STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOHN J. MERRICK, JR.	:	**DETERMINATION**
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Nonresident Earnings Tax under the Administrative Code of the City of New York for the Years 1995, 1996 and 1997.	:	DTA NOS. 817978, 817979 AND 817980

Petitioner, John J. Merrick, Jr., 120 Glen Valley Road, Yardley, Pennsylvania 19067, filed a petition for redetermination of deficiencies or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City nonresident earnings tax under the Administrative Code of the City of New York for the years 1995, 1996 and 1997.

A small claims hearing was held before Dennis M. Galliher, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 24, 2002 at 9:15 A.M., which date began the three-month period for the issuance of this determination. Petitioner appeared *pro se*. The Division of Taxation appeared by Barbara G. Billet, Esq. (Max Wyszomirski).

ISSUE

Whether petitioner, a nonresident, has established that the time spent working at his home outside of New York was a necessary requirement of his job as opposed to a matter of his own convenience.

FINDINGS OF FACT

1. Petitioner, John J. Merrick, Jr., filed a timely New York State Nonresident and Part Year Resident Income Tax Return (Form IT-203) under Filing Status "2" ("Married filing joint return") for each of the years 1995, 1996 and 1997. Petitioner also filed a City of New York Nonresident Earnings Tax Return (Form NYC-203) for each of such years.[1] On each of these returns, at Schedule "A" thereof, Mr. Merrick's compensation from his New York employer was allocated within and without New York State and City on the basis of the number of days worked in New York versus the number of days worked outside of New York. Specifically, petitioner premised his allocation of income on the claim that he worked 34 out of 220 working days outside of New York in 1995 and 49 out of 225 working days outside of New York in both 1996 and 1997. Petitioner further specified, on Schedule "A", that 26 of such days in 1995 and 43 of such days in both 1996 and 1997 were worked at his home in Pennsylvania.

2. Petitioner resided in Yardley, Pennsylvania during each of the years at issue, was not a New York State or City domiciliary, and did not maintain a place of abode in New York State or City during any of such years. It is undisputed that petitioner was therefore subject to New York State and City tax only as a nonresident.

3. The Division of Taxation ("Division") issued to petitioner three notices of deficiency. These notices, covering the years 1995, 1996 and 1997, are dated February 16, 1999, April 12, 1999 and December 13, 1999, respectively, and assert additional tax due in the respective amounts of $3,291.54, $5,841.41 and $5,157.21, plus interest. The basis for the calculation and imposition of additional tax for each year is the Division's reduction of the number of days

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[1] Attached to each of petitioner's returns is Form IT-203-C ("Spouse's Certification") certifying that petitioner's spouse had no New York source income for the years in issue. Hence, Mrs. Merrick is not a party to these proceedings.

claimed by petitioner to have been worked outside of New York. Specifically, the Division disallowed, as out-of-state working days, all of the days where petitioner worked at his home (i.e., 26 days in 1995 and 43 days in 1996 and in 1997), thus effectively increasing the ratio by which petitioner's income could be allocated to New York.[2]

4. There is no dispute as to the total number of days worked by petitioner during the years in issue, or the number of such days when petitioner's work was performed at out-of-state locations, including at his home. Rather, the only issue is whether petitioner is entitled to treat the specific days he worked at his home in Pennsylvania as non-New York working days, as was done on his returns, thus leaving the portion of his income attributed to such days not subject to New York State or City tax.

5. Petitioner earned a B.A. in economics from La Salle University in 1976. He continued his studies thereafter at Brown University, earning an M.A. in economics in 1987 and a Ph.D. in economics in 1981. Thereafter, petitioner taught at New York University's Stern School of Business, as an Assistant Professor of Finance and as an Associate Professor of Finance during the years 1981 through 1988, and served as a visiting research scholar at the Federal Reserve Bank of Philadelphia during 1986 and 1987.

6. In 1988, petitioner left the academic world and accepted employment with Lehman Brothers, Inc. ("Lehman Brothers"), in New York City. Petitioner first worked as the head of Lehman Brothers' fixed income (bonds and derivatives) research group. Petitioner progressed to Product Manager (Futures and Options Desk), where he developed investment products and strategies, explained them to Lehman Brothers' customers, and then applied them for such

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[2] The disallowance of claimed out-of-state working days results in an increase to the number of in-state working days, thus increasing the ratio by which a nonresident's income from a New York State employer is subjected to New York State and City taxes.

customers. Thereafter, petitioner progressed to Proprietary Trader (Multimarket Trading Desk) and Vice President of Lehman Brother's Fixed Income Division, where he developed relative value differential trading strategies (hedges) based on his mathematical research. Trading using these strategies was done on a proprietary basis (i.e., for Lehman Brothers' account rather than for customers).

7. Petitioner remained with Lehman Brothers until 1994, at which time he was recruited to work for Barclay Investments, Inc. ("Barclay") in New York City as its Global Fixed Income Portfolio Manager and Head of Research. Petitioner fulfilled three roles for Barclay. He served as chief researcher, he developed investment strategies and products for customers and for Barclay, and he served as portfolio manager. In his work at Barclay, as in his work for Lehman Brothers, petitioner utilized the same general bases for identifying and developing products and strategies, to wit, his mathematical research and resulting models and formulae. However, at Barclay he did so with respect to a global market of obligations as opposed to his earlier work with Lehman Brothers which focused on United States Treasury obligations.

8. When petitioner joined Barclay, he was a part of its newly established ten-person investment group. This group was located in an approximately 1,000 square foot leased office space in mid-town Manhattan. Petitioner's space within such office consisted of an open desk area approximately four feet by five feet within this entirely open, loud and often chaotic trading room. There was no closed conference room, library or quiet area in this space, nor any secure area for personal materials. Petitioner remained with Barclay throughout the years in issue in this matter (1995, 1996 and 1997).[3] After petitioner left Barclay, the firm leased larger quarters

[3] Petitioner returned to academia, teaching at the Stern School of Business from 1999 through 2001, after which he accepted a position at the Baruch College Zicklin School of Business in New York City where he is currently employed.

of approximately 3,000 square feet which included a conference room and some space in which the firm began to accumulate its own library of research materials.

9. The crux of petitioner's claim, that the disallowed days worked at home were worked there of necessity rather than for his own convenience, rests on the differences between academic employment versus employment with an investment firm. Petitioner explained that the culture and norm in academic employment encourages the development, open sharing and discussion of ideas. In his particular area of expertise, the aim is to be able to predict (or "be ahead of") movements in the world's financial markets. Petitioner explained that his employment with an investment firm also encouraged and in fact depended upon the development of such ideas, with the same aim of being ahead of the movement of markets, coupled with the actual use of these theories on behalf of the investment firm and its clients. The distinction, however, is that while such theories are openly discussed and evaluated in the academic context, there is a necessary realm of proprietary secrecy, borne of competition, among and within the investment firms.

10. Review of petitioner's curriculum vitae reveals that petitioner published extensively in the fields of finance, economics and investments. Petitioner has authored or co-authored at least three books, as well as numerous articles in the areas of financial markets, including specifically futures markets and hedging theories and strategies. All of petitioner's published writings were done during his years in academia. However, in order to protect the economic value of his research and resulting investment strategies, he did no publishing during the eleven years when he was employed for the investment houses Lehman Brothers and Barclay.

11. Petitioner explained that the well known investment theories, models and practices taught at business schools are already being employed by investment firms, and that a given

individual's knowledge and application of such theories is of no unique value to an investment firm. Rather, petitioner's value to an investment firm such as Barclays comes from his ability to generate, from his research, new theories, strategies and formulae for investing, and to identify or create new investment products to which such theories, strategies and formulae may be profitably applied on behalf of the firm and its clients. The open exchange of such unique theories and formulae, and the research materials from which they are derived, in general as well as within a particular investment firm, would dissipate if not essentially eliminate petitioner's unique employment value to the firm. Hence, in order for petitioner to "maintain his own employment value," he understood and acted to maintain the secrecy of his research materials and notes, including specifically the formulae and theories derived therefrom, upon which he based his investment decisions.

12. Petitioner's research materials were accumulated initially during his years of schooling, teaching and researching, and thereafter on an ongoing basis while employed by Lehman Brothers and by Barclay. These materials are housed in a library in petitioner's home in Yardley, Pennsylvania. Approximately two thirds of this library consists of standard textbooks. The remainder consists of numerous looseleaf binders containing articles, internal analyses and research papers and memoranda, together with petitioner's own notes and analysis thereon, accumulated from Wall Street investment firms and from various other sources over many years. These items were not, for the most part, publicly distributed or generally available. Petitioner's library also includes numerous file folders in filing cabinets containing newspaper and journal clippings, unpublished memos, fax notes, and the like, as well as petitioner's own notes, theories and formulae derived therefrom. Petitioner's research materials are eclectic and unique in that they represent and encompass a large variety of sources of information not generally available,

as well as the results of his own personal research and testing of theories derived from such materials and information. The most critical element of petitioner's research library appears to have been his specific personal and unpublished notes (working papers and product pieces), with the attendant mathematical equations, models and formulae, which formed the core of his unique methods or strategies upon which his financial trades for his employer and clients were based. It is these latter items, which were proprietary to petitioner, for which the assurance of security was most necessary. Petitioner described his value to his employer as his original thinking and development of applications, and explained that the base from which this occurs is his multi-year accumulated collection of materials, including notes of ideas and "works in progress." He further explained that these "works in progress" as well as his then currently used trading formulae and strategies based thereon, could be deciphered by others in his area of expertise or by his employer or co-workers by bringing in an academic with specialty in applied mathematics to decipher petitioner's notes and apply the results.

13. It is clear that the contents of petitioner's library of materials (in its existing "hard copy" form) could not have been transported back and forth from his home to his office at Barclay on a daily or ongoing basis.[4] Petitioner's final product, his trading programs, were brought to Barclay's offices for execution. However, his unique personal research materials and notes underlying and explaining the programs and why the trades were to be executed in a given manner were never brought to Barclay's offices, for to do so would have minimized Barclay's need for petitioner's services.

[4] At hearing, petitioner provided a DVD presentation of his home library, showing the extent of his collection of materials, including looseleaf binders, file cabinets and folders.

14. As noted, Barclay provided no separate or secure area within its offices during petitioner's tenure. Petitioner explained the "cold reality" of the intensely competitive financial world where if his employment, for any reason, had been terminated, he would have been escorted from the premises immediately. He explained that any research or other materials would have remained in the employer's office, impounded until such time as ownership claims to such materials were "straightened out," after which he would (hopefully) have been allowed to retrieve them. However, petitioner explained that during the intervening period of time (the "cooling off" period), the materials upon which his trading theories and formulae were based would have been examined and dissected (including analysis by outside persons hired for such purpose), with the result that his competitive advantage and his worth to his employer would have been entirely compromised. Hence, petitioner maintained his library of research materials at his home.

15. Petitioner's at home working days were described as "pure thinking" days as distinguished from his working days at Barclay's offices which involved the execution of trade programs based on the formulae and strategies developed at home from his notes and research materials. Petitioner's at home work days involved reworking, adjusting and retooling his core materials to adapt his trading programs to new or changing markets and financial instruments. The period of consecutive days spent at home was small where petitioner was making only minor changes to his programs, and was somewhat longer if he was adjusting for very new markets or financial instruments.

16. There is no evidence that Barclay ever discussed or attempted to set up a separate or secure office enclosure for petitioner at its New York City offices, and petitioner opined that

such a space would not, in reality, have been a "one key" space which was entirely secure. By a letter dated March 25, 1999, Barclay stated the following:

> During John Merrick's tenure at Barclay Investment, Inc. (April 1994 to present), Mr. Merrick has periodically worked from his home in Pennsylvania. He performed financial model construction as well as other research duties there as the New York office, being a trading environment, was not conducive to the quiet environment he required to perform the above duties. This work was authorized by the firm.

CONCLUSIONS OF LAW

A. Tax Law §631(a) provides that the New York source income of a nonresident individual (such as petitioner) includes the net amount of items of income, gain, loss and deduction reported in the Federal adjusted gross income that are "derived from or connected with New York sources." Included among these items are those attributable to a business, trade, profession or occupation carried on in this State (Tax Law § 631[b][1]).

B. Tax Law § 631(c) provides, in part, that:

> "[i]f a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the [commissioner of taxation], the items of income, gain, loss and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations."

C. Regulations of the Commissioner of Taxation in effect during the years at issue provided as follows:

> "[i]f the nonresident employee (including corporate officers, but excluding employees provided for in [former] 131.17 of this Part) performs service for his employer both within and without New York State, his income derived from New York sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State (20 NYCRR former 131.18).

D. Petitioner argues that if any of his compensation is subject to New York tax, it should not include compensation attributable to days when petitioner did not work in New York State,

including specifically days worked at his home in Yardley, Pennsylvania. Petitioner's position is that such work was not performed at home for his own convenience, but rather was performed out of necessity and with the permission of his employer.

E. Petitioner's allocation of compensation within and without New York State, specifically on the basis of days worked at the office in his home in Yardley, turns on whether such days were worked outside of his employer's New York office of necessity in the service of his employer and not for his own convenience. This so-called "convenience of the employer" test is set forth at 20 NYCRR former 131.16, which provided, in relevant part, as follows:

> any allowance claimed for days worked outside of the State must be based upon the performance of services which of necessity - as distinguished from convenience - obligated the employee to out-of-state duties in the service of his employer.

F. The case law on this issue supports the convenience versus necessity test as valid (***Matter of Speno v. Gallman,*** 35 NY2d 256, 360 NYS2d 855), and holds in essence that services performed at an out-of-state home, which could have been performed at the employer's in-State office, are performed for the employee's convenience and not for the employer's necessity (***id., see Matter of Fass v. State Tax Commn.,*** 68 AD2d 877, 414 NYS2d 780, ***affd*** 50 NY2d 932, 431 NYS2d 526; ***Matter of Colleary v. Tully***, 69 AD2d 922, 415 NYS2d 266; ***Matter of Wheeler v. State Tax Commn.***, 72 AD2d 878, 421 NYS2d 942; ***Matter of Kitman v. State Tax Commn.***, 92 AD2d 1018, 461 NYS2d 448). Even though an office in an employee's home may be equipped by and intended for an employer's purposes, it must also be established that the employee's work was performed there of necessity for the employer ***(Matter of Fischer v. State Tax Commn.***, 107 AD2d 918, 489 NYS2d 345).

G. In ***Matter of Kitman v State Tax Commn. (supra.)***, the court observed that "[b]ecause of the obvious potential for abuse, where the home is the workplace in question, the [former

State Tax Commission] has generally applied a strict standard of employer necessity in these cases, which, with rare exception, has been upheld by the courts [citations omitted]."[5] One such exception of note was ***Matter of Fass v. State Tax Commn. (supra.)***, where the court found the employee's out-of-State services at his home to be for the employer's necessity. The services at issue in ***Fass***, testing and investigating new products, did not involve an office *per se*, but rather required access to highly specialized facilities including ballistics equipment, a firing range, garages, stables, kennels, and sophisticated testing and evaluating equipment. This equipment was, concededly, not available at or near the employer's office. In later cases, such as ***Matter of Wheeler v. State Tax Commn. (supra.),*** and ***Matter of Kitman (supra.)***, the court distinguished the type of services, and required facilities and equipment, in ***Fass*** from the services, office equipment and circumstances of an expert in trading, selling and underwriting municipal bonds ***(Wheeler)*** and a television reviewer and critic ***(Kitman)***.

More specifically, in ***Wheeler*** the claim of necessity was premised on the arguments that the petitioner had to work on weekends performing various analyses in order to be prepared for the next week's bond market activity, and that the employer's New York office was unavailable to petitioner because an alarm system was activated on weekends and because the mail at the office was not sorted. In ***Kitman***, the claimed at-home necessity was based on the petitioner's need for specialized equipment (four television sets and a video tape recorder) not installed at the employer's New York office, the potential disruptive effect of this equipment on other employees in the New York office, the long hours worked by the petitioner (6:00 A.M. until past

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[5] The "potential for abuse" noted in ***Kitman*** stems from the possibility of a nonresident taxpayer simply choosing to work at home (essentially manipulating his work location by choice based on convenience) and thereby gaining the tax benefit of income allocation not available to his identically situated in-state resident fellow employee (***Matter of Speno v. Gallman, supra.; see also Matter of Colleary v. Tully, supra.***).

midnight) monitoring several television channels at once on multiple televisions, and the specialized style of writing requiring input from petitioner's family who would not be available at the New York office.

In both cases the court rejected the claim that performing the services at home was required as an absolute necessity from the employer's standpoint. In ***Wheeler***, the court concluded that "[w]ith the exercise of but a minimum of ingenuity and effort, the office could have been available to petitioner." In ***Kitman***, the court, relying on ***Wheeler,*** noted "there is no evidence showing that the office could not be set up in such a way as to *insulate petitioner* from the other workers [citation omitted]." (Emphasis supplied.) The court further observed, with respect to the claim of need for access to his family for input, that "again, with the exercise of a little ingenuity, some means (possibly a special telephone line) could be devised for him to get input from them [citation omitted]."[6]

H. Petitioner argues, persuasively, that he could not bring his library of research materials and his personal notes to his employer's place of business due to security concerns and because he could not perform calculations and "pure thinking" there for lack of a quiet space in the office. Despite his claims to the contrary, it appears that with a bit of effort and ingenuity petitioner's security concerns could have been allayed and his need for quiet space satisfied (***Matter of Evans v. Tax Commn of the State of New York***, 82 AD2d 1010, 442 NYS2d 174, ***lv denied***, 54 NY2d 606, 443 NYS2d 1029); ***Matter of Kitman v. State Tax Commn., supra***). The record includes no evidence that petitioner ever requested that his employer provide secure storage space for research materials or even discussed the possibility of locating his materials on

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[6] Further contrasting ***Fass*** with ***Kitman,*** it seems a safe assumption that any potential disruption to other employees in the office caused by Mr. Kitman's simultaneous viewing of multiple television sets would be far less than the potential disruption caused by Mr. Fass in discharging various firearms in the office.

premises. Rather, it appears that petitioner's employer may have simply acquiesced to petitioner's spending certain days working at home. The fact that this situation may have been expedient for all parties does not mean that petitioner's employer's acquiescence constituted necessity. Instead, the fact that petitioner worked at home on certain days ultimately resulted from his choice to do so and not from some necessity imposed by his employer (***see Phillips v. New York State Dept. of Taxation and Finance***, 267 AD2d 927, 700 NYX2d 566, ***lv denied,*** 94 NY2d 763, 708 NYS2d 52).

I. It seems self-evident that it was, on some level, more convenient for petitioner to work at home instead of at the office. While *concern* about disclosure of his research methods, materials and results appears to have been as much or more of a factor than *convenience* in leading petitioner to the choice to work at home, it remains that such choice was made by petitioner and was not dictated by his employer. Petitioner's services were not of such a specialized nature that they could not reasonably have been performed at his employer's offices with but a minimum of accommodation. For instance, it would seem that contractual employment terms providing notice and a right to remove personal materials prior to termination, the provision of an on-premises safe for petitioner's materials, or even the provision of nearby office space selected and controlled by petitioner, rather than vast renovations to petitioner's employer's offices, would have sufficed to satisfy petitioner's legitimate security concerns. None of these possible measures approach the highly specialized facilities and testing equipment, including ballistics equipment, firing ranges, stables, garages and kennels, at issue in ***Matter of Fass v. State Tax Commn. (supra)*** which were not available at or near the employer's office. The fact that petitioner's employer did not provide the accommodations petitioner believed were necessary but rather simply allowed petitioner to work at home does not constitute

necessity or requirement. According to petitioner's arguments, it seems that his employer would have been delighted to have petitioner bring his materials to the office, a circumstance that runs entirely counter to a conclusion that petitioner's employer obligated him to perform services at home. While recognizing the importance petitioner assigned to maintaining absolute confidentiality of his research materials, and accepting that the same was the result of legitimate concern, the resulting choice to work at home was, ultimately, a choice made by petitioner and not a necessary out-of-state assignment imposed by his employer. In the final analysis, there was no employer requirement for petitioner to perform services at his home. As a result, petitioner is not entitled to treat such at-home working days as non-New York days for purposes of income allocation (20 NYCRR former 131.16).

J. The petition of John J. Merrick, Jr. is hereby denied and the notices of deficiency dated February 16, 1999, April 12, 1999 and December 13, 1999 are sustained.

DATED: Troy, New York
April 18, 2002

/s/ Dennis M. Galliher
PRESIDING OFFICER