

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
James A. & Vilia Y. Michaelsen	:	
for Redetermination of a Deficiency or a Revision	:	AFFIDAVIT OF MAILING
of a Determination or a Refund of Personal Income	:	
Tax under Article 22 of the Tax Law for the Year	:	
1973.	:	

State of New York
County of Albany

David Parchuck, 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 4th day of February, 1983, he served the within notice of Decision by certified mail upon James A. & Vilia Y. Michaelsen, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

James A. & Vilia Y. Michaelsen
c/o Avon Overseas, LTD
Bowater House, Knightsbridge
London, ENGLAND, SW1X7LR

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
4th day of February, 1983.

David Parchuck

Conrad A. Haglund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
James A. & Vilia Y. Michaelsen :
AFFIDAVIT OF MAILING
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 :
1973. :

State of New York
County of Albany

David Parchuck, 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 4th day of February, 1983, he served the within notice of Decision by certified mail upon Arnold Y. Kapiloff the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Arnold Y. Kapiloff
Walker, Walker & Kapiloff
60 E. 42nd St.
New York, NY 10165

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
4th day of February, 1983.

David Parchuck

Barrie A. Haglund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

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

February 4, 1983

James A. & Vilia Y. Michaelsen
c/o Avon Overseas, LTD
Bowater House, Knightsbridge
London, ENGLAND, SW1X7LR

Dear Mr. & Mrs. Michaelsen:

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
Law Bureau - Litigation Unit
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Arnold Y. Kapiloff
Walker, Walker & Kapiloff
60 E. 42nd St.
New York, NY 10165
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
JAMES A. MICHAELSEN and VILIA Y. MICHAELSEN
for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article
22 of the Tax Law for the Year 1973.

DECISION

Petitioners, James A. Michaelsen and Vilia Y. Michaelsen, c/o Avon Overseas, Ltd., Bowater House, Knightsbridge, London, England, SW1X7LR, 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 1973 (File No. 19459).

A formal hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on March 15, 1982 at 3:00 P.M. Petitioners appeared by Walker, Walker & Kapiloff, P.C., (Arnold Y. Kapiloff, Esq., and Ronald S. Herbst, Esq., of counsel). The Audit Division appeared by Paul B. Coburn, Esq., (Paul A. Lefebvre, Esq., of counsel).

ISSUE

Whether the gain realized upon the disposition of certain shares of stock acquired through the exercise of qualified stock options granted by a New York employer to a non-resident employee is taxable as New York source income.

FINDINGS OF FACT

1. Petitioners, James A. Michaelsen and Vilia Y. Michaelsen, husband and wife, were residents of the State of Connecticut in 1973.

2. Petitioners timely filed a New York State Income Tax Nonresident Return for 1973, on which they claimed a refund due of \$5,497.00. A Wage and

Tax Statement attached to this return listed petitioner James A. Michaelson's employer as Avon Products, Inc., 9 West 57th Street, New York, New York.

3. On February 28, 1977, the Audit Division issued to petitioners a Notice of Deficiency asserting additional tax due for 1973 in the amount of \$21,142.00, plus interest of \$3,372.12 for a total due of \$24,514.12. This total was reduced by the amount of refund claimed by petitioners (\$5,497.00), leaving an amount due of \$19,017.12.

4. A Statement of Audit Changes dated January 29, 1975 explained that the above asserted deficiency was due to adjustments made by the Audit Division to petitioners' 1973 return as follows:

- a) Increasing the ratio by which petitioners allocated their income in and out of New York State. The Audit Division denied petitioners' claim that six (6) days worked at home constituted days worked of necessity outside of New York State for petitioner James Michaelson's employer. This denial increases petitioners' allocation ratio from 221/287 up to 227/287.
- b) Including as taxable income an amount equal to the cost of life insurance premiums paid for petitioner James Michaelson by his employer.
- c) Including as New York taxable income an amount equal to the gain from the sale of certain stock in 1973 reported as ordinary income for Federal income tax purposes.

5. Petitioners have conceded and do not contest the Audit Division's increase in petitioners' allocation ratio and inclusion in income of life insurance premiums paid by the employer (see Finding of Fact "4(a) and (b)"), but do contest the inclusion of gain from the sale of stock.

6. In 1968, petitioner James A. Michaelson was granted certain stock options to purchase shares of the capital stock of his employer, Avon Products, Inc. ("Avon"), pursuant to a qualified stock option plan.

7. Pursuant to the exercise of certain of the above options, Mr. Michaelsen was issued 3000 shares of Avon capital stock on March 13, 1972 and another 3000 shares of such stock on February 22, 1973. It is the gain realized by petitioners on the disposition of these 6000 shares of Avon stock which is at issue herein.

8. Petitioners disposed of all of the above 6000 shares of Avon stock in 1973. For Federal income tax purposes, the sale of this stock in 1973 resulted in a disqualifying disposition of stock acquired by the exercise of a qualified stock option, since the stock was not held for the three (3) year period required by the Internal Revenue Code.¹ Accordingly, the gain realized on the disposition was reported as ordinary income (rather than as gain from the sale or exchange of a capital asset) on petitioners' 1973 Federal income tax return. However, no part of the gain realized was included by petitioners on their 1973 New York State Income Tax Nonresident Return.

9. At the hearing, petitioners and the Audit Division agreed that the 6000 shares of stock acquired pursuant to exercise of the options were not pledged as collateral by petitioner James A. Michaelsen to Avon, nor were they in any similar sense tied to or used in connection with a business, trade, profession or occupation carried on by petitioners in New York State. However, petitioner James A. Michaelsen was entitled to receive the stock from Avon as a result of his position as a corporate officer (corporate group vice president) and senior executive with Avon in New York City. A copy of the plan under which the options were granted was not offered as evidence at the hearing.

¹ Treatment of the sale of the stock as a disqualifying disposition is not at issue herein.

CONCLUSIONS OF LAW

A. That section 422(b) of the Internal Revenue Code of 1954, as amended, provides in part that the term "qualified stock option" means an option granted to an individual for any reason connected with his employment by a corporation, if granted by the employer corporation to purchase stock of such corporation.

B. That in spite of the statement that the subject stock was neither pledged, tied to nor otherwise similarly used in connection with a business, trade, profession or occupation carried on by petitioners in New York State, the options through which the stock was acquired were granted to petitioner James A. Michaelson as the result of his position as a senior executive and corporate officer of Avon. Furthermore, there is no evidence to indicate that the options through which the stock was acquired were issued other than as a form of compensation to petitioner James A. Michaelson for past services to Avon or as an incentive for future services to Avon. Accordingly, the stock acquired through the exercise of the options was connected to petitioner James A. Michaelson's employment as a corporate executive and officer with Avon at its office in New York City, New York, and hence connected with New York sources in accordance with the meaning and intent of section 632(b) of the Tax law and 20 NYCRR 131.2 and 131.4. (see Matter of Billy C. and Rosamond G. Christensen, State Tax Commission, August 26, 1977).²

² See also Treas. Reg. Sec. 1.421-6(d)(7) referring to the gain realized on a disqualifying disposition of stock acquired by the exercise of a qualified stock option as compensation resulting from such stock option.

C. That the New York adjusted gross income of a nonresident individual is defined by section 632(a)(1) of the Tax Law as the sum of the net amounts of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources. The income received from the disqualifying disposition of stock purchased through the stock options constitutes compensation and is connected with New York sources. Accordingly, said item of income is to be included in petitioners' New York adjusted gross income in accordance with the meaning and intent of section 632(a) of the Tax Law.

D. That the petition of James A. and Vilia Y. Michaelson is hereby denied and the Notice of Deficiency issued February 28, 1977 together with such interest as may be lawfully owing is sustained.

DATED: Albany, New York

FEB 04 1983

STATE TAX COMMISSION

ACTING PRESIDENT

COMMISSIONER

COMMISSIONER