

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Eugene J.T. Flanagan :
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Personal Income :
Tax under Article 22 of the Tax Law for the Year :
1972. :

AFFIDAVIT OF MAILING

State of New York
County of Albany

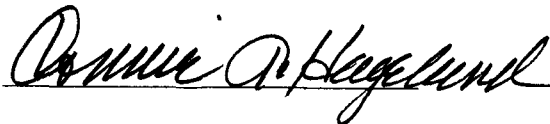
Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 27th day of November, 1981, he served the within notice of Decision by certified mail upon Eugene J.T. Flanagan, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

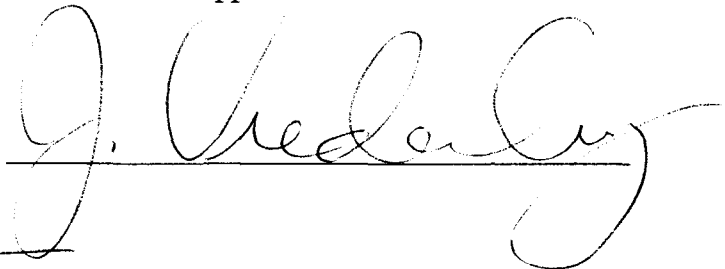
Eugene J.T. Flanagan
153 Dorchester Road
Scarsdale, NY 10583

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
27th day of November, 1981.


Dennis A. Haglund


Jay Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION

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Eugene J.T. Flanagan :
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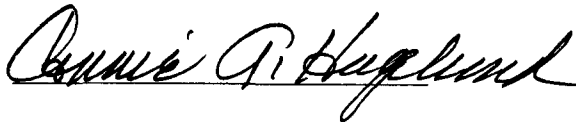
Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 27th day of November, 1981, he served the within notice of Decision by certified mail upon James W. Shea the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

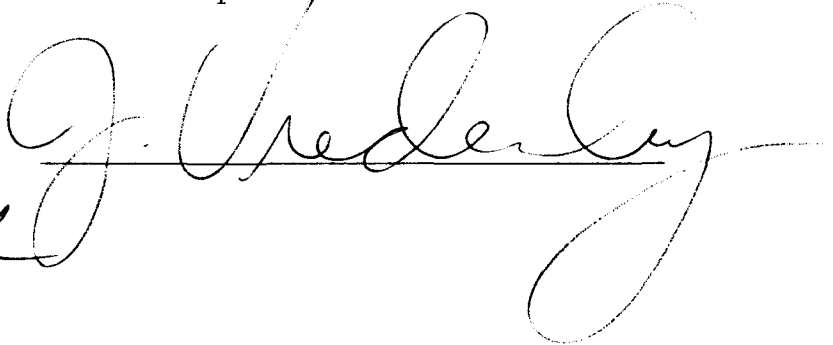
James W. Shea
Conboy, Hewitt, O'Brien & Boardman
20 Exchange Pl.
New York, NY 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
27th day of November, 1981.


James W. Shea


Jay Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

November 27, 1981

Eugene J.T. Flanagan
153 Dorchester Road
Scarsdale, NY 10583

Dear Mr. Flanagan:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
James W. Shea
Conboy, Hewitt, O'Brien & Boardman
20 Exchange Pl.
New York, NY 10005
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
EUGENE J.T. FLANAGAN	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Year 1972.	:	

Petitioner, Eugene J.T. Flanagan, 153 Dorchester Road, Scarsdale, New York 10583, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1972 (File No. 14488).

A formal hearing was held before Melvin S. Barasch, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 11, 1978 at 2:00 P.M. The petitioner appeared by Conboy, Hewitt, O'Brien & Boardman, Esqs., (James W. Shea, Esq., of counsel). The Audit Division appeared by Peter Crotty, Esq., (Bruce A. Zalaman, Esq., of counsel).

ISSUE

Whether interest payments made by petitioner in order to exercise a qualified stock option constituted a deduction for allocable expenses under section 623 of the Tax Law.

FINDINGS OF FACT

1. On February 28, 1975, the Audit Division issued a Statement of Audit Changes against the petitioner Eugene J.T. Flanagan asserting additional income tax under Article 22 of the Tax Law for the year 1972 in the amount of \$801.75, plus interest. Accordingly, on February 24, 1976 a Notice of Deficiency was issued against the petitioner for the year 1972 in the amount of \$973.90,

including interest. Petitioner timely filed a petition with respect to the aforementioned deficiency.

2. The deficiency is based on the inclusion of petitioner's interest expense in determining those allocable expenses which are attributable to items of tax preference.

3. On November 2, 1970, the petitioner entered into a "stock option agreement" with Phillip Morris, Inc., his employer, which allowed petitioner to purchase, in the aggregate, no more than 7,500 shares of the common stock of Phillip Morris, Inc. at the fixed price of \$44.625 per share prior to October 31, 1975, subject to certain conditions not relevant to this matter. On December 16, 1971 petitioner exercised his option to purchase 1500 shares of said stock at \$44.625 per share reserving his right to purchase 6,000 additional shares. On the same date petitioner executed a demand note in the sum of \$66,900.00 in favor of Bankers Trust Co. which thereupon advanced \$66,900.00 to petitioner who then made payment to Phillip Morris, Inc. by delivery of a check in their favor in the amount of \$66,937.50 in payment for the 1500 shares purchased by him at the option price. On April 10, 1972, petitioner purchased 2250 shares of stock of Phillip Morris, Inc. pursuant to his option, still reserving his right to the purchase of 3750 additional shares of stock. On the same date petitioner again executed a demand note in favor of Bankers Trust Co. in the amount of \$100,000.00 in exchange for an equivalent sum and made payment to Phillip Morris by delivery of a check in the amount of \$100,406.25 in payment for the 2250 shares purchased at the option price.

4. During the year 1972, petitioner incurred and paid the following monthly interest with respect to the outstanding loans from Bankers Trust Co., the interest being computed monthly (based on the then existing "prime rate"):

<u>DATE PAID</u>	<u>AMOUNT OF LOAN OUTSTANDING</u>	<u>AMOUNT OF INTEREST</u>
1/4/72	\$ 66,900.00	\$ 172.82
2/2/72	66,900.00	313.60
3/2/72	66,900.00	279.21
4/4/72	66,900.00	293.62
5/2/72	166,900.00	626.52
6/2/72	166,900.00	790.46
7/5/72	166,900.00	770.76
8/2/72	166,900.00	847.25
9/5/72	166,900.00	835.66
10/3/72	166,900.00	834.50
11/2/72	166,900.00	897.09
12/4/72	166,900.00	855.02
	TOTAL INTEREST	\$7,516.51

5. Petitioner, in his computation of modification for allocable expenses attributable to items of tax preference, failed to include the \$7,516.51 on line 1(a) of Part IV of New York State Minimum Income Tax Computation Schedule (IT-220) with a notation that such interest was excludable under Section 163 of the Internal Revenue Code and deductible under Section 212.

6. During the year in issue the petitioner was a New York resident.

CONCLUSIONS OF LAW

A. That in 1969 the Federal income tax law was amended to redistribute the tax burden by imposing a tax on certain "items of tax preference". These items of tax preference are defined in section 57 of the Internal Revenue Code and include stock options. New York imposes a similar tax on the New York minimum taxable income of every individual, estate or trust (section 601-A Tax Law). During the year at issue, New York, in addition to the minimum tax, also required a reduction in the Federal itemized deductions available for personal income tax purposes to taxpayers with items of tax preference in excess of the specific deduction. (Section 615(c)(4) of Tax Law, repealed by L. 1978 ch. 70.)

B. That former section 623(a) of the Tax Law provided a formula by which the allocation of expenses attributable to items of tax preference was computed. Former section 623(b)(1) provided in part, that the allocable expenses for a resident individual were to include interest deductible solely by reason of section 163 of the Internal Revenue Code of 1954, as modified by the applicable additions provided for in subsection (d) of section 615 of the Tax Law.

C. That the petitioner's interest expenses are of a personal nature and therefore deductible solely under section 163 of the Internal Revenue Code and not under section 162 or 212 of said Code. (see Petition of Neil A. McConnell and Serena R. McConnell, State Tax Commission, January 16, 1981)

D. That the interest payments on the indebtedness incurred by petitioner in order to exercise a qualified stock option are subject to modification within the intent and meaning of the former section 615(c)(4) of the Tax Law.

E. That the petition of Eugene J.T. Flanagan is hereby denied and the Notice of Deficiency is sustained.

DATED: Albany, New York

NOV 27 1981

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER