STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ANTHONY L. CLAPES AND JILL A. CLAPES	:	DECISION DTA NO. 818992
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1996, 1997 and 1998.	:	

Petitioners Anthony L. Clapes and Jill A. Clapes, 3077 Kaohinani Drive, Honolulu, Hawaii 96817, filed an exception to the determination of the Administrative Law Judge issued on September 18, 2003. Petitioners appeared *pro se*. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Barbara J. Russo, Esq., of counsel).

Petitioners filed a brief in support of their exception and the Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Petitioners' request for oral argument was withdrawn.

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

ISSUES

I. Whether certain income, including stock options, received by petitioner Anthony Clapes, a nonresident of New York, from IBM during the years at issue was derived from or connected with New York sources and, therefore, subject to New York income tax.

II. Whether, assuming the stock options in question were properly subject to New York income tax, such options should have been valued as of the date of grant and not the date of exercise.

III. Whether the taxation of the subject income violates the Commerce Clause or the Due Process Clause of the United States Constitution.

FINDINGS OF FACT

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

On April 23, 2001, following an audit, the Division of Taxation ("Division") issued to petitioners, Anthony L. Clapes and Jill A. Clapes,[1] a Notice of Deficiency which asserted additional tax due for the years 1996, 1997, and 1998 as follows:

Year	1996	1997	1998	Total
Tax Assessed	$48,136.99	$20,276.63	$13,628.30	$82,041.92

The Notice of Deficiency also asserted penalty and interest due for each of the years at issue.

Petitioners are and were, at all times relevant herein, nonresidents of New York State. Petitioners filed timely joint New York State nonresident income tax returns (Form IT-203) for the years 1996 and 1997. Petitioners did not file a New York nonresident return for 1998. During each of these three years, petitioner received income from International Business Machines ("IBM") which was reported by IBM on form W-2.

[1] Jill A. Clapes is a petitioner in this matter solely because she filed joint New York nonresident income tax returns with her spouse, Anthony L. Clapes, for 1996 and 1997 and a joint Federal return for 1998. All of the income at issue was paid to Anthony L. Clapes. Accordingly, unless otherwise indicated, all references to petitioner herein shall refer to Anthony L. Clapes.

The Division's audit of petitioner's returns for the years at issue focused on the difference between petitioner's Federal adjusted gross income (AGI) and New York source income as reported. Specifically, the Division increased the amount of petitioner's income from IBM allocable to New York for each of the years at issue. The Division made no adjustments to petitioner's reported Federal AGI.

On his 1996 New York return, petitioner reported New York source income (as defined in Tax Law § 631) of $367,762.00 and New York adjusted gross income (defined as Federal adjusted gross income with certain modifications [***see***, Tax Law § 612(a)]) of $1,391,786.00. Petitioner thus reported an income percentage of 26.42 percent with a New York tax base of $98,285.00. Petitioner's reported New York State tax liability was therefore $25,966.90. IBM withheld New York income tax of $96,008.00. Petitioner thus claimed a refund of $70,041.00. On audit, the Division determined tax due for 1996 of $74,103.99, or a deficiency of $48,136.99. The Division thus determined an income percentage of 75.39 percent and New York source income of $1,049,365.57 for 1996.[2]

On his 1997 New York return petitioner reported New York source income of $2,053,934.00 and New York adjusted gross income of $3,257,760.00. Petitioners thus reported an income percentage of 63.04 percent. Applying that percentage to petitioner's reported New York tax base of $222,266.00 results in a New York tax liability of $140,139.00. IBM withheld New York tax of $161,371.00. Petitioner thus claimed a refund of $21,232.00. On audit the

[2] The Division's audit file in this matter was in the Division's office in the World Trade Center on September 11, 2001 and was therefore lost. Accordingly, the Division's audit workpapers, copies of petitioner's Federal returns for the years at issue and 1996 New York return and other documents used by the Division in calculating the subject deficiencies are not in the record. Petitioner's 1996 New York source income amount has been extrapolated from other information in the record.

Division determined a tax liability of $160,415.63, or a deficiency of $20,276.63 (***see***, above). The Division thus determined an income percentage of 72.17 percent and New York source income of $2,351,217.11 for 1997.

Petitioner did not file a 1998 New York return. On his Federal return for that year petitioner reported $563,880.00 in adjusted gross income, including $341,156.00 in wage income. The Division's records indicate that IBM paid petitioner $263,967.00 in 1998. On audit the Division determined that some portion of this IBM income[3] was allocable to New York and asserted New York tax due in the amount of $13,628.30.

Petitioner does not contest the Division's computation of tax.

In his petition, petitioner protests the Notice of Deficiency in its entirety and also seeks a refund of all amounts previously paid in respect of the years at issue. Notwithstanding this position, petitioner does not dispute that his regular salary paid to him by IBM for services rendered through March 11, 1996 were properly subject to New York income tax. Petitioner's regular salary in 1996 was approximately $375,000.00.

Petitioner was employed by IBM for about 30 years. He began as a law clerk in IBM's Law Department in August 1967 and by 1992 had become IBM's Assistant General Counsel for Litigation, responsible for all IBM litigation in the United States, and he frequently consulted on IBM litigation outside the United States. As Assistant General Counsel for Litigation, petitioner managed a staff of approximately 10 to 12 attorneys and 30 or more paralegals (depending on the workload), with a budget of about one-half to two-thirds of the entire IBM Law Department's budget for any given year.

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[3] The percentage of income allocated to New York on audit is not in the record. Petitioner takes the position that no portion of the income from IBM in 1998 is subject to New York income tax.

During his time at IBM, petitioner was involved in many matters of importance to the company, including several large and long-standing antitrust cases during the 1970s, several trade secret and copyright cases involving computer hardware and software, patent cases, and a decade-long, huge intellectual property arbitration involving the copying of operating system software for IBM's mainframe flagship computers.

Prior to 1995, petitioner had written two books on computer software law. He had also written numerous articles on technology and the law in national journals and had lectured widely on technology and the law around the country. IBM recognized and supported these activities, often paying petitioner's expenses. IBM also purchased copies of petitioner's books and distributed them within its Law Department and elsewhere within the company. In 1992, petitioner was named one of the top 30 high-tech intellectual property lawyers in the country in a peer review conducted by the National Law Journal.

As IBM's assistant general counsel (and later as senior advisor to the general counsel [***see***, above]), petitioner's office and primary place of employment was located in New York State. During the course of his career with IBM, petitioner was assigned to and worked in Paris for three years and in Los Angeles for one year. Petitioner was offered, but declined, assignments in Lima, Peru; San Jose, California; Tokyo, Japan; and a second assignment in Paris.

Throughout his career at IBM petitioner's job performance was always assessed as far exceeding expectations. Petitioner was always ranked at the top grade in IBM's periodic assessment performance appraisal.

At the time he commenced his employment at IBM petitioner executed an Employee Confidential Information and Invention Agreement dated August 7, 1967, pursuant to which

petitioner agreed, in consideration of his employment at IBM, to "not disclose to anyone outside of IBM, or use in other than IBM's business, any confidential information or material relating to the business of IBM or its subsidiaries, either during or after [his] IBM employment, except with IBM's written permission."

During his employment at IBM petitioner participated in IBM's 1989 and 1994 Long-Term Performance Plans. The prospectus for both plans provided that the plan's objective was to attract and retain key executives and employees and "to reward them for making major contributions to the company." Participants in the plans would receive long-term incentive awards, thereby providing such participants with a proprietary interest in the company. Participants could be awarded stock options and awards of cash or stock in the form of performance stock units. Stock options awarded under the plans could be incentive stock options (ISO's) or nonstatutory (nonqualified) stock options. Stock options under the plans were nontransferable and thus were not actively traded on an established market.

Pursuant to an agreement dated May 18, 1993 petitioner was awarded a nonstatutory stock option grant for 13,224 shares of IBM stock under the 1989 Long-Term Performance Plan which vested in three installments: one-half on the second anniversary of the grant, and one-fourth on the third and fourth anniversaries. This agreement provides that stock option grants not yet vested at the time of retirement will be cancelled and that, "[f]or purposes of this Agreement alone," shares at option not yet vested shall be cancelled upon commencement of a leave of absence bridging to retirement.

