STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT ABODEELY AND CONSTANCE ABODEELY	:	DETERMINATION DTA NOS. 821863 AND 821939
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2003, 2004 and 2005.	:	

Petitioners, Robert Abodeely and Constance Abodeely, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 2003, 2004 and 2005.

On February 27, 2008 and April 14, 2008, respectively, petitioners, appearing by Petralia, Webb and O'Connell, P.C. (Arnold R. Petralia, Esq., of counsel), and the Division of Taxation, appearing by Daniel Smirlock, Esq. (Margaret T. Neri, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by July 30, 2008, which date began the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly denied petitioners' requests for refunds for the years 2003 and 2004 and properly reversed its allowance of a refund for the year 2005 in connection with the exercise of stock options during those years.

FINDINGS OF FACT

The parties entered into a Stipulation of Facts which has been incorporated into the Findings of Fact below. In addition, the Division of Taxation submitted 15 proposed findings of fact, all of which have been incorporated into the Findings of Fact, to the extent that they are consistent with the stipulated facts, except for proposed findings 14 and 15, which, as restatements of procedural matters, are not proper or necessary.

1. Robert and Constance Abodeely were married at all times relevant herein. Constance Abodeely is a party because she filed joint New York State income tax returns with Robert Abodeely for the years at issue. All further references to the petitioner are to Robert Abodeely unless otherwise stated.

2. Petitioner worked for Pfizer Corporation (Pfizer) or its subsidiaries or divisions in New York State from August 7, 1988 until January 14, 1999 when he retired. His last paycheck was January 14, 1999. Pfizer and its subsidiaries and divisions are referred to collectively as Pfizer.

3. At all times during his employment, petitioner was a resident of New Jersey and performed services for Pfizer within and without New York State. The days worked in New York State and total days worked are as follows:

	Days Worked in NY	Total Days Worked
1996	113	230
1997	178	225
1998	100	225
1999	0	0

4. Incentive Stock Options (ISO's) and Non Qualified Options (NQO's) were granted to petitioner by Pfizer in 1992 and 1996 for Pfizer common stock incident to his employment.

5. Following his retirement in 1999, petitioner continued to live in New Jersey. He never resided in New York during the years in issue.

6. In every case, the NQO's were exercised and sold on the same date. ISO's were all exercised on January 25, 1999 and sold in 2003. The following tables show the details of each option exercise and sale of the option stock.

2003

Non Qualified Stock Options Reported on a W-2

Sale/Exercise Date	Grant Date	Grant Type	# Shares Sold	Grant Price	Exercise Price	Gain Per Share	Total Gain
4/10/03	8/22/96	NQO	1,500	12.42	33.07	20.65	30,975
3/31/03	8/22/96	NQO	2,000	12.42	33.02	19.60	39,200
3/26/03	8/22/96	NQO	1,000	12.42	31.82	19.40	19,400
3/21/03	8/22/96	NQO	3,000	12.42	29.95	17.53	52,590
6/06/03	8/22/96	NQO	1,194	12.42	33.60	21.18	25,289
9/18/03	8/28/96	NQO	2,235	18.35	32.32	13.97	31,223
9/18/03	8/28/96	NQO	7,764	18.35	32.30	13.95	108,308
9/12/03	8/28/96	NQO	9,999	18.35	31.77	13.42	134,214
TOTAL							441,199

ISO's Reported on Schedule D

Sale/Exercise Date	Grant Date	Grant Type	# Shares	Grant Price	Exercise Price	Gain Per Share	Total Gain
9/8/03	8/17/92	ISO	2,900	6.75	38.93	32.18	93,322
9/8/03	8/17/92	ISO	6,600	6.75	38.93	32.18	212,388
9/8/03	8/17/92	ISO	500	6.75	38.93	32.18	16,090
TOTAL							321,800

2004

NQO's Reported on a W-2

Sale/Exercise Date	Grant Date	Grant Type	# Shares	Grant Price	Exercise Price	Gain Per Share	Total Gain
4/7/04	8/22/96	NQO	2,000	12.42	35.77	23.35	46,700
6/1/04	8/22/96	NQO	2,000	12.42	35.33	22.91	45,280
TOTAL							91,980

2005

NQO's Reported on a W-2

Sale/Exercise Date	Grant Date	Grant Type	# Shares	Grant Price	Exercise Price	Gain Per Share	Total Gain
4/15/05	8/22/96	NQO	4,000	12.42	27.87	15.45	61,800
12/13/05	8/22/96	NQO	4,000	12.42	21.95	9.53	38,120
12/13/05	8/28/96	NQO	6,789	18.35	21.95	3.60	24,440
TOTAL							124,360

7. Petitioner was reflected on the Pfizer payroll records at all times during his employment and was eligible to participate in its employee plans.

8. Petitioner filed a nonresident income tax return for each of the years in issue prior to the decision in ***Matter of Stuckless*** (Tax Appeals Tribunal, August 17, 2006) (***Stuckless II***).

9. Petitioner reported the option income based on the number of days worked in New York from date of grant to date of exercise.

10. Following the decision in ***Stuckless II***, petitioner filed amended personal income tax returns for the years in issue, claiming a refund of the New York tax on the option stock income. The refund was initially granted for the year 2005 in the amount of $2,678.22, plus interest. The

refunds were denied for the years 2003 and 2004 by a Notice of Disallowance, dated July 20, 2007. The notice stated that petitioner's status as "retired" created a special circumstance which justified the use of an alternative allocation pursuant to income tax regulation 20 NYCRR former 132.24 to reach a fair and equitable allocation.

11. The Division of Taxation issued a Notice of Deficiency, notice number L-028966913, dated September 20, 2007, for the tax year 2005, disallowing the refund previously granted and asserting tax due in the sum of $2,678.22 plus interest.

12. Both the Notice of Disallowance and the Notice of Deficiency took the position that ***Stuckless II*** did not apply. Rather, the Division of Taxation chose to apply an alternative allocation method under 20 NYCRR former 132.24 to tax petitioner's option gain.

13. Petitioner had no work days in New York or elsewhere for the years in which he exercised his options and sold his stock.

SUMMARY OF THE PARTIES' POSITIONS

14. Petitioner argues that the rationale of the ***Stuckless II*** decision is controlling, and that income from the exercise of stock options granted to him in connection with his employment should not have been allocated to New York because he had no working days in New York in the years in which the income was realized. Petitioner contends that the regulation at 20 NYCRR 132.18 provides the proper basis for allocation in this matter, citing the Tribunal's language in ***Stuckless II*** which said, "there is no such allocation when there are no New York work days in a period." Since petitioner did not work in New York during the years in issue, the Division cannot allocate income to New York.

15. Petitioner points out that Tax Law § 631(c) anticipated implementation of an allocation or apportionment scheme by regulation, but none were promulgated to address the exercise of stock options by nonresidents.

16. Petitioner maintains that the Division's attempt to rely on the regulation at 20 NYCRR former 132.24 is contrary to the Tribunal's rationale in ***Stuckless II***, because that regulatory section was intended to address only ad hoc situations to prevent unfair or inequitable results in allocation cases. Thus, the Division's reasoning here is the same as that expressed in TSB-M-95(3)I, with which the Tribunal disagreed in ***Stuckless II.***

17. The Division of Taxation argues that since petitioner had no working days anywhere following his retirement in January of 1999, 20 NYCRR 132.18 is inapplicable because that regulation focused on days worked within and without New York and did not take into account nonworking days. Therefore, the Division concludes that ***Stuckless II*** is inapplicable as well. To reach a fair and equitable result, the Division contends that this matter must be governed by 20 NYCRR former 132.24.

CONCLUSIONS OF LAW

A. Tax Law § 601(e) provides for the imposition of income tax on the taxable income of nonresidents, like petitioner, from sources in New York.

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 items attributable to a business, trade, profession or occupation carried on in New York (Tax Law § 631[b][1][B]). Petitioner was employed by a New York employer, performing

services both within and without New York during the course of his employment. Tax Law § 631(c) provides:

> 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 petitioner's compensation, he received nonstatutory stock options during years prior to those in issue. Since the income in issue resulted from the exercise of those options, Tax Law § 631(c) requires an apportionment or allocation pursuant to the regulations. However, for the years in issue, there was no regulation that specifically addressed the allocation of income from a nonresident's exercise of employer granted stock options.

B. The regulation at 20 NYCRR 132.18 provides a general rule for the allocation of a nonresident employee's income, and states, in part, 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 this employment, derived from or connected with New York State sources, are similarly determined . . . .
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> (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 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.

In ***Stuckless II***, the Tribunal stated:

> The general rules applicable to employees performing services partly within New York are set out in section 132.18(a) and (b), which are quoted in part above. These

> 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 work without the state. The rule in paragraph (b) looks to the period in which "compensation [is] received" in determining whether the ratio set out in paragraph (a) applies or alternatively the period is simply eliminated from the calculation.

Pursuant to this rationale, a period would be eliminated if it contained no New York State work days by a nonresident employee. Thus, where there are no New York State work days in a period, the result would be no allocation of the income. In the instant matter, petitioner owed no tax since, following his retirement on January 14, 1999, he had no further New York employment, and therefore, there was no basis for allocation. Yet, the Division rejected the obvious outcome which resulted when according petitioner zero New York working days in the formula.

The rule of 20 NYCRR 132.18(b) is plainly 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 income. The Division's incredulity at such a result is not a basis for permitting it to resort to an ad hoc provision (20 NYCRR former 132.24)[1] to address what was specifically not included in 20 NYCRR 132.18(b).

The Division, met with circumstances not specifically addressed by 20 NYCRR 132.18(a) and (b) that would deprive it of all taxable income from petitioner, concluded that these were special circumstances that demanded an alternate allocation method permitted by 20 NYCRR former 132.24 to avoid an unfair and inequitable result.

In ***Stuckless II***, the Tribunal considered and rejected the Division's attempt to use 20 NYCRR former 132.24 to justify an allocation methodology for stock options as set forth in

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[1]The regulation at 20 NYCRR former 132.24 provided that where regulatory provisions designed to apportion and allocate a nonresident's income to New York State in a fair and equitable manner failed to do so, the Division may require a taxpayer to apportion and allocate income under an alternate method prescribed by it.

Technical Services Memorandum TSB-M-95(3)I. The Memorandum proposed a set of highly articulated rules tantamount to a general rule of allocation, as general in scope as that found in 20 NYCRR 132.18(b). The Tribunal said that since it was not a properly promulgated regulation under the State Administrative Procedure Act, it could and should not have the force and effect of a regulation. In light of the fact that 20 NYCRR 132.18(b) provided a formula for allocating, or not allocating, petitioner's option income in a plain and clear manner, the Division's rush to use an alternative allocation method pursuant to 20 NYCRR former 132.24 was unfounded. It appears the Division, facing an unfavorable result from a tax revenue standpoint, proposed an "equitable" rule of general application to skirt the rule-making process, which was explicitly condemned by the Tribunal in ***Stuckless II.*** The regulation at 20 NYCRR former 132.24 was designed to prevent inequitable and unfair results when those regulatory sections, including 132.18, failed to so do. The Division has corrupted this intention by using it to amend 20 NYCRR 132.18 to reach a result beyond its plain language.

C. The Division's assertion of tax herein also seems to run afoul of the basic rules of accrual, i.e., if the income in question is not accruable to the years in issue, then there should be no tax due. In ***Stuckless II,*** the Tribunal said that income is includible in gross income when all the events have occurred which fix the right to receive that income and the amount can be determined with reasonable accuracy (citing Treas Reg § 1.451-[a]). With respect to the NQO's, income is realized at the time of exercise, while it is realized at the time of sale of the option stock for ISO's. Thus, the income in issue was accruable to the years in issue - - years in which there was no New York employment, and therefore no tax due.

D. The Division's reliance on ***Matter of Halloran*** (Tax Appeals Tribunal, August 2, 1990) is misplaced. There, the Tribunal was called upon to determine whether sick leave, used in a

period when that petitioner did not work in New York State or anywhere, was subject to income taxation. The Division of Taxation had determined that the sick leave utilized by Mr. Halloran was "a form of wage continuation for work performed in prior periods." The Division argued that such payments constituted regular earnings as an employee even though the taxpayer did not actually render any services for compensation. Mr. Halloran was an employee during the period he received the income, which was accrued in direct relation to his years of employment.

The Tribunal agreed with the Division and rejected the petitioner's argument that the inclusion of nonworking sick days was in error. The Tribunal said that petitioner's contention ignored the plain language set forth in the regulation at 20 NYCRR 132.18(a) that its application is limited to circumstances in which services are rendered both within and without the state. As petitioner in the year at issue performed no services either within or without the state, the language set forth in 20 NYCRR 131.18(a) was not applicable.

Halloran was decided under Tax Law former § 632(a)(1) (now Tax Law § 631[a][1]), which contained no provision for apportionment or allocation like Tax Law § 631(c), the subsection in issue for petitioner herein, and the section specifically addressed by the Tribunal in ***Stuckless II***.

That being the case, the rationale in ***Stuckless II*** and not ***Halloran*** is applicable here, and just as no allocation was permitted in ***Stuckless II*** because there was no applicable regulation applying Tax Law § 631(c) to stock options, no regulations exist here which follow the directive language of Tax Law § 631(c) to apportion or allocate items of income, gain or loss under "such regulations." Just as in ***Stuckless II,*** the Division has attempted to fashion a new allocation rule of general applicability, which was not the intended use of 20 NYCRR former 132.24, a regulation meant to be utilized on an ad hoc basis to cure inequitable or unfair results.

E. The petition of Robert and Constance Abodeely is granted, the Notice of Deficiency with respect to 2005, dated September 20, 2007, is canceled, and petitioners' refund applications for 2003 and 2004 are granted.

DATED: Troy, New York
January 29, 2009

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE