STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
WARREN R. and ROSEMARY B. HAAS	:	DECISION DTA No. 812971
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1988.	:	

Petitioners Warren R. and Rosemary B. Haas, 38 Pocono Road, Denville, New Jersey 07834-2922 and the Division of Taxation filed exceptions to the determination of the Administrative Law Judge issued on February 1, 1996. Petitioners appeared by Lipman & Biltekoff, LLP (Allan R. Lipman, Esq., of counsel) and Litwin & Holsinger (Gerald H. Litwin, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Kenneth J. Schultz, Esq., of counsel).

Both parties filed briefs on exception, in opposition to the other party's exception and reply briefs. The parties' requests for oral argument were denied.

Commissioner DeWitt delivered the decision of the Tax Appeals Tribunal. Commissioners Jenkins and Pinto concur.

ISSUES

I. Whether payment made to petitioners pursuant to a covenant not to compete is income derived from or connected with New York sources.

II. Whether petitioners' motion to vacate the Notice of Deficiency issued to them should be granted.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioners submitted 31 Proposed Findings of Fact. Those facts to which the Division of Taxation ("Division") did not object and those requiring a minor clarification are incorporated below as proposed (Proposed Findings 1-4, 8, 9, and 17-19).

Those Proposed Findings which the Division agreed were reflected by the record, but not relevant to the issues of the case are included below to supplement the facts of the case. Such findings provide a broaderexplanation of the factual setting in which the issues arose (Proposed Findings 5-7, 10-12, and 22).

With respect to Proposed Findings to which the Division objected primarily on the basis of violation of the parol evidence rule, a discussion of the rule is set forth in the Conclusions of Law. Proposed Findings 13-16, established by the record, do not violate the parol evidence rule. Regarding Proposed Findings of Fact 20-21 and 23-31, and the Division's objections thereto, a discussion of the principles of the parol evidence rule and application to this matter is contained in the Conclusions of Law.

The Division submitted 8 Proposed Findings of Fact. Petitioner objected to 6 of the 8 on the basis that, while established by the record, such facts are not relevant to, or dispositive of the issues. All of the Division's Proposed Findings are set forth below, either separately or incorporated into other related facts. Such findings provide a broader view of the facts of this matter and are based upon evidence in the record.

Additional Findings of Fact set forth by the Administrative Law Judge are also incorporated below to complete the record. Other findings have been modified in form only.

The Division issued to petitioners[1] a Notice of Deficiency dated March 19, 1993, asserting additional tax due under Article 22 for the tax year 1988 in the amount of $154,031.59, plus interest in the amount of $60,333.45, for a total amount due of $214,365.04.

Preceding the issuance of the Notice of Deficiency, the Division notified petitioners of its

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[1]Rosemary Haas is a petitioner only by reason of having filed a joint return with Mr. Haas. Therefore, references to "petitioner" will refer to Mr. Haas.

findings in a Statement of Personal Income Tax Audit Changes pertaining to this matter dated November 16, 1992. The following explanation was provided:

> "It has been determined through audit that the Covenant Not to Compete amount of $1,880,000 paid to Warren R. Haas by Merrill Lynch Specialists Inc. as shown on the 1988 IT-203 Return is taxable to New York State."

A Consent Extending the Period of Limitation for Assessment of Personal Income Taxes under Article 22 was executed by petitioner and the Division on December 13 and 23, 1991, respectively, for the purpose of extending the period of assessment for the 1988 year to April 15, 1993.

Petitioner, Warren Haas, was born on July 2, 1927 in New York City. His family moved to New Jersey in 1938. He resided in Mountain Lakes, New Jersey from 1938 to 1962 and was active in that community as Scoutmaster, Fire Chief, Police Commissioner, Civil Air Patrol and fund raising drives. During the tax year in issue, and currently, Mr. Haas resides in Denville, New Jersey.

Mr. Haas entered the Marine Corps in 1945. In 1947, he left the regular Marine Corps to join the Reserves. In 1950, he was recalled for the Korean War and spent two years on active duty overseas. Petitioner returned to civilian life in 1951.

While serving in the Marine Corps, Mr. Haas met a Mr. Tompane. Mr. Tompane suggested that Mr. Haas work with him on the New York Stock Exchange. During their military career, the two gentlemen later joined the same Marine Reserve unit and Mr. Tompane further encouraged Mr. Haas to come to the Stock Exchange.

In 1947, at age 20, Mr. Haas went to work for Mr. Tompane as a specialist clerk on the trading floor of the New York Stock Exchange. As a specialist clerk, Mr. Haas recorded numerous entries of buy and sell orders. He executed orders, reported orders and performed many administrative chores on the floor of the stock exchange until October 1958, when he was 31 years old. At that time, Mr. Tompane gave Mr. Haas sufficient funds to become a member of the New York Stock Exchange and partner in Mr. Tompane's brokerage firm with a 2% interest. Except for two years of active duty with the Marine Corps in Korea, Mr. Haas worked

continuously in New York City from October 6, 1947 to May 31, 1990.

As a member of the exchange, or as a specialist broker, his position differed in that a specialist clerk is behind the counter whereas a specialist broker stands out in front of the counter on the block of the exchange and makes trades with other brokers. Every security listed is assigned to a location in the exchange. A broker stands at the specific location on the stock exchange floor, with a specialist clerk standing behind him, and he executes orders in a specialty stock assigned by the stock exchange.

After Mr. Haas had been a partner for 16 or 17 years, Mr. Tompane decided to leave the firm. In 1974 or 1975, he made Mr. Haas the senior partner of the firm. At that time, the firm had 25 or 30 securities with respect to which it was registered as the sole specialist. This included the Allen Group, Williams Company, Sterling Drug, United States Steel, Royal Dutch Petroleum and other stocks, and Mr. Haas developed expertise in these stocks and was responsible to make a market in the stocks on behalf of the brokerage firm. Mr. Haas's prime expertise was with Williams Brothers, the Allen Group, United States Steel and three or four stocks issued by United States Steel.

The purpose of the New York Stock Exchange is to provide an auction market where buyers and sellers meet and are exposed to the best possible market. The New York Stock Exchange is a city block square with about 3,500 people working in one room. There are about 1,800 securities that are listed and each security listed is assigned to a specialist. There is only one specialist firm that is assigned to a given security. There were no other specialists on the New York Stock Exchange that dealt in the stock in which Mr. Haas traded. When Mr. Haas began working at the New York Stock Exchange, there were about 140 specialists. In 1990, there existed between 45 and 50 firms.

On October 19, 1987, also referred to as "Black Monday", the market suffered substantial losses. The previous Friday, October 16, 1987, was a very bad day on the New York Stock Exchange, with the market down 120 points. This represented a huge loss. The market seemed to go down without any apparent reason. It was anticipated that Monday was going to be a

good day because the market had gone down on Friday without any special reason, but on Monday the market plummeted 500 points. Despite the precipitously declining market, the specialists had to continue to buy and sell and "make a market". This was because the specialist has the privilege of being the market-maker. In a declining market, the specialist has to buy a certain number of shares at every eighth or quarter of a point and must do the same thing on the "upside". If there are no public orders, the specialist has to insert himself to stabilize the market. The basic function of the specialist is to execute orders for the brokers, while working to stabilize the market and minimize disparity between supply and demand.

On Black Monday, the stock market came down for reasons which were not apparent. During that day the specialists continued to trade stock to the best of their ability. Nevertheless, the Tompane firm lost $7 million that day.

Because of how the system worked, the Tompane firm was required to trade Black Monday and early the next morning on orders that were still coming into the stock exchange. These orders were entered from around the country during trading hours of 9:30 A.M. to 4:00 P.M. Because there was such a mass of orders, the stock exchange required the specialists to stay open and trade every stock that was entered between 9:30 A.M. and 4:00 P.M. according to the time of the order and the time on the floor of the stock exchange.

The specialist has the "book" where the 400 or 500 member firms come when they want to buy shares. They send their order via paper or they communicate electronically to the floor of the stock exchange to the specialist, and that order is protected when the stock sells at the price the customer wishes to buy or sell.

The "market" means that, when the order gets to the floor of the exchange and is a "buy" order, it is immediately executed against the lowest seller. The orders are handled by the specialist. If there is a void of public interest, either up or down, the specialist has to buy stock to stabilize the market. He does this with his own buying power, and this is developed by the partners' contributing capital to the partnership. The specialist has to "trade even though 50% of the time you don't want to trade".

The so-called "book" for many years was just a loose-leaf book and the specialist entered the orders according to the priority of the time received. When a stock sold down to that price the orders were executed in the order of the time entry in the book. With the new direct order turnaround system the orders were electronically entered in the specialist's book, which is now an electronic book. The orders come in electronically and the electronic book is at the specialist's station for the stock in which that specialist deals. The electronic book shows the best bid (meaning the best buyer) and the best offer (which is the best seller). The information is available on a screen located above the specialist's head on the floor of the stock exchange so that a broker walking in who represents a member firm can see what the best bid and offer is, how many shares are offered at the best bid and how many shares are offered at the best selling price.

The same information is displayed on the Philadelphia, Baltimore, Boston Exchange, the Midwest Exchange in Chicago and the Pacific Exchange. The Pacific Exchange consists of two trading floors; one in Los Angeles and one in San Francisco. The input on the screen is done electronically by specialists on all of the stock exchanges. When there is input on the screen from one of the other stock exchanges it is indicated by a symbol such as "M" for the Midwest stock exchange, "P" for the Pacific stock exchange, "B" for the Boston exchange, etc.

The Intermarket Trading System requires that the public on the New York Stock Exchange receives the best possible execution. If he is a buyer, the specialist meets the lowest seller through the electronic system or the specialist standing there, and the same thing happens with the seller.

If a specialist on the New York Stock Exchange is not bidding a "half" but is bidding "three-eighths", then he may have to execute the order based on the "half" from the Midwest exchange. He cannot sell down to "three-eighths". Therefore, it is very important to always watch what the other markets are doing as to the best bid and offer on the screen at that time because the specialist on the New York Stock Exchange has to execute the order given by the other stock exchanges if they do a better job.

Specialists on each of the other stock exchanges were in competition with Mr. Haas when he was a specialist on the New York Stock Exchange. This is because specialists on the other stock exchanges could execute orders on the New York Stock Exchange and top the bid of the specialists on the New York Stock Exchange. This meant that they could pay more than a specialist such as Mr. Haas was willing to pay or they could sell for less than Mr. Haas, as a specialist, was willing to sell. Most of the business on the other stock exchanges is done against the New York Stock Exchange because it is the largest market.

Prior to October 1987, brokerage firms could not be specialists because of the obvious competition with being a market-maker on the exchange and also being an upstairs broker or an insurance company. The stock exchange did not want to have brokerage firms that dealt with the public as specialists on the floor of the exchange. Prior to Black Monday, Merrill Lynch and other large brokerage firms could not directly or indirectly through subsidiaries have firms that were specialists on the New York Stock Exchange.

There was activity which attempted to change that rule, and in 1985 there was some indication that Merrill Lynch might be interested in purchasing Tompane if the rule was changed. There was some communication by Merrill Lynch to Mr. Haas on October 10, 1987 that the rule might be changed on October 23rd or 24th at the upcoming board meeting of the New York Stock Exchange. Some interest was shown by Mr. Haas.

After Black Monday, there was some renewed interest by Merrill Lynch to pursue such purchase. It became necessary for Mr. Haas's firm to obtain extra capital because all of the partners were former clerks and did not have the requisite funds. They needed to raise additional capital or be forced to sell out.

Meetings were held with Merrill Lynch and its attorneys and the attorney and accountant for the Tompane firm. A deal was negotiated, subject to permission from the New York Stock Exchange, which was obtained. The agreement was entered into as of October 23, 1987, and set forth the purchase price in Section 1.3. Mr. Haas provided testimony that Merrill Lynch explained to him very explicitly that Mr. Haas was going to work for Merrill Lynch and "that's

it", and other than in another capacity, that he could not go anywhere else as a specialist.

Portions of the October 23, 1987 Agreement between A.B. Tompane ("ABT"), its General and Limited Partners and Merrill Lynch Specialists Inc. ("MLSI") provide as follows:

> "1.1. Allocated and Assigned Securities. Five of the General Partners are registered with the NYSE as specialists in the equities and warrants set forth on Schedule 1.1(a) hereto (the 'ABT Specialist Book'), such securities (the 'Securities') having been allocated and assigned by the NYSE to ABT as a specialist unit, and each General Partner agrees to join MLSI. ABT and the General Partners agree to use their best efforts to have the NYSE allocate or assign the Securities to MLSI as a specialist unit.
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> "2.2. Use of and/or Lease of Membership. Warren R. Haas, Frank A. Delaney, John P. Moran, Roland J. Cadotte and Thomas M. Schwalenberg are each a member in good standing of the NYSE. So long as they remain employees of MLSI, each of the foregoing Partners agrees to remain a member in good standing of the NYSE and to use his membership solely and exclusively for the benefit of MLSI, or, at the request of MLSI, to enter into a Lease Agreement in the form attached hereto as Exhibit C to lease his membership at no cost to a designee of MLSI.
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> "5.1. Agreement Not to Compete. ABT and each of the General Partners severally agrees that for a period of five (5) years after the date of this Agreement, they will not engage, and will not permit any partnership of which any of the General Partners may be a partner or any corporation of which any of the General Partners may be an officer, director or owner of 5% or more of the voting securities to engage, or assist, directly or indirectly, financially or otherwise, any party other than MLSI to engage in the business of acting as a competing specialist or as a registered competitive market maker (except to the extent called upon under the NYSE rules to do so) on the NYSE in securities allocated to ABT or then allocated to MLSI. MLSI shall be entitled, if it so elects, to institute and prosecute proceedings in any court of competent jurisdiction, either at law or in equity, to obtain damages for any breach of this Section 5.1 and/or to seek immediate injunctive relief against ABT and/or the General Partners.
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> "7.11. Entire Agreement. This Agreement, together with the exhibits, schedules, lists, certificates, agreements and other instruments delivered pursuant to this Agreement, and any amendments hereafter executed and delivered in accordance with Section 7.2 of this Agreement, constitutes the entire agreement of ABT, the General Partners and MLSI, and supersedes any and all prior written or oral agreements or understandings between and among ABT, the General Partners and MLSI, pertaining to the matters contemplated under this Agreement, including, without limitation, the letter from MLSI to ABT dated October 21, 1987."

Mr. Haas and his partners agreed that they would not compete in any way, shape or form

with any partnership, directly or indirectly, with Merrill Lynch in any of the stocks that the firm had when the agreement was signed or stocks which Merrill Lynch Specialists would subsequently add to their portfolio of specialty stocks. It was Mr. Haas's understanding that the covenant not to compete prohibited him from being a specialist on any of the stock exchanges that participated in the Intermarket Trading System. To Mr. Haas it meant that for five years he could not be a specialist, broker, dealer, partner or a capital partner of any member firm that had anything to do with being the corporation's broker or banker of any of the stock that the firm had or whatever Merrill Lynch would acquire in the next five years.

Merrill Lynch told Mr. Haas that it thought it would be a specialist in a hundred or more companies. As a result, it believed ABT was too small, and it inquired about other firms.

Petitioner provided testimony that the noncompetition agreement restricted him from going to another of the five stock exchanges if he went with a specialist firm on that exchange who was a specialist in one or more of the stocks in which Merrill Lynch was a specialist. If the specialist on the other stock exchange was not a specialist in any one of the 20 some odd stocks in which Merrill Lynch was a specialist at the time Mr. Haas could join that firm, but subsequently, if Merrill Lynch and the Midwest specialist became specialists in the same stock, Mr. Haas would have to leave that firm because he would have money or capital or be a participant in violation of the agreement. In a sense, Mr. Haas would be competing by being a general or even a limited partner of another firm (that subsequent to that date, based on the anticipated growth of new listings and/or Merrill Lynch's acquiring other specialist units, which they did, and well over 100 stocks) and he would be "knocked out".

Petitioner's belief was that he could not compete by working with Chase Bank or being in its trading department. He could not compete by initiating orders on his own (not directly with the public) or by taking a position in any of the stocks. In Mr. Haas's opinion, he was paid just to stay home and he did so. He did not initially stay at home, but stayed home until Merrill Lynch suggested he was too old to work.

Along these same lines, Mr. Haas further explained that if a person sends an order to the

Pacific Exchange, it is electronically routed to the floor of either the Los Angeles Exchange or the San Francisco Exchange. Although petitioner and his wife loved San Francisco and had friends there, Mr. Haas believed he could only go there if he retired. In other words, he was prevented from going there prior to October 24, 1992 as, for example, a stockbroker. He believed himself to be out of the job market except to be a specialist.

For clarification, Mr. Haas explained that a "specialist" has to try to guess what the management of U.S. Steel (or any other company) could do to make more money because a specialist has to anticipate buying stock. The specialist must prognosticate whether the stock will go up based on management decision or product quality. Mr. Haas testified that "it's a learning experience. . .very few people. . .last 43 years. . . . It's an extremely tough job. . . . If you don't learn you are not going to make any money if you don't watch anything." (Tr., p. 66.)

In 1987 and 1988, Mr. Haas had opportunities to work on other stock exchanges but he believed the covenant prevented him from doing so. Mr. Haas could have gone to the Midwest Exchange, the largest market-maker of listed stock on the New York Stock Exchange. Mr. Haas could have gone to Philadelphia since it wanted someone to make a market in U.S. Steel.

In response to questioning by the Administrative Law Judge, Mr. Haas explained that he could not have left Merrill Lynch and gone into business for himself working for member firms as a specialist on the floor because if those firms ever did anything that Merrill Lynch engaged in over the years and Mr. Haas invested capital, it might be used to compete with Merrill Lynch. For example, Solomon competes with Merrill Lynch every day to try to become underwriters, and that is direct competition. Mr. Haas could work as an employee, but Mr. Haas could not be a specialist or member of the Exchange. He could have obtained a job in the business but not in any way that related to the name of any security in which Merrill Lynch was a specialist for five years.

In a less than common occurrence, Mr. Haas had a partner who decided to leave his firm and compete with the firm as a market-maker specialist in four stocks in which the firm was a specialist. This person had a specialist's book, a long loose-leaf notebook and access to the

screens. He could see what other specialists were doing on the other stock exchanges. He would attempt to entice other brokers to give him the order and maybe do it for less commission.

Mr. Haas recalled a similar occurrence happening 5 times in his 43 years of experience, where an individual thought that he could make more money by not splitting with other partners. He could pick the stock that he wanted but could not get further than four feet away from the specialist's location. If the person was resourceful enough, he could compete. Mr. Haas's firm could have been resourceful enough when the partner left to compete against the firm to require him to agree not to do so by signing a covenant. This is an example where there are other specialists that can operate in the same exchange in the same stock. They have to have the capital and the administrative ability to do it and they have to stand right at the place where the specialist who deals in the stock is located. He would also have to have a partner to give him relief. Mr. Haas indicated that although the constitution governing the trading system allowed such competition, it virtually never takes place because it is administratively and financially impossible. The concept of such competition exists to afford specialists protection from a charge of monopoly.

When Mr. Haas was terminated by Merrill Lynch, he had to go home. He could not work on Wall Street except as a clerk. He had opportunities in San Francisco and could have teamed up with very capable people there, but believed that he could not do so until after the covenant expired in October 1992.

Petitioner filed a New York State Nonresident and Part-Year Resident Income Tax Return, Form IT-203, for each of the 1988 and 1989 calendar years, both of which were submitted into evidence. In both tax years, Mr. Haas's W-2's were issued by Merrill Lynch Specialists, Inc., the company which purchased Mr. Haas's former firm, A.B. Tompane & Co. For 1988 and 1989, respectively, petitioner reported wage income in the amounts of $399,173.00 and $217,015.00, and allocated 100% of such wage income to New York State.

The 1988 return indicated that income received from a "covenant not to compete by

Merrill Lynch" in the amount of $1,880,000.00 was reported on petitioner's Federal return. No portion of that amount was reported in the New York column which depicted petitioner's nonresident income taxable to New York.

Petitioner filed a State of New Jersey Income Tax Resident Return for the tax year 1988, on which he included in "other income" the covenant not to compete by Merrill Lynch in the amount of $1,880,000.00. New Jersey State tax was accordingly paid on such income.

OPINION

Tax Law § 631(a) provides that the New York source income of a nonresident individual shall be the sum of the net amount of items of income, gain, loss and deduction included in the individual's Federal adjusted gross income which are "derived from or connected with New York sources." Relevant to this proceeding, items of income, gain, loss and deduction "derived from or connected with New York sources" are those items which are either: (a) attributable to a business, trade, profession or occupation carried on in New York; or (b) income from intangible personal property "only to the extent that such income is from property employed in a business, trade, profession or occupation carried on" in New York (Tax Law §§ 631[b][1][B] and 631[b][2]).

In her determination, the Administrative Law Judge concluded that the income at issue qualified as New York source income pursuant to both Tax Law §§ 631(b)(1)(B) and 631(b)(2):

> "the activity upon which petitioner received the payment for the covenant not to compete was petitioner's occupation and profession as a registered specialist, also referred to as a competitive market maker, which was connected to New York State from the inception of his career, and certainly derived from the skills he possessed and employed in his position with ABT. The consideration given by petitioner was the agreement not to perform as a registered specialist in a manner which would compete with Merrill Lynch for a specified period. . . . Thus, the income from the covenant is derived from or connected with New York sources" (Determination, conclusion of law "C").

Further, the Administrative Law Judge concluded that the income arose from intangible personal property employed in a business, trade, profession or occupation carried on in New York:

> "[t]he covenant was certainly an asset of Merrill Lynch's business, particularly the segment which replaced ABT as the registered specialists in certain stocks. In fact, the protection afforded by the covenant gave Merrill Lynch the 'standing' to be the competitive market makers in such stocks. I cannot draw a conclusion other than that the covenant was employed, used and relied upon by Merrill Lynch in its business as registered specialists on the NYSE. Accordingly, the income received from the covenant is properly subject to taxation by New York" (Determination, conclusion of law "D").

The Administrative Law Judge contrasted the situation of petitioner with that of the taxpayer in Matter of McSpadden (Tax Appeals Tribunal, September 15, 1994). She concluded that:

> "[in McSpadden] [t]he Administrative Law Judge held that petitioner possessed a right to future employment secured by his mere promise to work in the future, and that the lump-sum payment was consideration received in exchange for petitioner's surrender of an item of intangible personal property, i.e., the remaining term value of petitioner's employment contract. Since petitioner's rights under the employment agreement were originally secured by consideration having no connection to New York, i.e., petitioner's promise to work for the company in the future, the lump-sum payment was determined to be nontaxable. In its affirming decision, citing Donahue v. Chu (104 AD2d 523, 479 NYS2d 889) the Tax Appeals Tribunal concluded that the consideration for the relinquishment of petitioner's right to future employment, which may or may not have taken place in New York, was not subject to New York taxation. . . . Critically unlike McSpadden, what he [Haas] gave up was not a contractual right or entitlement" (Determination, conclusion of law "B").

In his exception, petitioner argues that the Administrative Law Judge incorrectly distinguished the McSpadden case on the basis of whether the payment pursuant to the covenant not to compete was due to the relinquishment of a contractual or non-contractual right. Petitioner argued that the Administrative Law Judge failed to conclude that the geographic scope of the covenant not to compete was relevant. He further argued that the Administrative Law Judge erroneously concluded that the covenant not to compete was an intangible asset employed in a business, trade, profession or occupation in New York and, therefore, income from the covenant was properly taxable to petitioner. Rather, petitioner argues that there is no authority in either the New York Tax Law or its regulations to include in petitioner's New York taxable income the payments received pursuant to the covenant not to compete.

In opposition to petitioner's exception, the Division argues that the Administrative Law

Judge correctly determined that the payment made by MLSI to petitioner was properly sourced to New York as an item of income attributable to a business, trade, profession or occupation carried on in New York State. In its exception, the Division argues that the Administrative Law Judge erroneously failed to find that, based on Korfund Co. v. Commissioner (1 TC 1180), the income at issue was derived from or connected with New York sources; the Administrative Law Judge should not have accepted the testimony of petitioner concerning the scope of the October 23, 1987 Agreement because of the parol evidence rule; and she erroneously concluded that a payment from a covenant not to compete was income from intangible personal property rather than compensation for personal services.

A. Income attributable to a business, trade, profession or occupation carried on in New York.

In determining whether income is derived from or connected with New York sources within the meaning of the statute, this Tribunal has stated:

> "it is necessary to identify the activity upon which the income was secured or earned . . . [and that] in making this determination, the consideration given by petitioner in exchange for the right to the income at issue is the controlling factor" (Matter of Laurino, Tax Appeals Tribunal, May 20, 1993, emphasis added).

Therefore, it is necessary to examine what petitioner gave up in exchange for the right to the income at issue. In this regard, the Administrative Law Judge concluded that:

> "[t]he payment for the covenant not to compete was consideration received in exchange for petitioner's surrender of his right to pursue employment in his chosen field" (Determination, conclusion of law "B").

While we agree with this conclusion, we do not agree with the Administrative Law Judge's conclusion that MLSI paid petitioner because of the skills he possessed and employed in his position with ABT as a registered specialist. While it was undoubtedly the skill and reputation petitioner had acquired over his more than 40-year career that induced MLSI to enter into a covenant not to compete with him, his possession of this skill was not the reason that MLSI made payment to him. The payment was made to petitioner in exchange for his promise not to use his skill for a specified period of time in the future to compete with MLSI. This sum

was not owed to petitioner by his former employer, ABT, as a result of services performed nor was it a retirement benefit based on past service. To hold petitioner subject to tax on his future earnings because he acquired his skill in New York would also require that the income of all similarly situated non-residents be taxed on that basis. There is no support in the Tax Law for such a broad-based concept.

We also disagree with the Administrative Law Judge's analysis of Matter of McSpadden (supra). When petitioner entered into the covenant not to compete with MLSI, he obtained a contractual right to payment which was essentially no different from the right to the lump sum payment afforded to the taxpayer in McSpadden. The difference which the Administrative Law Judge found significant between McSpadden and petitioner is the nature of and consideration given to acquire the right which was surrendered in each case; i.e., whether the right surrendered was contractual or non-contractual and whether the consideration given to obtain that right had a connection to New York. We do not believe that there is any statutory or regulatory basis for these distinctions nor do our previous decisions make such distinctions pertinent.

Further, it must be remembered that in McSpadden, the taxpayer's promise to work in the future and the consideration given to the taxpayer in exchange for that right were the subject of the original employment agreement. When that agreement was terminated and replaced by a new agreement, valuable consideration was given not for the promise to work in the future but for the surrender of the right to be employed in the future. It was the consideration for the termination agreement, not for the original employment agreement, that was at issue in McSpadden.

In the present case, there was no prior employment relationship between petitioner and MLSI. Therefore, it was impossible for petitioner to have surrendered a non-existent contractual right to future employment. However, our decisions in Laurino and McSpadden do not stand for the proposition that income received as a result of a covenant not to compete is only excluded from New York income when it results from the termination of an employment

relationship. If, as this Tribunal concluded, consideration paid to the taxpayer in McSpadden in exchange for his right to work in the future for a New York employer in New York State had no connection to New York, then we fail to see how consideration paid to petitioner in the instant case in exchange for his right to compete in any capacity in the future with MLSI as a specialist on the NYSE can be sourced to New York.

The Division argues that the Administrative Law Judge erroneously accepted the testimony of petitioner concerning the scope of the October 23, 1987 Agreement because the parol evidence rule precluded such testimony. The Division argues that the testimony of petitioner served to create an ambiguity in the Agreement under the guise of explaining such an ambiguity. The Administrative Law Judge found that there was a significant ambiguity concerning the specific trade terms utilized in the Agreement, the understanding between the parties and the complex business environment in which the Agreement arose. Therefore, she allowed petitioner to explain this ambiguity through his testimony. Based on his testimony, she concluded that in order to actually compete with MLSI, petitioner would be acting as a registered specialist on one of the other five regional exchanges. However, she found that there was no basis to assume that a position competitive with MLSI would be located in New York.

We agree with the conclusion of the Administrative Law Judge that there was an ambiguity in the Agreement concerning the scope of the restriction on petitioner's future activities. However, we do not agree with the Administrative Law Judge's conclusion that there was no basis to assume that a position competitive with MLSI would be located in New York. In fact, petitioner testified to a situation wherein a former member of his firm unsuccessfully attempted to compete with that firm on the NYSE. When the Administrative Law Judge asked petitioner whether this competitor could have successfully competed if he had been more resourceful, petitioner replied: "Yes. But we should have been resourceful enough when he left to tell him not to compete" (Tr., p. 83). It was just such resourcefulness that MLSI exhibited when it entered into the covenant not to compete with petitioner. Therefore, we conclude that the record indicates that if petitioner were to compete with MLSI on the NYSE, he might have

competed in New York, as well as on other regional markets.

The Division argues that Korfund Co. v. Commissioner (supra) requires that we consider the source of this income to be New York because petitioner had a right to compete with MLSI in New York and that is where he gave up that right. In Korfund, the Tax Court considered whether the taxpayer, a New York corporation, was liable for withholding tax on amounts paid to certain nonresident aliens pursuant to an agreement not to compete with the taxpayer. The Tax Court found that the rights of the nonresident aliens to do business in the United States were interests in property in this country. Since the situs of their right to income from this property was in the United States, the income derived from foregoing the use of these rights for a specified period of time was earned and produced in the United States and subject to withholding taxes.

We do not find Korfund to be dispositive of the issues in the present case. The Legislature has specified what it considers to be income derived from or connected with New York sources in Tax Law § 631. There is no indication that the Legislature intended that the provisions of the Internal Revenue Code concerning the source of income for nonresident aliens would apply to a determination of taxable income pursuant to Tax Law § 631. Section 861 of the Internal Revenue Code defines those items of gross income which are treated as income from sources within the United States. Such items of income include, among others, all items of interest and dividends of domestic corporations, rents and royalties from any interest in property within the United States and all social security benefits. In sum, the items included in source income from within the United States form a much broader category than those which are included in the income of a nonresident pursuant to Tax Law § 631 and have little applicability in determining the issue at hand.

In Cox v. Helvering (71 F2d 987), the Court compared payment under a covenant not to compete to earned income and stated: "If . . . [the taxpayer] sells his services for wages or salary, what he receives is income. If he refrains from exercising his skill and ability in a particular line for a definite period, what he receives in compensation in the common

understanding is just as much a gain and is income" (Cox v. Helvering, 71 F2d 987, 988). Therefore, we agree with the Division that the payment pursuant to the covenant not to compete is ordinary income to petitioner. However, to be taxable by New York, this income must be attributable to a business, trade, profession or occupation carried on in New York. If there was no covenant not to compete, we have concluded that petitioner might have exercised his skill and ability in competition with MLSI in New York. If such competing services were rendered in New York, tax on the earnings therefrom would have been payable to New York. However, the contractual payment was made for the observance of the covenant not to perform competing services in New York and elsewhere. Therefore, the taxpayer could only comply with the terms of the contract and be entitled to compensation pursuant to the agreement by refraining from performing competing services in New York and elsewhere. If petitioner did perform competing services in New York, he would have been in breach of his Agreement and not have earned the compensation which is now sought to be taxed. If he is taxed by the jurisdiction where he would have performed services but for the covenant, then he is being taxed on a business, trade, profession or occupation not carried on in New York, clearly a situation not embraced by Tax Law § 631(b)(1)(B) (see also, Milligan v. Commissioner, 38 F 3d 1094, 1098 n.6 [9th Cir 1994] "[n]oncompetition does not constitute the carrying on of a trade or business," quoting Barrett v. Commissioner, 58 T.C. 284, 289).

The Administrative Law Judge rejected the Division's position that pursuant to 20 NYCRR former 131.4(d) petitioner's payments received under a covenant not to compete were retirement benefits and compensation for personal services to the extent those services were performed in New York State. Former section 131.4(d) provides that when a nonresident receives a pension or other retirement benefit attributable to his former services in New York State, that benefit is not taxable for New York State income tax purposes if it constitutes an annuity. The regulation further provides that if the pension or retirement benefit does not constitute an annuity, then:

> "it is taxable for New York State personal income tax purposes to the extent that the services were performed in New York State. The term

> compensation for personal services as used in the foregoing sentence includes, but is not limited to . . . amounts received upon retirement under a covenant not to compete" (emphasis added).

Petitioner did not retire from his former employer and the funds at issue were not paid as part of a retirement package. As a result, we affirm the conclusion of the Administrative Law Judge on this issue.

As a result of the foregoing, we conclude that the payment received by petitioner pursuant to the covenant not to compete was not subject to New York State income tax pursuant to Tax Law § 631(b)(1)(B) because it was not "attributable to a business, trade, profession or occupation carried on in New York" by him.

B. Income from intangible personal property employed in a business, trade, profession or occupation carried on in New York.

We agree with the conclusion by the Administrative Law Judge that the covenant not to compete was an intangible asset of MLSI and that income which may have been received as a result of the employment of that covenant in a business, trade, profession or occupation carried on in New York is properly subject to taxation by New York. However, we do not agree that such income is taxable to petitioner. In Sonnleitner v. Commissioner (598 F2d 464), the Court held: "It is well settled that consideration paid for a bona fide covenant not to compete represents ordinary income to the seller . . . and an amortizable deduction to the buyer for the duration of the covenant" (Sonnleitner v. Commissioner, 598 F2d 464, 466). While the record does not contain any indication of how MLSI treated the covenant not to compete or whether or not it earned any income for MLSI, Federal case law supports the Administrative Law Judge's conclusion that, in the hands of MLSI, this covenant was a corporate asset. However, any income earned by the employment of this asset would be income to MLSI and not income to petitioner. This is readily evident in the instant situation since the amount of income at issue was paid to petitioner in a lump sum shortly after the execution of the Agreement and was not dependent on or attributable to any income being earned from the covenant not to compete.

The Appellate Division in Matter of Epstein v. State Tax Commn. (89 AD2d 256, 456

NYS2d 454) considered whether the income from certain intangible personal property (interest on the unpaid balance of a purchase money mortgage note resulting from the sale of New York real property) constituted New York taxable income to a nonresident. The Court stated that:

> "[c]learly, the property which the statute requires to be employed in a business, trade, profession, or occupation carried on in this State is the very same intangible personal property . . . from which the income is derived . . . . Moreover, we have previously construed the statutory reference to property in paragraph (2) of subdivision (b) of section 632 to refer to the taxpayer's property (Matter of Linsley v. Gallman, 38 AD2d 367, 369, 329 NYS2d 486, affd. 33 NY2d 863, 352 NYS2d 199, 307 NE2d 257)" (Matter of Epstein v. State Tax Commn., supra, 456 NYS2d 454, 456).

Thus, payment to petitioner pursuant to the covenant not to compete is not income from intangible personal property employed by petitioner in a business, trade, profession or occupation carried on in New York pursuant to Tax Law § 631(b)(2).

C. Motion to Vacate Assessment.

Subsequent to the filing of exceptions in this matter by both parties, petitioner, on January 13, 1997, filed a motion to vacate the assessment at issue herein with the Tax Appeals Tribunal (hereinafter "Tribunal") because this Tribunal failed to render its decision on petitioner's exception within the six-month period mandated by Tax Law § 2006 and 20 NYCRR 3000.17(e). Petitioner argues that the Tribunal's failure to comply with the deadline of December 23, 1996 was due to the failure of New York State to appoint two new commissioners to the Tribunal to fill vacancies created during 1996 which left the Tribunal unable to render decisions. Thus, petitioner argues that it would be unfair and unwarranted for the Tribunal not to vacate the assessment. Petitioner also raises several constitutional arguments concerning the underlying assessment which were not presented to either the Administrative Law Judge or to this Tribunal in his exception.

The Division, on February 12, 1997, filed its affidavit and supporting papers in opposition to this motion. The Division argues that this Tribunal should disregard the arguments of petitioner that do not relate to the subject of this motion but seek to introduce constitutional issues concerning the assessment. Further, as to the merits of the motion, the

Division argues that from August 3, 1996 until the confirmation of the appointment of two new commissioners on December 3, 1996, the Tribunal did not have a quorum enabling it to consider and issue decisions. Therefore, the six-month period for review of such decisions did not commence until December 3, 1996 and had not expired on December 23, 1996 as alleged by petitioner. Further, the time limit specified for the issuance of decisions is directory and not mandatory.

We deny petitioner's motion. Initially, we note that the parties hereto, having each filed exceptions to the determination of the Administrative Law Judge and having each been afforded ample time to present briefs on the issues before us for consideration, may not now raise new issues for our consideration as to the merits of the underlying assessment without our permission. As a result, we have disregarded the constitutional arguments raised for the first time by petitioner on this motion.

We also disagree with the premise of petitioner that because the Tribunal did not issue a decision in this matter by December 23, 1996, the underlying assessment must be vacated. As the Division notes in its opposition papers, the Tribunal is comprised of three commissioners. On July 3, 1996, then Commissioner John Dugan resigned from his position as Commissioner. On August 3, 1996, then Commissioner Francis Koenig retired from his position as Commissioner, thus leaving only one Commissioner holding such office. Commissioners are appointed by the Governor of New York by and with the advice and consent of the Senate (Tax Law § 2004). On December 3, 1996, the Senate confirmed the appointment by the Governor of two new Commissioners. Pursuant to Tax Law § 2004, a majority of the Tribunal constitutes a quorum for the purpose of carrying out its duties, including issuing decisions. Therefore, from August 3, 1996 until December 3, 1996, the Tribunal was statutorily unable to issue decisions in any cases pending before it. In its motion, petitioner has not alleged that he suffered any prejudice as a result of the Tribunal's failure to issue its decision on or before December 23, 1996. Further, petitioner has not directed us to any authority that would require us to vacate the assessment in this case. Therefore, although the result of our decision in this matter is the

cancellation of the March 19, 1993 Notice of Deficiency issued to petitioner, this relief is not granted as a result of petitioner's motion.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The motion of Warren R. and Rosemary B. Haas is denied;
2. The exception of Warren R. and Rosemary B. Haas is granted;
3. The exception of the Division of Taxation is denied;
4. The determination of the Administrative Law Judge is reversed;
5. The petition of Warren R. and Rosemary B. Haas is granted; and
6. The Notice of Deficiency, dated March 19, 1993, is cancelled.

DATED: Troy, New York
April 17, 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