Petitioner was also awarded grants of ISO's and nonstatutory options under the 1989 plan pursuant to an agreement dated February 15, 1994 and under the 1994 plan pursuant to an

agreement dated March 20, 1995. These agreements provided that the ISO grant would become exercisable in two equal installments on the first and second anniversaries of the grant and would remain exercisable until expiration or cancellation as provided under the respective plans. These agreements also provided that the nonstatutory grants would become exercisable in four equal installments on the first, second, third and fourth anniversaries of the grants and would remain exercisable until expiration or cancellation as provided under the respective plans.

Also under the 1994 Plan, petitioner was awarded a "Long-Term Performance Incentive opportunity in the form of Performance Stock Units" ("PSU's") pursuant to an agreement dated March 20, 1995. Pursuant to this agreement petitioner would receive payments of cash or stock based upon IBM "achieving cumulative business targets of earnings per share and cash flow" during a 1995 through 1997 long-term performance incentive period. The agreement provided that one-half of the earned PSU's would be paid in cash at the end of the performance period and that the remaining one-half would be denominated restricted stock units for a two-year period and would thereafter be payable in stock or cash based on fair market value as of December 31, 1999. This agreement further provided that if a participant retired under the terms of a company retirement plan, then all PSU's would be prorated and this reduced number would be earned and paid as described above. The March 20, 1995 agreement also stated that the payments made thereunder would not be considered part of the participant's earnings for purposes of calculating benefits and entitlements under an IBM retirement plan.

Under both the 1989 and 1994 Plans, any unexpired, unpaid, or deferred awards were subject to cancellation or rescission if the participant violated his agreement with the company regarding confidential information or if the participant rendered services for or engaged in a

business which was a competitor of IBM or if the rendering of such services became prejudicial to or in conflict with the interests of IBM.

During the time of petitioner's employment at IBM, the company had a nondiscrimination policy which provided that the termination of employees was to be conducted without discrimination based on age and that the company's managers were expected to insure that the IBM work environment was free from all forms of discrimination. It was also the company's policy to comply with all state and Federal laws, including those dealing with equal opportunity.

In April 1995, the general counsel of IBM, with whom petitioner had worked for nine or ten years, retired and a new general counsel, from outside the company, was hired a few months later. In or about September 1995, without any change in petitioner's performance, his employment status changed. Petitioner was no longer assistant general counsel. He was now a senior advisor to the general counsel. Petitioner no longer had any managerial or supervisory responsibilities. He no longer had any lawyers or paralegals working for him. He no longer attended senior management meetings. He had previously attended senior management meetings on a regular basis.

The job of assistant general counsel was given to a person over age 40 but younger than petitioner. This individual did not have greater experience than petitioner.

Soon after his change in status petitioner began discussions with IBM management regarding his future with the company. Pursuant to these discussions it was petitioner's understanding that he had two choices with respect to his career at IBM. He could either retire from IBM before reaching retirement age and thereby risk the loss of awards of stock options and cash under the 1989 and 1994 Long-Term Performance Plans, or he could accept a

Retirement Bridge Leave of Absence. At the time (early 1996), petitioner was 53 years old and had achieved 28 years (plus a few months) of service with IBM.

As relevant in this matter, IBM employees are eligible to retire under the IBM Retirement Plan when they have achieved 30 years of service or when they have reached age 55 with 15 years of service.

IBM's Retirement Bridge Leave is intended to provide eligible employees with the opportunity to voluntarily leave IBM to pursue other interests and then retire from IBM at a later date. Petitioner was eligible to participate in the Retirement Bridge Plan. Participants in the Retirement Bridge Plan receive service credit for retirement eligibility purposes for the period they are on the bridge leave. While on leave, the participants are paid neither their regular IBM salary nor their IBM retirement income. At the end of the leave, upon retirement, participants commence receipt of retirement income under the IBM retirement plan. Participants must agree to retire and not return to IBM employment during their leave. Participants may pursue income-producing activities while on the Retirement Bridge Leave of Absence, but are subject to IBM's business conduct guidelines. Participants must notify IBM of any prospective employment during the leave period that may potentially conflict with the business conduct guidelines. If such guidelines are violated, the bridge retirement leave may be terminated and the individual will be considered to have resigned, if they are not then eligible to retire. The Retirement Bridge program's Summary Plan Description provides that participants in the program must sign a release that may include a covenant not to compete and other forms relating to the leave of absence. The Summary Plan Description indicates that the release is intended to relinquish all claims that the participant may have, of any kind, against IBM.

Petitioner's discussions with IBM eventually led to petitioner's execution, on March 11, 1996, of a letter agreement dated February 12, 1996 ("February 12 Agreement") setting forth the terms of his termination of employment at IBM, in relevant part, as follows:

> In connection with your decision to take a Retirement Bridge Leave of Absence . . . beginning May 1, 1996, and to retire from [IBM] on September 1, 1997, this letter agreement sets forth the total and complete understanding between IBM and you related to payments and other consideration to be provided to you by IBM, and your undertakings and obligations to IBM.
>
> IBM hereby agrees to provide you with the following consideration:
>
> 1. You will remain a regular IBM employee until April 30, 1996 . . . .
>
> 2. You will be paid the following amounts, less all amounts reasonably determined by IBM to be required to be withheld under federal, state or local law:
>
> (a) A payment for your 1995 incentive based on attainment of objectives as determined by IBM in 1996, to be paid shortly thereafter.
>
> (b) A payment of $31,667, which is a prorated payment of your target 1996 annual incentive covering the first four months of 1996. The payment will be made in early 1997.
>
> (c) A payment for unused vacation days you have through April 30, 1996.
>
> (d) A lump sum payment of $180,000 to be paid on May 15, 1996, provided you have executed an additional general release of IBM and covenant not to sue IBM in a form acceptable to IBM on or about April 30, 1996.
>
> (e) You will be provided with up to $8,500 of outplacement assistance . . . .
>
> (f) Payments:
>
> In cash: After the end of the 1995-1997 long-term performance incentive period, for a number of units calculated based on 294 units (which is one-half of the 1,325 long-term performance stock units awarded to you on February 28, 1995 multiplied by 16/36 which is the portion of the performance period in which you participated); and
>
> In stock or cash at the Executive Compensation and Management Resources Committee's discretion: which payment will be restricted through

December 31, 1999, and payable thereafter, for a number of units which is calculated based on 294 units (the balance of the 1,325 long-term performance stock units awarded to you on February 28, 1995, again multiplied by 16/36 which is the portion of the performance period in which you participated).

The actual payments will be based on the number of units earned and the value of the units, both as calculated under the Senior Management Group 1995 Long-Term Incentives description. 737 units (the balance of the 1,325 units awarded to you on February 28, 1995) are hereby cancelled.

The above payments are exclusive of and in addition to your entitlement to income from the IBM Retirement Plan . . . and any other benefits to which you are entitled as an employee or retiree.

In addition, unless your stock option grant agreement specifies otherwise, your existing stock option grants will be fully exercisable after April 30, 1996 for their respective terms, subject to your continuing compliance with your obligations under the IBM 1989 and 1994 Long-Term Performance Plans, and predecessor IBM stock option plans, to the extent applicable. The stock option agreement signed by you on May 18, 1993, specifies that shares at option not yet vested shall be cancelled upon a leave of absence bridging to retirement. Accordingly, the third installment of these stock options (totaling 3,306 shares) are cancelled effective May 1, 1996.

3. In consideration of the foregoing, you agree knowingly and voluntarily:

(a) On behalf of yourself . . . to release and do hereby release IBM . . . from any and all claims . . . and liabilities . . . including, but not limited to, any claims such as those which are related to your employment with IBM and the termination of that employment, any claim under the Age Discrimination Employment Act of 1967, as amended, Title VII of the Civil Rights Act, as amended, and any other federal or state law dealing with discrimination in employment on the basis of . . . age, which you now have or may have . . . .

* * *

(b) Never to institute any suit or action at law or in equity against IBM or those associated with IBM by reason of any claim you had prior to the execution of this Agreement or now have relating to your employment or the termination of your employment with IBM.

If you violate this agreement by suing IBM or those associated with IBM, you will pay all costs and expenses of defending the suit . . . .

If IBM brings an action to enforce this Agreement and IBM prevails, you will pay all costs and expenses incurred by IBM in connection with that suit . . . .

(c) For a period beginning upon your signing this Agreement through three years after the date of your retirement from IBM, you will not without first notifying IBM and obtaining its written approval, which approval shall not be unreasonably withheld or delayed and which approval will consider the scope and significance of competitive activity: engage directly or indirectly in any business or be employed by any firm or organization which competes with IBM or its subsidiaries; engage in any activity which is or becomes prejudicial to or is or becomes in conflict with the interests of IBM or its subsidiaries; or attempt either directly or indirectly to influence any employee of IBM or its subsidiaries to leave IBM's employ. You acknowledge that these limitations are reasonable and not unduly restrictive because, as Assistant General Counsel and Senior Advisor to the Senior Vice President and General Counsel, you have had unique and extraordinary responsibilities and extensive access to highly sensitive confidential IBM information, and because of the consideration you are receiving from IBM pursuant to this Agreement.

You also acknowledge that this in no way releases you of any obligations you have as a result of your being an attorney for IBM, or any obligations you have under other agreements with IBM.

(d) In your position as Assistant General Counsel and Senior Advisor to the Senior Vice President and General Counsel, you acquired and now possess, to a greater extent than most IBM employees, information which is confidential and proprietary to IBM . . . The disclosure of this information would be detrimental to IBM and could cause it economic loss.

(e) You have been reminded of your responsibilities and legal obligations to IBM regarding confidential information and intellectual property that will continue after your employment with IBM ceases.

(f) You are aware of your legal obligations as stated in the employment agreement relating to inventions and confidential information . . . to which you have agreed and do agree, which includes your obligation not to, without IBM's written permission, disclose to anyone outside of IBM or use in other than IBM's business, any confidential information . . . .

(h) You understand that your obligation not to use or disclose confidential information of IBM remain in effect after you end active full-time employment with IBM and after the termination of your employment with IBM and that if, at any time in the future, you wish to disclose or use any such confidential material or if you should be in doubt as to whether any information may be confidential to

> IBM, you will, prior to such disclosure or use, obtain written permission from IBM to do so. . . .
>
> (I) Should you wish at some future time to publish material or grant interviews which disclose information which may be IBM confidential information or involves your experiences at IBM, you must obtain prior written permission from IBM. . . .

Petitioner executed an Agreement dated and signed April 30, 1996 which supplemented the February 12 Agreement. This Agreement repeated IBM's promise to pay petitioner $180,000.00 in connection with his departure from active employment at IBM as of April 30, 1996. Such amount was paid to petitioner on or about May 15, 1996. By the April 30 Agreement, petitioner also repeated promises made in the February 12 Agreement granting a general release of IBM and promising not to sue IBM.

Pursuant to the February 12 Agreement petitioner remained a regular employee of IBM until April 30, 1996, took a retirement bridge leave of absence from May 1, 1996 through August 31, 1997, and then retired from IBM on September 1, 1997.

As of May 1, 1996 IBM no longer provided petitioner with an office in New York State. As of that date, IBM no longer required any services of petitioner in New York or elsewhere and petitioner did not provide any services to IBM in New York or elsewhere.

Petitioner estimates that his 1996 income was comprised of $122,596.00 in regular salary, $110,000.00 as a payment for unused vacation days, $180,000.00 in the lump sum payment on signing the April 30 Agreement, some portion of the $8,500.00 allocated for outplacement assistance, and $1,061,840.00 representing the difference between the market price and option price of stock options on the date of exercise. Petitioner estimates that his 1997 income was comprised of $31,667.00 for his 1996 annual incentive and $3,213,093.00 representing the

difference between the market price and option price of stock options on the date of exercise. There is insufficient evidence in the record to verify these estimates.

IBM's Form 10-K Annual Report for the fiscal year ended December 31, 1996 contained a pro forma disclosure listing net earnings and earnings per share which recognized a fair market value of all awards of stock-based compensation which were granted in 1995 and 1996. For purposes of such pro forma disclosures, IBM used the Black-Scholes model to value the stock options granted in those years. The Black-Scholes model, developed by Nobel laureate economists Robert Merton and Myron Scholes, and Fischer Black, is used by thousands of traders and investors every day to value stock options in markets throughout the world.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted applicable provisions of the Tax Law delineating the income of a nonresident, such as petitioner, which is subject to New York personal income tax. The Administrative Law Judge also cited applicable case law regarding the determination of whether a nonresident's income was secured or earned pursuant to activities connected with or derived from New York sources. The Administrative Law Judge determined the lump sum payment to petitioner of $180,000.00 and the amount paid on petitioner's behalf for outplacement assistance was not secured or earned by his New York employment at IBM as assistant general counsel and senior advisor to the general counsel. However, the Administrative Law Judge found that all other IBM income during the years at issue was derived from or connected with New York sources and, thus, properly subject to New York income tax.

Specifically, the Administrative Law Judge found petitioner's regular salary as senior advisor to the general counsel for the period March 11, 1996 through April 30, 1996, the

payments for petitioner's 1995 annual incentive and the prorated 1996 incentive, and the 1996 payment for unused vacation days were attributable to New York sources.

Additionally, the Administrative Law Judge determined that payments in stock or cash based on performance stock units awarded to petitioner on February 28, 1995 under the 1994 Long Term Performance Plan and the stock options awarded to petitioner on May 18, 1993, February 15, 1994, and March 20, 1995 under the 1989 and 1994 Plans were secured or earned through petitioner's IBM employment and were, therefore, properly considered New York source income for the years at issue. The Administrative Law Judge relied on the language of the prospectus for the 1989 and the 1994 Plans as well as the decision of the Court of Appeals in ***Matter of Michaelsen v. New York State Tax Commn.*** (67 NY2d 579, 505 NYS2d 585). The Administrative Law Judge rejected petitioner's argument that payments under the Long Term Performance Plans were not payment for services rendered and, therefore, not subject to New York income tax.

The Administrative Law Judge also rejected petitioner's assertion that the February 12 Agreement effectively "zeroed out" any prior claims by petitioner against IBM and that the consideration listed therein constituted new consideration payable by IBM to petitioner for the promises of petitioner as listed in the Agreement.

The Administrative Law Judge distinguished petitioner's position from that of the taxpayer in ***Matter of Colitti*** (Tax Appeals Tribunal, June 19, 2003). In that case, the petitioner gave up his rights to incentive stock options which had been acquired in connection with his employment and acquired new rights to stock options under the terms of an employment termination agreement. The Administrative Law Judge found that contrary to petitioner's

assertion, the February 12 Agreement indicated that the stock option agreements and the incentive award agreement would remain in effect and petitioner did not give up his rights under such agreements, which were derived from or connected with his New York employment.

The Administrative Law Judge held that the general release in the February 12 Agreement did not negate any claims petitioner had for salary, incentive pay for 1995 and 1996, and accrued vacation as compensation for services rendered. The Administrative Law Judge concluded that petitioner's substantive rights to salary, incentive pay and accrued vacation were secured by his provision of services to IBM in New York and were not consideration for the promises in the Agreement.

The Administrative Law Judge found that petitioner failed to prove that the amounts listed as consideration in the February 12 Agreement constitute the replacement of a future income stream in settlement of an ADEA claim. The Administrative Law Judge also determined that the releases and the covenants not to compete in the February 12 Agreement were consideration for the benefits of the Bridge Leave program, such as full IBM pension benefits at the conclusion of the leave and commencement of retirement.

The Administrative Law Judge did find in petitioner's favor in regard to the $180,000.00 lump sum payment and the outplacement assistance. The Administrative Law Judge concluded that these payments were secured only by petitioner's execution of the February 12 Agreement and the April 30 Supplemental Agreement and were earned by refraining from performing competing services in New York and elsewhere. Accordingly, the Administrative Law Judge held that such income was not attributable to a business, trade, profession or occupation carried on in New York within the meaning of Tax Law § 631(b)(1)(B).

The Administrative Law Judge rejected the Division's argument that petitioner was collaterally estopped from raising the issue of whether the stock options in question should have been valued as of the date of grant because petitioner had raised this same argument in a previous hearing (involving an earlier year) before an administrative law judge in the Division of Tax Appeals. The Administrative Law Judge relied on Tax Law § 2010(5), which provides that Administrative Law Judge determinations "shall not be cited" or "be given any force or effect in any other proceedings."

The Administrative Law Judge considered petitioner's contention that the fundamental premise underlying the Court of Appeals decision in ***Matter of Michaelsen v. New York State Tax Commn. (supra)*** concerning the proper valuation of the compensation attributable to certain employee stock options was wrong and that the decision was obsolete. The Administrative Law Judge found that contrary to petitioner's assertions, and notwithstanding IBM's use of the Black-Scholes model to value the stock options granted in 1995 and 1996 and the wide use and acceptance of the Black-Scholes model, the ***Michaelsen*** decision remained valid. Accordingly, the Administrative Law Judge held that the Division properly valued the options at issue as of the date of exercise.

Finally, the Administrative Law Judge dismissed petitioner's assertion that the subject deficiency violated the Commerce Clause and the Due Process Clause of the United States Constitution. The Administrative Law Judge found that the subject stock options, incentive award, salary, incentive pay and accrued vacation were secured or earned in connection with petitioner's provision of services to IBM in New York.

ARGUMENTS ON EXCEPTION

On exception, petitioner asserts that the payments made by IBM, except for six weeks of salary, were paid to petitioner after he had permanently vacated his New York employer's offices and pursuant to a termination agreement. Petitioner argues that based on the March 11, 1996 Agreement, he released claims relating to his employment and its termination as well as claims under the Age Discrimination in Employment Act. Petitioner also claims that he made promises of future performance unconnected with New York (covenants not to compete, not to engage in activity prejudicial to or in conflict with IBM's interest and not to recruit IBM employees, etc.) in return for future payment. As a result, petitioner maintains that there was no rational basis for the application of ***Michaelsen*** to the valuation of petitioner's stock options received from IBM.

Petitioner asserts that, assuming the IBM stock options granted to petitioner were taxable by New York, such options could have and should have been valued by the Division as of the dates of grant. Petitioner asserts that the decision of the Court of Appeals in ***Matter of Michaelsen v. New York State Tax Commn.*** (***supra***), which held that qualified employee stock options granted to a nonresident for either past services or incentive for future services were compensation attributable to the employee's New York employment and that the value or amount of such compensation is properly measured by the difference between the option price and the fair market value of the stock on the date of exercise, is obsolete. Petitioner notes that the Black-Scholes model was readily available for use by the Division in ascertaining the date of grant value of the options at issue.

Petitioner maintains that the imposition of New York tax on the income in question fails a commerce clause challenge because the activity giving rise to the income in question had no substantial nexus to New York and the application of the tax was not fairly related to the service provided by New York.

The Division, in opposition to petitioner's exception, argues that the Administrative Law Judge correctly placed the burden of proof on petitioner. The Division believes that the Administrative Law Judge was correct in concluding that petitioner's income from IBM for the years at issue, except for the $180,000.00 lump sum payment and the outplacement assistance, was New York source income because it was earned or secured by petitioner's New York employment at IBM. The Division asserts that the February 12, 1996 correspondence was not an agreement by which petitioner received payment in return for relinquishing his rights to future income and a promise of future performance. Rather, it demonstrated petitioner's choice to take the Retirement Bridge Leave of Absence and the consideration for that was petitioner's prior years of service with IBM.

The Division supports the Administrative Law Judge's reliance on ***Michaelsen*** to hold that petitioner's stock options were compensation attributable to an employee's business, trade, profession or occupation carried on in New York. The Division also agrees with the Administrative Law Judge's rejection of petitioner's argument that the payments to him were made by IBM to compensate him for loss of future income stream and as incentives for future performance. The Division argues that the income petitioner received was not linked to a covenant not to compete. Further, unlike the taxpayer in ***Matter of Colitti (supra)***, the Division maintains that petitioner did not give up his vested stock options pursuant to the 1989 and 1994

Long Term Performance Plans in order to obtain the income at issue. The Division agrees with the Administrative Law Judge that the payments by IBM to petitioner were not damages received as the settlement of a tort claim. Finally, the Division asserts that petitioner's stock options were properly valued when exercised and not at the date of grant.

OPINION

Petitioner has presented substantially the same arguments on exception as were considered and rejected by the Administrative Law Judge. We find that the Administrative Law Judge completely and adequately addressed the issues presented to him and correctly applied the relevant law to the facts of this case. Petitioner has offered no evidence below, and no argument on exception, that would provide a basis for us to modify the determination in any respect. Thus, we affirm the determination of the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Anthony L. Clapes and Jill A. Clapes is denied;

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

3. The petition of Anthony L. Clapes and Jill A. Clapes is granted to the extent indicated in conclusion of law "G" of the Administrative Law Judge's determination, but in all other respects is denied; and

4. The Notice of Deficiency dated April 23, 1998, as modified in accordance with paragraph “3" above, is sustained.

DATED: Troy, New York
January 6, 2005

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

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