicated this additional minor amount.

[6]Penalties were imposed under Tax Law § 1085(a)(1); (b)(1), (2) and (k) for failure to file, failure to pay, negligence and substantial underpayment of taxes.

[7]

See Footnote "5."

matter, petitioner withdrew such contention. A Conciliation Order dated June 18, 1993 had upheld the assertion of additional tax of $321,379.00, plus penalties and interest, except the assertion of penalty under Tax Law § 1085(k).[8]

We modify finding of fact "19" of the Administrative Law Judge's determination to read as follows:

> Subsequent to the conciliation conference, petitioner developed its position that gains from the sale of the stock options should be allocated to New York by an investment allocation percentage of 4.8540% and not by a business allocation percentage of 100%. A schedule labeled "Computation of Tax on Allocated Net Income" included in the field audit report (Exhibit "F") shows how the Division computed tax due for the taxpayer's 1987 fiscal year as follows:

Federal taxable income	$3,562,473.00
50% of dividends non-sub	(8,302.00)
Entire net income per audit	$3,554,171.00
Investment income for allocation	548,325.00
Business income for allocation	3,005,846.00[9]
Investment allocation %	4.8540%
Business allocation %	100.0000%
Allocated investment income	26,616.00
Allocated business income	3,005,846.00
Total allocated income	3,032,462.00
Allocated taxable net income	3,032,462.00
Tax rate	9%
Tax on allocated net income	$ 272,922.00

> The MCTD surcharge rate of 17% applied to the tax of $272,922.00 results in a surcharge of $46,397.00. The sum of these amounts is $319,319.00, the amount of tax for the taxpayer's fiscal year which is at issue here as noted in Finding of Fact "17".[10]

The Taxpayer's Expert

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[8] An auditor's memorandum dated April 2, 1993 (Division's Exhibit "G") shows that the auditor had agreed "with the taxpayer that the 1085(k) penalty should be waived as per recent instructions from Albany" (because penalty for substantial understatement of liability should not be imposed with the negligence penalty).

[9] As noted in Finding of Fact "14," Joric realized gains of $2,660,528.00 and $404,225.00 on its sale of Burlington stock options, for a total gain of $3,064,753.00. The record does not disclose why this amount is $58,907.00 greater than the amount shown above as "business income for allocation" of $3,005,846.00.

[10] We modified this finding to reflect the fact that the MCTD surcharge rate during the year in issue was 17% rather than the 9% set forth in the Administrative Law Judge's original finding.

In support of its position that the Division should treat income from the sale of stock options as investment income, not business income, because stock options are investment capital, not business capital, petitioner presented the testimony of Stephen Figlewski, an economist and professor of finance at the New York University Stein School of Business. In Professor Figlewski's opinion, "buying an option is, in terms of financial economics, a capital asset in the same way that stock is a capital asset" (tr., pp. 40-41). Like the stock of which it is a derivative, an option is a form of investment in the business of a corporation. Its value depends on the corporation's success, as does the value of stock. Like stock, the money that is made or lost on the option market changes hands among investors and does not actually return to the underlying company, which does not get fresh money when the transactions occur.

In response to a leading question, Professor Figlewski agreed that stock options provide the buyer with rights in the corporate enterprise. He elaborated:

> "[I]n the sense that the option gives you a right to control the stock, and the stockholder has rights in the corporate enterprise. Then the option essentially is giving you the right to acquire these rights in the corporate enterprise -- I am trying to say 'as a matter of right' . . ." (tr., p. 47).

According to Professor Figlewski, in a hostile takeover attempt, stock options are essentially equivalent to the purchase of the underlying stock:

> "If I were trying to do a hostile takeover, any way I could think of locking in the stock at the price that is fixed today, is the same" (tr., p. 51).

Moreover, the acquisition of stock options is the "cost effective way" of carrying out a hostile takeover because, in Professor Figlewski's words, "[t]he option is the more leveraged instrument" by which more stock can be controlled "with the same amount of money" (tr., p. 52). In short, Professor Figlewski views stock options as "means of investment" (tr., p. 47).

The Division's auditor testified that, prior to January 1, 1990, the Division always treated income from the sale of stock options as business income and he computed additional tax asserted as due, as detailed in Finding of Fact "19", based upon an automatic application of

this established policy. The issue at hand, according to the auditor, did not come up in the course of the audit. Rather, the taxpayer argued that stock options should be treated as investment capital, not business capital, after the conciliation conference. At that point, the auditor analyzed the issue and concluded that the stock options were properly treated as business capital because they "were not designed as means of investment by Joric Corporation", but rather their purpose was "[t]o take over . . . Burlington" (tr., p. 61). The auditor emphasized that the taxpayer "did not invest in any other stocks or options in any other company" (tr., p. 61).

The parties executed a Stipulation of Facts dated June 23, 1994, of which relevant portions have been incorporated into these findings of fact.

We make the following additional finding of fact:

> On December 23, 1996, petitioner made a motion to reargue based upon the fact that two of the commissioners of the Tax Appeals Tribunal who will decide this case were not commissioners at the oral argument held on March 14, 1996.

OPINION

In the determination below, the Administrative Law Judge found that the Division had acted properly in not applying the amended regulation (i.e., 20 NYCRR 3-3.2[c]) retroactively to the date of the statute it was intended to interpret. Relying primarily on this Tribunal's decision in Matter of Varrington Corp. (Tax Appeals Tribunal, March 23, 1995), the Administrative Law Judge found that treatment of stock options as "other securities" in the amended regulation "represented a significant change in Departmental policy because, under the prior regulations, stock options were not considered 'other securities', a position which had been sustained by the Appellate Division, Third Department . . ." (Determination, conclusion of law "G"). As a result of this change in policy, he found that the new regulation had to be applied prospectively only.

The Administrative Law Judge also found that under the old regulation the stock options could not be considered "other securities," citing to the four requirements for such treatment

contained in that former regulation and upheld in Matter of Pohatcong Investors (Tax Appeals Tribunal, December 1, 1988, confirmed Matter of Pohatcong Investors v. Commissioner of Taxation & Fin., 156 AD2d 791, 549 NYS2d 211). Specifically, he found that stock options did not meet the fourth requirement of the regulation, i.e., they did not provide a distribution of rights in or obligations of, the corporate enterprise.

On exception, petitioner argues that the Administrative Law Judge erred in not applying the new regulation retroactively. According to petitioner, the case law requires that newly-promulgated regulations be given retroactive effect as of the date of the underlying statute "because such regulations only interpret the law and do not create it" (Petitioner's brief, p. 16). Petitioner argues that the limited circumstances under which prospective application of regulations is appropriate are not present in the current case. Petitioner also maintains that the Administrative Law Judge erred in relying on Matter of Varrington Corp. (supra) because in that case there was a reversal, by regulation, of a long-standing, publicly announced policy, while in the instant matter, the Division "had no publicly articulated position on stock options before the drafting of the new regulations . . ." (Petitioner's brief, p. 26).

Petitioner argues alternatively that, even under the old regulations, stock options were "other securities" because they met the four-part test for such securities set forth in the regulation. Petitioner contends that the Administrative Law Judge erred in ruling that stock options do not provide a distribution of rights in a corporate enterprise and that Matter of Pohatcong Investors (supra), upon which the Administrative Law Judge relied, was not applicable to the instant case because it involved the creator of covered call options and not the purchaser of such options. Petitioner also argues that the Administrative Law Judge ruled, incorrectly, that stock options did not meet the first element of the test, i.e., that they were not of a like nature as stocks and bonds because they were not identical to stocks and bonds.

Petitioner also argues, for the first time on exception, that the penalties imposed by the Division should be abated because petitioner had reasonable cause and acted with due care.

The Division, in its exception, seeks to correct two technical errors in the determination.

In its argument in opposition to petitioner's exception, the Division contends that the Administrative Law Judge correctly refused to apply the new regulation retroactively for two reasons: the old regulation was rational, having been upheld by the Court in Matter of Pohatcong Investors v. Commissioner of Taxation & Fin. (156 AD2d 791, 549 NYS2d 211), and the new regulation represented a change to a long-standing policy.

As for the abatement of penalties, the Division argues that petitioner made no attempt whatsoever to ascertain its correct tax liability prior to the audit for the year in issue and did not advance its present position that options are investment capital until after the audit. Thus, at the time of filing the return, there was no reasonable cause for not paying the correct amount.

Tax Law § 210(1) provides that the corporation franchise tax is to be computed by whichever of the four alternative methods results in the greatest tax. The method at issue here consists of a tax of 9% on the taxpayer's entire net income base. Tax Law § 210(1)(a) provides, in relevant part, that:

> "[t]he taxpayer's entire net income base shall mean the portion of the taxpayer's entire net income allocated within the state as hereinafter provided . . . ."

For purposes of allocation, entire net income is classified as business income or investment income each of which is multiplied by a business allocation percentage or an investment allocation percentage, as appropriate (Tax Law § 210[a], [b]).

Tax Law § 208 (former [6]) defines "investment income" to mean "income, including capital gains in excess of capital losses, from investment capital, to the extent included in computing entire net income . . . ." Business income is defined by Tax Law § 208(8) to mean entire net income minus investment income. Investment income is thus dependent upon the amount of the taxpayer's investment capital which is defined by Tax Law § 208(5) as "investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business . . . ." The issue in this case thus becomes whether the stock options constituted "other securities" so that the income from their sale should be included in investment income or business income. Specifically, the question is

whether the new regulations, which include stock options as other securities, should be applied retroactively or whether the old regulations may be interpreted to have already included stock options within the definition of other securities.

The prior corporate tax regulations at 20 NYCRR former 3-4.2(c) defined "other securities" as follows:

> "The other securities referred to . . . are limited to securities issued by governmental bodies and securities issued by corporations of a like nature as stocks and bonds, which are customarily sold in the open market or on a recognized exchange, designed as a means of investment, and issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises. Thus other securities include debentures, notes of a type commonly dealt in upon securities exchanges or markets or commonly dealt in as a medium for investment, and certificates of indebtedness which have many of the essential characteristics of bonds, and certificates of interest and other instruments evidencing proprietary rights in corporate enterprises which have many of the essential characteristics of stock. They do not include corporate obligations not commonly known as securities, such as real property bonds and mortgages, chattel bonds and mortgages, contracts of sales, purchase money obligations, short-term notes acquired in the ordinary course of trade or business for services rendered or for sales of property which is primarily held for sale to customers, bills of lading, bills of exchange, bankers' acceptances and other commercial instruments."

The current regulation, 20 NYCRR 3-3.2, specifically includes stock options within the definition of "other securities":

> "(a)(1) The term investment capital means the taxpayer's investments in stocks, bonds and other securities issued by a corporation [exception not relevant to this matter omitted] . . . .
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> * * *
>
> "(c) For purposes of paragraph (1) of subdivision (a) of this section, the phrase stocks, bonds and other securities means:
>
> > "(1) stocks and similar corporate equity instruments, such as business trust certificates, and units in a publicly traded partnership included in the definition of 'corporation' contained in section 208.1 of the Tax Law;
> >
> > "(2) debt instruments issued by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing;

> "(3) qualifying corporate debt instruments . . . ;
>
> "(4) options on any item described in paragraph (1), (2), or (3) of this subdivision [exception not relevant to this matter omitted], or on a stock or bond index, or on a futures contract on such an index, unless the options are purchased primarily to diminish the taxpayer's risk of loss from holding one or more positions in assets which constitute business or subsidiary capital; and
>
> "(5) stock rights and stock warrants not in the possession of the issuer thereof" (third emphasis added).

In order to decide upon the retroactive application of the amended regulation, it is necessary to analyze the interpretation and applicability of the original regulation. Therefore, the first issue to be discussed will be whether the former regulatory definition of "other securities" included stock options. We affirm the Administrative Law Judge on this issue.

This Tribunal as well as the Appellate Division, Third Department, in Pohatcong Investors has already ruled that income derived from the sale of stock options is business income rather than investment income under the former regulations. While it is true as pointed out by petitioner that the facts in Pohatcong were slightly different from the facts in the instant case, the differences are not critical. In Pohatcong, the petitioner was the creator and seller of the options, not the purchaser. However, this fact was significant only in the analysis of the second requirement under the old regulations, that is, whether the options were designed as a means of investment. The Court decided that in the hands of the creator of the options they were not a means of investment as they would be in the hands of a purchaser "or holder of the option contract who truly has an investment" (Matter of Pohatcong Investors v. Commissioner of Taxation & Fin., supra, 549 NYS2d 211, 213). On the other hand, in discussing the fourth requirement of the former regulations, the difference between the creator and the purchaser of the options did not enter into the analysis. The Court held that:

> "it is apparent that options contracts, like commodities futures contracts, are contracts to buy or sell at a future date that do not provide a distribution of rights or obligations in the enterprise. The Tribunal's interpretation of 20 NYCRR 3-4.2(c) to mean that the instrument must provide a distribution of rights or obligations in the issuing corporation is not irrational and must be upheld . . ." (Matter of Pohatcong Investors v. Commissioner of Taxation & Fin., supra, 549

NYS2d 211, 213).

Petitioner has not shown that the options in issue in this matter were different from the options in issue in Pohatcong; it has only shown that their function as an investment was different in Pohatcong from their function here. However, that has not been an issue in this case, inasmuch as the Division has conceded this. Petitioner has also complained about the Administrative Law Judge's description of the stock options as "only executory contracts." It must be pointed out that this language was quoted directly from this Tribunal's decision in Pohatcong and we see no reason not to apply the description to these options as well. Another point addressed by petitioner concerning the Administrative Law Judge's language in the determination below involved his discussion of the differences between stock and stock options. It is clear that he was addressing these differences for the sole purpose of showing that stock options do not provide a distribution of rights or obligations in the corporate enterprise. He was not trying to say that the stock options also ran afoul of the first requirement of the former regulation, which states that the instruments must be "of a like nature as stocks and bonds . . ." (20 NYCRR former 3-4.2[c]). For the sole purpose for which it was intended, we agree with the Administrative Law Judge that stocks and stock options are very different instruments.

We now turn to the question of the retroactive application of the new regulations. We affirm the Administrative Law Judge on this issue. Petitioner has presented many valid arguments and cited to a variety of cases dealing with the effect to be given regulations vis-a-vis the statutes they relate to. It is true that, in most cases, the regulations will be given retroactive effect to the date of the underlying statute, and specifically, "regulations interpreting tax statutes are retroactive to the effective date of the statute to which they relate unless the taxing authority limits such retroactive limitation . . ." (Matter of Varrington Corp. v. City of New York Department of Finance, 201 AD2d 282, 607 NYS2d 630, 631, confirmed 85 NY2d 28, 623 NYS2d 534). However, in this case there are two elements which require a departure from this rule. First, the taxing authority did limit the retroactive impact of the regulation by specifically making it prospective, both in the Notice of Adoption in the New York State Register dated

December 6, 1989, and in a special memorandum dated July 13, 1990 (TSB-M-90[4]C). Second, the statute involved in this case, on at least two occasions, has been held to be "patently ambiguous" (Matter of Mobil Intl. Fin. Corp. v. New York State Tax Commn., 117 AD2d 103, 501 NYS2d 947; Matter of Howard Johnson Co. v. State Tax Commn., 105 AD2d 948, 481 NYS2d 909, revd on other grounds 65 NY2d 726, 492 NYS2d 11). Thus, the statute could be given several different, even conflicting, meanings and that is exactly the situation which has developed here. The original interpretation given to the term "other securities" was that it did not include stock options. As discussed above, this interpretation has been upheld as valid, both by the Tribunal and the Court. Until 1990, then, this was the validated policy of the Division. Petitioner has pointed to no authority, and we have not been able to find any, which requires the Division to set forth all of its policies in a specific published format. Nor has petitioner demonstrated that the Division applied this same policy in different ways to different taxpayers. Suffice it to say, therefore, that it was the policy of the Division, until 1990, to treat income from stock options as business income. In 1990, the Division decided to change its interpretation of the statute by promulgating a new regulation which treats income from stock options as investment income. Neither party to this proceeding would argue that this new regulation presents an invalid interpretation of the statute. Accordingly, we have a new and completely opposite interpretation of a patently ambiguous statute where both old and new interpretations are equally valid. This is clearly the type of situation which this Tribunal has held should not be given retroactive application in Matter of Varrington Corp. (supra).

Thus, two of the reasons for not giving the new regulation retroactive application are present in this case: first, the taxing authority limited such retroactive application (see, Matter of Varrington Corp. v. City of New York Department of Finance, supra) and, second, there has been a distinct reversal of policy by the taxing authority. While such reversal of policy did not prejudice petitioner, there may well have been any number of taxpayers who had higher investment allocation percentages than business allocation percentages to whom a retroactive application of the reversal in policy would have been grossly unfair, if not illegal. Thus, we

find that the Division acted properly in giving the new regulation a prospective application only.

Petitioner has raised for the first time on exception the issue of whether penalties should be abated. This is both a factual and legal issue and since it was not addressed at the proceeding below, there were very few facts presented bearing on this issue. The chief reason offered by petitioner for abatement of penalties is that reasonable minds could differ on whether stock options were to be classified as business income or investment income. However, 20 NYCRR 107.6, which sets forth the definition of reasonable cause, requires that reasonable cause be shown for the failure to act on the date provided by the law. In this case, that would mean the date when the tax returns were due to be filed. While petitioner's argument concerning the ambiguity of stock options might have some merit under the proper circumstances, the few facts presented in this case demonstrate that this was never a reason for not filing returns and not paying tax at the time prescribed by the statute. The stock options theory was never even raised as a viable argument until after the conciliation conference, long after the returns were due. There has been no evidence presented as to why petitioner did not file the returns at the time they were due and there is no evidence as to what steps petitioner took to inform itself about whether it had any liability. Later, long after the fact, petitioner arrived at some viable arguments, but there is no evidence that these reasons were the cause of the failure to act. We, therefore, find that petitioner has failed to show reasonable cause for the abatement of the penalties imposed.

Motion for Reargument

Petitioner has made a motion for reargument before the Tax Appeals Tribunal even though it has thoroughly briefed the issues on appeal and argued its position before this Tribunal on March 14, 1996.

Petitioner contends that oral argument plays a unique role in the appellate decision-making process that cannot be replicated by a mere reading of the transcript. We agree, and petitioner has been afforded the privilege of arguing herein, an opportunity of which petitioner took full advantage. Petitioner's representative answered five questions from the Tribunal and

responded to all of the Division's oral points in the three minutes reserved by him for rebuttal.

Petitioner argues that the substantive issue of retroactivity in this case, purported to be of first impression by petitioner, will only be fully considered if reargument is granted. We disagree. Petitioner filed a 40-page brief and a 14-page reply to the 18-page brief filed by the Division with the Tribunal. The oral argument was recorded in 31 pages. In addition, petitioner felt the need to submit further written argument concerning proposed Treasury regulations and this was granted, even though it was well beyond the time allotted for doing so.

Petitioner has been afforded and taken advantage of every opportunity to present its case. Petitioner's contention that its case is important and needs the full attention of this Tribunal to reach a fair decision is a point with which we agree, but we believe granting reargument in this matter will serve no further usefulness.

As further support for our decision, we rely upon the regulation at 20 NYCRR 3000.17(d)(3), which states that:

> "[a] commissioner who is not present at oral argument but who is otherwise authorized to participate in a decision may participate in rendering such decision after reading the transcript of the oral argument."

Therefore, the two members of the Tribunal appointed after oral argument, after reading the entire record in this matter, together with the briefs filed with the Tribunal, the additional correspondence concerning the proposed Treasury regulations and the transcript of the oral argument, are fully and adequately prepared to decide the issues presented in this matter as equally as the third member who participated in the oral argument.

Ultimately, the decision to grant oral argument is always in the discretion of the Tribunal (20 NYCRR 3000.17[d][2]) and we have determined that reargument will not serve any useful purpose nor make the issues and contentions any clearer. Additional argument would only add further delay to the issuance of this case.

Additional Argument submitted on January 15, 1997

On January 15, 1997, petitioner submitted a letter to the Secretary of the Tax Appeals

Tribunal which sought to point out additional support for its position. This submission was accepted by the Secretary to the Tax Appeals Tribunal, who afforded the Division an opportunity to respond. The Division responded by letter dated March 6, 1997. Petitioner's unsolicited and unauthorized reply to the Division's letter, dated March 17, 1997, was returned to petitioner by the Secretary on March 21, 1997.

Petitioner contends that its position is strengthened by recently proposed regulations of the United States Department of the Treasury, amending Treasury Regulations §§ 1.354-1(e), 1.355-1(b) and 1.356-3(b), which recognize that stock options are a form of investment in a corporation, thus, lending support to its position that the term "other securities" was meant to include stock options.

The Division responds that the proposed regulations are largely irrelevant to this matter and, to the extent that they are relevant, they support the Division's position. The Division argues that the Treasury's explanation of the changes states that the rules have no effect on other Internal Revenue Code ("IRC") provisions governing the treatment of stock options for other purposes. The Division also contends that there is no basis for resorting to a comparison to the Federal proposed regulations when there were corporate franchise tax regulations on point for the years in issue. Finally, the Division argues that the proposed Treasury regulations cited above support its argument, i.e., it is reasonable not to include stock options within the scope of the terms stock or securities for purposes of Article 9-A.

We agree with the Division. A careful analysis of the proposed Treasury regulations do not add support to petitioner's argument that the stock options herein should have been included in investment capital.

The proposed amendments to the Income Tax Regulations under sections 354, 355 and 356 of the IRC of 1986, relating to exchanges of stock and securities in certain reorganizations, address the receipt, as part of a reorganization, of rights to acquire stock of a corporation that is a party to the reorganization. Current regulations under sections 354 and 355 provide that stock rights and stock warrants are not included in the term "stock or other securities." The proposed

regulations treat rights to acquire stock issued by a corporation that is a party to a reorganization as securities of the corporation. The proposed regulations treat rights to acquire stock as securities having no principal amount, resulting in the taxpayer not recognizing any gain under section 356 upon the receipt of a stock right.

As the Division noted, the proposed Treasury regulations are less persuasive than the Division's own regulations which include stock options in the definition of other securities (20 NYCRR 3-3.2[c][4]). However, since we have refused to retroactively apply the new Division regulation, petitioner's contention that the proposed Treasury regulations strengthen its position is not persuasive.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Dominion Textile, (USA) Inc., as successor to Joric Corp. is denied;

2. The exception of the Division of Taxation is granted;

3. The motion for reargument made by Dominion Textile, (USA) Inc., as successor to Joric Corp. is denied;

4. The determination of the Administrative Law Judge is affirmed;

5. The petition of Dominion Textile, (USA) Inc., as successor to Joric Corp. is denied; and

6. The Notice of Deficiency, dated June 12, 1992, is sustained.

DATED: Troy, New York
April 10, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner