STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
THOMAS R. AND EILEEN P. HOPKINS	:	DETERMINATION DTA NO. 821812
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2003 and 2004.	:	

Petitioners, Thomas R. and Eileen P. Hopkins,[1] filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2003 and 2004.

On January 18, 2008 and January 31, 2008, respectively, petitioners appearing by Petralia, Webb & O'Connell, P.C. (Arnold R. Petralia, Esq., of counsel), and the Division of Taxation appearing by Daniel Smirlock, Esq. (Barbara J. Russo, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by July 8, 2008, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

---

[1] Eileen P. Hopkins's name is included herein by virtue of having filed joint income tax returns with Thomas R. Hopkins. For purposes of this determination, references to "petitioner" shall mean Thomas R. Hopkins, while "petitioners" shall mean Thomas R. Hopkins and Eileen P. Hopkins.

ISSUE

Whether the Division of Taxation properly denied petitioners' request for a refund of personal income tax paid in connection with the exercise of certain stock options in the years 2003 and 2004.

FINDINGS OF FACT[2]

1. Petitioner Thomas R. Hopkins worked for Marsh & McLennan Companies, Inc. (Marsh & McLennan) from December 1984 until his retirement on January 1, 2002.

2. From December 1994 to January 1, 2002, petitioner was assigned to Seabury & Smith, Inc. (Seabury & Smith). Seabury & Smith was a wholly owned subsidiary of, or otherwise controlled by, Marsh & McLennan. At all times while with Seabury & Smith, petitioner was reflected on the Marsh & McLennan payroll records and was eligible to participate in Marsh & McLennan employee plans. Marsh & McLennan was located in New York State.

3. At all times during petitioner's employment, Mr. and Mrs. Hopkins were residents of Connecticut. Following petitioner's retirement on January 1, 2002, Mr. and Mrs. Hopkins lived in Connecticut and, thereafter, in New Hampshire. Petitioners did not reside in New York at any time, and at present petitioners reside in Vermont.

4. Incident to petitioner's employment, Marsh and McLennan granted nonstatutory stock options (NSOs) to petitioner in 1993, 1995 and 1996 for shares of Marsh and McLennan stock.

5. On January 28, 2003 and thereafter on February 24, 2003, while residing in Connecticut, petitioner exercised NSOs for 12,000 shares of stock and 30,000 shares of stock,

---

[2] The parties entered into a stipulation of facts in this matter and such facts are set forth in the Findings of Fact herein. The Division of Taxation included in its brief requested findings of fact numbered 1 through 16. Such requested facts are likewise set forth in the Findings of Fact herein, with the exception of requested facts numbered 15 and 16 which merely set forth procedural matters neither relevant nor necessary in arriving at a determination in this matter.

respectively. On October 5, 2004, while residing in New Hampshire, petitioner exercised NSOs for 27,000 shares of stock. On each of the exercise dates, petitioner was a nonresident of New York with no New York employment.

6. The details of and gain realized on each exercise are as follows:

Exercise Date	Grant Date	Grant Type	Number of Shares Exercised	Grant Price	Option Exercise Cost	Gain Per Share	Total Gain
01/28/03	03/16/93	NSO	12,000	$15.604167	$187,250.00	$26.405833	$316,870.00
02/24/03	03/16/93	NSO	30,000	$15.604167	$468,125.00	$26.165833	$784,974.99
10/05/04	05/16/95	NSO	15,000	$13.093750	$196,406.25	$33.581250	$503,718.75
10/05/04	03/21/96	NSO	12,000	$15.843750	$190,125.00	$30.831250	$369,975.00

7. Petitioners filed a joint New York State nonresident income tax return for each of the years 2003 and 2004, on which they reported option income based on the number of days worked in New York from the date of option grant to the date of vesting.

8. The total number of days worked by petitioner, and the number of such days worked in New York State and outside of New York State for each of the years 1988 through 2004, are as follows:

Year	Total Days Worked	Days Worked in NYS	Days Worked Outside of NYS
1988	220	200	20
1989	224	199	25
1990	226	192	34
1991	226	186	40
1992	225	173	52
1993	216	175	41

1994	227	166	61
1995	236	205	31
1996	237	197	40
1997	238	212	26
1998	228	194	34
1999	228	185	43
2000	228	188	40
2001	228	205	23
2002	0	0	0
2003	0	0	0
2004	0	0	0

As shown by the foregoing chart, petitioner, who retired January 1, 2002, performed no services anywhere during the option exercise years (2003 and 2004), either within or without New York State, as an employee of Marsh & McLennan (or its subsidiary Seabury & Smith).

9. After the Tax Appeals Tribunal's decision in ***Matter of Stuckless*** (Tax Appeals Tribunal, August 17, 2006) (***Stuckless II***), petitioners filed amended returns for 2003 and 2004 requesting refunds of the New York State tax paid on the stock option income in the respective amounts of $70,570.00 and $57,380.00.

10. On June 8, 2007, the Division of Taxation (Division) issued to petitioners a Notice of Disallowance denying petitioners' request for refunds on the following basis:

> An individual may receive payments such as stock options in consideration for past services upon termination of employment. This income is to be included in a nonresident's New York source income if it is derived or connected with prior service performed in New York State.
>
> The Stuckless decision does not apply to your situation. What distinguishes your case from the Stuckless case is that your employment was terminated; as a result you have no wage allocation in the year of exercise. In the

> Stuckless case, the taxpayer was a nonresident who exercised stock options while still working for the granting employer, and had no New York source income in the year of exercise.
>
> In your case, since there is no wage allocation at all in the year of exercise, we have to look at what is fair and equitable. We are therefore, invoking regulation section 132.24 which gives the Department discretionary authority to use a fair and equitable method for allocation of this stock option income. The method we are using is the allocation used on the original filings. If you feel that there is a more equitable way to allocate your income to New York State, please provide documentation and we will review your case.

SUMMARY OF THE PARTIES' POSITIONS

11. Petitioners assert that the Tribunal's decision in ***Stuckless II*** is dispositive in this matter. Petitioners argue that, under ***Stuckless II*** and the law and regulations in place during the years in issue, income from the exercise of stock options granted to an employee in connection with his employment may not be allocated to and taxed by New York State if, in the year or period in which the income is realized (here, upon exercise of the options), the employee has no New York working days. Petitioners note that the applicable regulation pertaining to the allocation of compensation income earned by one who performed personal services for his employer partly within and partly without New York State is 20 NYCRR 132.18, which calls for allocation based on the ratio of days worked within New York State to days worked everywhere. Petitioners argue that this allocation ratio is set forth at paragraph (a) of the regulation, and is also carried forward and made applicable at paragraph (b) of the regulation, limited in application, however, only to periods in which the income recipient has days worked in New York State. Petitioners point out that petitioner, having retired, had no New York work days during the years in issue when he exercised his options and realized the gain therefrom, and thus maintain that none of the income at issue is allocable to or taxable by New York State.

12. Petitioners argue in the alternative that if 20 NYCRR 132.18(b) is not applicable under the facts of this case, the Division is not entitled to fashion an alternative allocation method under 20 NYCRR 132.24, as is sought here, to reach the income in question. Petitioners again rely on ***Stuckless II*** for the proposition that 20 NYCRR 132.24 was intended to be applied on an ad hoc basis to cure situations where application of the existing regulations addressing apportionment and allocation (20 NYCRR 132.15 through 132.23) resulted in unfair or inequitable results. In this regard, petitioners argue that the Division's proposed method of allocation (based upon the ratio of days worked in New York compared to days worked everywhere in the years in which the options were granted) sets forth a general rule to be applied to all retired nonresidents who exercised stock options after retirement (when they had no New York working days). Petitioners point out that this is no different from the Division's attempt to use the general rule of multi-year-based day count ratio allocation as set forth in a Division Technical Services Bureau Memorandum (***see*** TSB-M-95[3]I). Petitioners assert that this is exactly what the Tribunal denied in ***Stuckless II*** as in violation of the requirement that apportionment and allocation of New York source income from a business, trade, profession or occupation carried on partly within and partly without New York State is to be made pursuant to regulations of the Commissioner of Taxation. Petitioners acknowledge, in response to the issuance of the Tribunal's decision in ***Stuckless II***, the enactment of Tax Law § 631(g) and § 638(c) and the Commissioner's promulgation and adoption of a regulation (20 NYCRR 132.24) that sets forth methods pursuant to which stock option income such as that in question may be allocated to and taxed by New York State. Petitioners point out, however, that the same law and regulations are applicable to years starting with 2006, and are not retroactive.

13. The Division, by contrast, sets forth two arguments. First, the Division points out that petitioner terminated his employment by retirement, and thus had no working days anywhere during the years in which the options were exercised and the income was realized.[3] The Division maintains this absence of any working days means that 20 NYCRR 132.18 and its aforementioned rule of allocation are inapplicable and that the result in ***Stuckless II*** is neither applicable nor binding herein. Second, and consequently, the Division argues that since 20 NYCRR 132.18 and ***Stuckless II*** are inapplicable, it may resort to 20 NYCRR 132.24 and fashion a fair and equitable alternative method of allocation for the income in issue. The Division's proposed method would be to allocate based on the ratio of days worked in New York to the total number of days worked in the particular years in which the subject options were granted to petitioner. According to the Division, this allocation method avoids the use of multi-year working day count-based allocation, in accord with the reasoning in ***Stuckless II***, is consistent with the approach adopted by the Tribunal in ***Matter of Halloran*** (Tax Appeals Tribunal, August 2, 1990), and (by implication) cures the unfair and inequitable result which would result from application of 20 NYCRR 132.18.

CONCLUSIONS OF LAW

A. There exist two bases upon which New York may assert jurisdiction and apply its personal income tax, to wit, residence of the person and source of the income, gain, loss or deduction (Tax Law § 601[a],[e]; ***Stuckless II***). Residents are subject to tax on their worldwide income regardless of source, while nonresidents are subject to tax only on their New York source

[3]The Division makes no assertion, nor is there any evidence, that the income at issue was pension or retirement income such that the multi-year allocation rule of 20 NYCRR 132.20 would apply thereto.

income (***id.***). Inasmuch as petitioner was a nonresident, it is upon the latter basis that he may be subjected to New York's personal income tax.

B. The New York source income of a nonresident individual includes the sum of the net amount of items of income, gain, loss and deduction entering into the individual's federal adjusted gross income derived from or connected with New York sources (Tax Law § 631[a][1]), and includes therein items attributable to a business, trade, profession or occupation carried on in New York State (Tax Law § 631[b][1][B]). Petitioner was employed by a New York employer, and he performed services for his employer both within New York State and without New York State during the course of such employment. Tax Law § 631(c) provides further specific statutory instruction concerning the issue of the source of an individual's income derived from a business, trade, profession or occupation carried on partly within and partly without New York State, as follows:

> If a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the tax commission, 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.

As part of his compensation for employment, petitioner received nonstatutory stock options during years prior to those at issue. Since the income in question resulted from the exercise of those stock options, Tax Law § 631(c) requires resort to the Commissioner's regulations to determine what portion, if any, of the subject income is properly considered New York source income allocable to and taxable by New York State.

C. There is no dispute between the parties that income derived from the exercise of nonstatutory stock options granted by an employer to its nonresident individual employee as part of that individual's compensation for the performance of personal services may be taxed as New

York source income to the extent such income is derived from or connected with New York (***see*** 20 NYCRR 132.4[b]), whether the income is received in a current year or, as here, in a later year (***see*** 20 NYCRR 132.4[c]). There is also no dispute that during the years in question, there was no specific regulation addressing the question of allocating income derived from a nonresident's exercise of employer granted stock options. Generally, the allocation of a nonresident employee's income, where that employee performs services for his employer both within and without New York, is determined by a fraction the numerator of which is the number of days worked in New York and the denominator of which is the total number of days worked, per 20 NYCRR 132.18. This regulation, referred to as the "default regulation" by petitioner and found by the Tribunal to be the applicable regulation in ***Stuckless II***, provides as follows:

> (a) If a nonresident employee . . . performs services for his employer both within and without New York State, his income derived from New York State 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. The items of gain, loss and deduction . . . of the employee attributable to his employment, derived from or connected with New York State sources, are similarly determined . . . . In making the allocation provided for in this section, no account is taken of nonworking days, including Saturdays, Sundays, holidays, days of absence because of illness or personal injury, vacation, or leave with or without pay.[4]
>
> (b) Where a nonresident employee . . . performs services both within and without New York State for only part of a taxable year, his income derived from New York State sources during that period includes only that portion of compensation received during the period he performs services both within and without New York State, multiplied by a fraction the numerator of which is the number of days he worked within New York State and the

[4] The fact that the allocation formula is based only on working days and takes no account of nonworking days does not assist the Division's argument that the absence of any working days in a period due to termination of employment means the regulation does not apply, but rather recognizes that allocation of income based on source requires a connection to New York via petitioner's employment and serves to prevent dilution of the allocation ratio resulting from the day-count method of the regulation.

> denominator of which is the number of days he worked both within and without New York State during the period he was required to perform service within and without New York State.

D. Petitioner maintains that the result in ***Stuckless II*** is dispositive in this case. The Division, by contrast, points out that petitioner had ceased employment by the time he exercised his options, and as a result had no working days anywhere when the income in issue was realized. The Division claims this fact negates application of 20 NYCRR 132.18, distinguishes the instant matter from ***Stuckless II***, and requires a different result. Given these circumstances, it will be helpful to review the facts and outcome of ***Stuckless II***. E. Randall Stuckless, a New York resident prior to September 1, 1996, was employed by Microsoft Corporation and was granted incentive stock options in connection with his employment. On September 1, 1996, Mr. Stuckless relocated to Seattle, Washington, and was a nonresident of New York State from that time until July 5, 1998, when he relocated back to New York State and again became a New York State resident. Mr. Stuckless remained employed by Microsoft at all times before, during and after this period, but during the time he was a resident of the State of Washington (and a nonresident of New York State) he had no working days in New York State for his employer. While he was a resident of the State of Washington, Mr. Stuckless exercised certain of the incentive stock options. He did not report any portion of the income resulting therefrom as income subject to New York State taxation. On audit, the Division determined that part of the option income was allocable to and taxable by New York, calculated such allocation based on the number of days Mr. Stuckless worked in New York compared to the number of days he worked both within and without New York for the period from the option grant dates to the option exercise dates, and asserted tax due on the allocated portion of the option income so determined.

E. On review, the Tax Appeals Tribunal held in ***Stuckless II*** that the stock option gain of a nonresident employee realized in a period during which the nonresident had no days worked in New York State could not, under the regulatory scheme then in place, be allocated to New York and subjected to tax by New York State. In so doing, the Tribunal recognized that there was no regulation specifically addressing the issue of stock option income allocation and concluded that the governing regulation was paragraph (b) of 20 NYCRR 132.18. More specifically, the Tribunal explained that paragraph (a) of 20 NYCRR 132.18 sets forth the general method for allocating compensation income of a nonresident as based on the ratio of the number of days worked in New York state compared to the total number of days worked. In turn, paragraph (b) of 20 NYCRR 132.18 limits the application of such day count allocation formula only to periods in which compensation for services performed within and without New York State is received and during which the recipient had New York work days. The Tribunal concluded that the Division's regulations did not allow for multi-year-based allocation of income for personal services performed partly within and partly without New York State (save for instances of retirement or pension compensation per 20 NYCRR 132.20), but rather allowed only for allocation in the year or period of income realization and only for periods during which there were New York working days. Hence, since Mr. Stuckless realized the incentive stock option income during periods when he had no New York work days (all of 1997 and the portion of 1998 prior to his again becoming a New York resident), such periods were eliminated from the allocation calculation, per 20 NYCRR 132.18(b), and none of the stock option income received in these periods was allocable to or taxable by New York State.

F. The Tribunal also addressed and rejected the Division's attempt to resort to an alternative method of allocation per 20 NYCRR 132.24 (now 20 NYCRR 132.25). The Tribunal

pointed out that Tax Law § 631(c) required apportionment and allocation to be made pursuant to regulations adopted by the Commissioner, and explained that 20 NYCRR 132.24 was intended to cure ad hoc situations where application of the existing allocation regulations (i.e., 20 NYCRR 132.15 through 132.23) resulted in palpably inequitable or unfair results, but was not available to fashion an allocation rule or method of general applicability. Thus, the Tribunal rejected application of the multi-year method of allocation proposed in ***Stuckless II***, as set forth in a Division Technical Services Bureau Memorandum (***see*** TSB-M-95[3]I). The Tribunal described such memorandum as "a highly articulated set of rules of general application," noting that the same "occupies eleven pages of single spaced type and governs the tax treatment of residents and nonresidents and part-year residents who hold statutory stock options, nonstatutory stock options, restricted stock and stock appreciation rights." The Tribunal viewed applying such memorandum as elevating the same to the status of a regulation without having undertaken the requisite process for adoption of a regulation. The Tribunal observed that none of the other regulatory provisions setting forth special rules for categories of nonresidents in situations where the general rules have been determined to produce inappropriate results (save for 20 NYCRR 132.20 [retirement payments]) allow for multiple-year allocation. The Tribunal pointed out that if the Division could simply adopt its memorandum as the alternative allocation method, then its adoption of 20 NYCRR 132.20, providing a multiple-year allocation formula for taxing nonannuity pension and retirement payments, "was an act of supererogation and that the same result might have been reached merely as an administrative interpretation of [20 NYCRR 132.4(c)]." In sum, since the applicable regulation (20 NYCRR 132.18[b]) did not provide for multi-year (or period), working day-count allocation but rather called for elimination of periods in which income was received but in which there were no New York working days, there was no allocation of Mr. Stuckless's

income for such periods. The Tribunal observed that the Division was not precluded from adopting regulations supporting use of the method of allocation it proposed (i.e., multi-year based allocation), but that such method was inconsistent with the Division's then-existing regulations on allocation.

G. The critical question in this case is whether the termination of petitioner's employment, with the consequent absence of any working days, as opposed to the absence of only New York working days (as in ***Stuckless II***), in a year of realization of income from the exercise of nonstatutory stock options by a nonresident changes the result of ***Stuckless II***. That is, does the fact that petitioner had no working days at all in the years of income realization negate application of 20 NYCRR 132.18 and its New York working days versus total working days ratio in the year of realization as the applicable method of apportionment and allocation, and allow the Division to proceed to another method of apportionment and allocation per 20 NYCRR 132.24. Petitioner claims that, having terminated his employment with the option-granting employer upon retirement and thus having no New York working days in the years in which the option income was realized, results in no New York source income subject to allocation. Petitioner maintains that 20 NYCRR 132.18(b) does not question why there were no New York work days but rather, as held in ***Stuckless II***, simply mandates elimination of periods in which a nonresident has no New York working days.

H. In ***Stuckless II***, the Tax Appeals Tribunal noted, as to 20 NYCRR 132.18, that "[a]lthough paragraph (a) does not state expressly the period over which the number of working days is to be calculated, paragraph (b) refers to the 'taxable year' and several examples are provided in which the rule of paragraph (a) is applied to the days worked during the taxable year

in which the income is realized." In reviewing the foregoing regulation, the Tribunal noted the distinction between paragraphs (a) and (b) thereof. Specifically, the Tribunal explained that:

> the method generally prescribed for determining the source of income from rendering personal services is proration based on the number of days worked in New York and the number of work days outside of the state (see, 20 NYCRR 132.18[a]). The Division's regulations also provide for a closing of the books for sourcing purposes, but no accruals, where there are periods involving no work in New York (see, 20 NYCRR 132.18[b]).

The Tribunal further explained that:

> [T]hese rules provide in paragraph (a) for an allocation based on a day count ratio during periods of work that include both work within the state and without the state. *The rule in paragraph (b) looks to the period in which "the compensation [is] received" in determining whether the ratio set out in paragraph (a) applies or alternatively the period is simply eliminated from the calculation.* (Emphasis added.)

In ***Stuckless II***, the Tribunal summarized petitioners' argument concerning the appropriate paragraph to be applied in the statement "[m]oreover, the governing regulation in this case is not subsection (a) of 20 NYCRR 132.18, but rather subsection (b) which specifically provides that *periods in which no services are performed in New York are excluded from the allocation formula*"(emphasis added). In restating and adopting this position in ***Stuckless II***, the Tribunal explained:

> Subparagraph (a) provides for an allocation of income based on days worked in New York. Subparagraph (b) provides that there is *no such allocation when there are no New York work days in a period*. Petitioner's position is that the Division is inappropriately attempting to apply subparagraph (a) by stretching the days included in the denominator of the fraction beyond a taxable year when in truth (b) is the governing provision since *the compensation at issue was received in a period in which no New York work was performed*. We find petitioner's argument persuasive. (Emphasis added.)

I. As distilled from the foregoing, paragraph (a) provides the method by which the extent of a nonresident's items of income, gain, loss and deduction constitute New York source income

allocable to and taxable by New York State, while paragraph (b) looks to the period in which the compensation was received and whether there were New York working days therein as the limitation on whether the allocation method set forth in paragraph (a) is applicable to determine the extent to which such income is taxable by New York for the period (part or whole taxable year). The day count method of allocation set forth in 20 NYCRR 132.18(a) applies where a nonresident has working days both in and out of New York during periods in which compensation for services is realized. In turn, the absence of New York working days in a given period of income realization results, per paragraph (b), in no allocation for such period. Under the regulations in place during the years in issue, the existence of New York working days *in the year or period in which compensation based stock option income was realized* by a nonresident was the necessary predicate allowing a portion of such income to be allocated to and taxed by New York State. Here, as in ***Stuckless II***, there were no New York working days during the relevant periods and thus there was no allocation of income for such periods per 20 NYCRR 132.18(b). By "closing the books" with no accruals for sourcing purposes to periods involving no working days in New York, paragraph (b) simply serves to exclude such periods altogether.

J. The application of paragraph (b) of 20 NYCRR 132.18 is neither explicitly nor implicitly contingent upon continuing employment and, as petitioner points out, it is possible to have periods with no New York working days either because employment activities were performed entirely outside of New York, as in the case of Mr. Stuckless, or because of termination of employment for whatever reason (including retirement), as in the case of petitioner herein. Obviously, it is possible to have a period with no New York work days that lasts for less than, all of, or more than an entire year. Paragraph (b) imposes no criteria as to why there are no New York work days, and it makes no difference that, due to his retirement,

petitioner had no working days. The regulatory scheme in place during the years at issue did not provide a method of allocation to be applied in lieu of 20 NYCRR 132.18(b) when there were no New York working days because employment had been terminated. The rule set forth in 20 NYCRR 132.18(b), as explained in ***Stuckless II***, is simply that if there are no New York working days during the period when the income is received, then such period is excluded from the calculation and there is no allocation of the income.

K. The practical difficulty in this case, as in ***Stuckless II***, arises from the fact that the compensation was in fact received (i.e., upon option exercise) in a taxable year subsequent to the year in which the options were granted. While it is undisputed that such income may be subjected to tax (20 NYCRR 132.4[c]), it remains that petitioner had no working days in New York (or anywhere) in the years of income realization, thus presenting the issue concerning whether there was an available methodology under the regulations in existence in such years by which the income could be allocated to New York. The Tribunal's conclusion that allocation and apportionment were required to be made pursuant to regulations adopted by the Commissioner of Taxation, per Tax Law § 631(c), and that the regulations then existing did not provide for determining the allocation ratio based on anything other than the New York working days in the year or period in which the income was received (i.e., did not allow for multi-year based allocation), left none of Mr. Stuckless's stock option income allocable to New York. That same analysis determines the result herein.

L. The Division has argued that because there were no working days anywhere (and not simply an absence of working days in New York State), 20 NYCRR 132.18 does not apply, and it is therefore both allowable and necessary to utilize another method to arrive at a fair and equitable allocation of petitioner's option income to New York. The Division posits that resort

to an alternative method is allowable pursuant to 20 NYCRR 132.24 (now 132.25), entitled "Other methods of allocation," which provides as follows:

> Sections 132.15 through 132.23 of this Part are designed to apportion and allocate to New York State, in a fair and equitable manner, a nonresident's items of income, gain, loss and deduction attributable to a business, trade, profession or occupation carried on partly within and partly without New York State. Where the methods provided under those sections do not so apportion and allocate those items, the Department may require a taxpayer to apportion and allocate those items under such method as it prescribes, as long as the prescribed method results in a fair and equitable apportionment and allocation. A nonresident individual may submit an alternative method of apportionment and allocation with respect to items of income, gain, loss and deduction attributable to a business, trade, profession or occupation carried on partly within and partly without New York State. The proposed method must be fully explained in the taxpayer's New York State nonresident personal income tax return. If the method proposed by the taxpayer is approved by the department, it may be used in lieu of the applicable method under sections 132.15 through 132.22 of this Part.

M. If, as the Division argues, 20 NYCRR 132.18 does not apply, then it is necessary to address the Division's proposal to apply an alternative method of allocation, per 20 NYCRR 132.24. In choosing its proposed alternative method, the Division addresses its inability to allocate over a period of multiple years, as was proposed but rejected in ***Stuckless II***, by making an allocation based upon petitioner's work day counts in the years when the options were granted. The Division describes its proposed alternative allocation method as resting on a "single well-established principle" that "[w]hen, in a year he performs no work anywhere, a nonresident realizes income attributable to work performed partly in New York in a prior year, that income is taxable at 'the proportionate level of services' performed 'during the period in which [it] was actually secured or earned.'" This approach, premised upon the argument that 20 NYCRR 132.18(b) does not apply and upon the outcome in ***Matter of Halloran***, still faces the primary problem of alternative allocation as identified by the Tribunal in ***Stuckless II***. That is, the Division's proposed alternative simply replaces one general method of allocation (multi-year

allocation) to be applied to all similarly situated nonresidents with another general (and here unwritten) method of allocation (single year of grant) to be likewise applicable to all similarly situated nonresidents as the general rule in the case of stock option income. This fails to address or overcome the Tribunal's holding that 20 NYCRR 132.24 was intended to be utilized on an ad hoc basis to rectify unfair or inequitable apportionment resulting from the application of the existing regulations, and was not intended to allow imposition of alternative rules of general application carrying the force of law which attaches to duly promulgated and adopted regulations. In rejecting this approach in ***Stuckless II***, the Tribunal stated:

> The rules and examples set out in section 132.18 of the regulations express, or strongly imply, an allocation based on work days within the taxable year in which the income is realized . . . . If the Division wishes to depart from the rules provided by those sections and create a separate set of new rules for identified special circumstances, we think such a change should be effected through legislation or adopted in regulations as was done in section 132.20 in the case of retirement payments and section 132.22 in the case of payments to professional athletes.[5]

N. The perceived unfairness or inequity from the Division's perspective appears to be that income potentially allocable to and taxable by New York is not being allocated and is thus lost to taxation. However, it is hard to accept that the absence of a specific regulation required for allocation of a nonresident's stock option income constitutes the type of inequity or unfairness which should be remedied by application of 20 NYCRR 132.24, and the creation of an alternative allocation scheme thereunder. This is especially true when the simple cure for the perceived problem was the adoption of a regulation addressing the situation, as was consistent

---

[5] During the years in issue, the other regulations providing methods of allocating income and deductions from sources within and without New York State addressed income from (or earned by) businesses (132.15), rental, sale or exchange of real estate (132.16), salesmen (132.17), seamen (132.19), pension and retirement benefits not qualifying as annuities (132.20 [including the provision for multi-year based allocation]), securities and commodities brokers (132.21), professional athletes (132.22) and owners of vessels (132.23).

with and required by Tax Law § 631[c]).[6] Moreover, and as petitioner points out, the alternative allocation formula proposed by the Division in this case simply trades a multi-year (or string of years) day count approach, as was proposed but rejected in ***Stuckless II***, for a single year (year of option grant) day count approach, essentially resulting in nothing more than an "end run" around the holding of ***Stuckless II***. Finally, the Division's proposal to apply a year-of-grant working-days ratio fails to acknowledge the issue of whether there would ever be any gain realized from the options which had little value at the time of their grant (e.g., the possibility that the options would never be exercised), or the question of taxing accretions in value occurring many years later and having little if anything to do with services performed by the income recipient.

O. It would be at best incongruous to accept the conclusion that continuing employment in a period in which stock option income is realized, but in which there are no New York working days, results in no income allocation and no taxation, while termination of employment and hence the absence of New York working days in a period of realization of such income leads to the opposite result of allocation and taxation. Neither the nature of the income, the time of its receipt nor the absence of New York working days in the period of receipt have changed in either instance, thus leaving the question of sourcing, allocation and taxability based solely on whether there were working days anywhere. Under ***Stuckless II***, and its holding with regard to the former regulatory scheme, a nonresident taxpayer who continues to be employed can avoid New York tax on employee stock option income by the mere expedient of timing the exercise of his options to periods in which he has no New York working days. Thus, by chance (or perhaps by mere

[6]Subsequent to the periods in issue here, and in response to the Tribunal's decision in ***Stuckless II***, the Tax Law was amended and the regulations were changed to allow for, among other things, multi-year day count based allocation with respect to stock option income such as that in question herein (***see*** Tax Law § 631[g]; § 638[c]; 20 NYCRR 132.24). These changes were made effective for 2006 and years thereafter.

serendipitous timing of a move to another jurisdiction) no New York tax will result. In contrast, a departure from the holding in ***Stuckless II***, as urged by the Division, would result in the same nonresident taxpayer, who terminates his employment and likewise times the exercise of the same options to periods in which he has no New York working days, being subject to allocation and taxation. Such an arbitrary result clearly must succumb to the better analysis and clear conclusion reached in ***Stuckless II*** that, where there are no New York working days in a year or period of a nonresident's realization of employer-granted stock option income, then such year or period is excluded from the calculation per 20 NYCRR 132.18 (b) and there is no allocation. While this may be bothersome to the extent that the option income arose in connection with employment services rendered in part in New York, and thus perhaps "should," at least in part, be subject to tax by New York, the same presents a circumstance capable of being remedied by the adoption of a new regulation and that remedy was in fact accomplished, albeit for years after those at issue herein. Ultimately, the problem is not that the Division's view of what "should" be subjected to tax is not justified, but rather that the Division was obliged to undertake its action pursuant to regulations. During the years in question the regulations promulgated by the Commissioner did not support the Division's proposed action. The fact that there will never be New York working days in a year of option exercise and resulting realization of income by a nonresident retiree (barring return to his former employment), such that the compensation income escapes New York taxation, does not allow the Division to impose an alternative general rule of allocation by administrative fiat to change this result. The critical distinction is not, as the Division argues, whether there was or was not employment, but simply whether there were or were not New York working days in the period of receipt. This was the necessary link by which income could be allocated to New York in a year or period in which it was realized. This

distinction (essentially the possibility of an allocation fraction because one is still employed) is insufficient to support the disparate treatment between Mr. Stuckless and petitioners herein, at least without a regulation supporting the same. In sum, the reason why one may have no New York work days (choice of timing, happenstance, voluntary or forced change of work assignment, loss of employment, retirement, etc.) does not overcome the analysis and outcome reached in ***Stuckless II***.

P. Finally, the Division's reliance on ***Matter of Halloran*** is misplaced. That case involved an employee who was out of work on sick leave for a full year and thus had no New York working days. The Tribunal determined that the income was entirely attributable to Mr. Halloran's prior work since he had accrued his sick leave benefit as the result of his employment. As a result, the Tribunal held that 20 NYCRR 132.18(a) did not apply, and instead used an alternative allocation method for the sick leave pay, under 20 NYCRR former 132.23 (now 20 NYCRR 132.25), based upon the average yearly ratio of New York working days to all working days for the five-year period of Mr. Halloran's employment immediately preceding 1986, the year in question. The Tribunal relied in ***Halloran*** upon Tax Law former § 632(a)(1) (now Tax Law § 631[a][1]) and did not address Tax Law § 631(c) and 20 NYCRR 132.18(b) in arriving at its decision. Furthermore, ***Halloran*** was decided some 18 years before ***Stuckless II***, and did not, unlike ***Stuckless II***, deal directly with stock option income. This distinction is noteworthy given that sick leave benefits are earned and typically accrue in direct relation to an employee's actual number of hours worked or time period of employment, whereas the accretions in stock value and hence the gain element derived therefrom may be viewed as the result of market factors less directly connected with an individual's employment hours or period of service. Further, the Division's argument, based on ***Halloran***, that the application of 20 NYCRR 132.18 is limited to

circumstances in which services are rendered both within and without New York State conflicts with the reasoning in ***Stuckless II***. That is, the Tribunal found 20 NYCRR 132.18(b) applicable to periods where services were *not* rendered both within and without New York State in holding that 20 NYCRR 132.18(b) served to eliminate periods where income was received but where there were no New York working days (i.e., no services rendered in New York State). To the extent the two cases reach inconsistent results, it seems apparent that ***Stuckless II*** must be read as effectively overruling ***Halloran***.

Q. The petition of Thomas R. Hopkins and Eileen P. Hopkins is hereby granted, the Division's June 8, 2007 Notice of Disallowance is cancelled, and petitioners' requests for refunds for the years 2003 and 2004 are granted.

DATED: Troy, New York
January 8, 2009

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE