STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL J. AND ANNA C. COLITTI	:	DETERMINATION DTA NO. 818210
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1995.	:	

Petitioners, Michael J. and Anna C. Colitti, 1202 Bell Flower Lane, West Chester, Pennsylvania 19380, 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 1995.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 77 Broadway, Buffalo, New York, on July 11, 2001 at 10:30 A.M., with all briefs submitted by October 31, 2001, which date began the six-month period for the issuance of this determination. Petitioners appeared by Gary M. Kanaley, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Jennifer L. Hink, Esq. of counsel).

ISSUE

Whether certain income earned by petitioner Michael Colitti, a New York nonresident, was earned in respect of a covenant not to compete and therefore not subject to New York personal income tax or whether such income was attributable to petitioner's prior employment in New York and therefore taxable.

FINDINGS OF FACT

1. On December 9, 1999, following an audit, the Division of Taxation ("Division") issued to petitioners, Michael J. and Anna C. Colitti, a Notice of Deficiency which asserted additional income tax due from petitioners in the amount of $33,058.58, plus interest, for the tax year 1995.

2. Petitioners terminated their New York residency on June 30, 1991 and were thus nonresidents in 1995. The deficiency herein arises from a Division determination that certain income paid to Michael Colitti by Corning, Inc. ("Corning") in 1995 was New York source income and therefore properly subject to New York income tax under Article 22.

3. Petitioner Michael J. Colitti[1] was employed by Corning, located in Corning, New York, from 1964 through 1989. During the course of his career, petitioner was plant manager of a facility that manufactured laboratory glassware and one that manufactured consumer products. Later in his career he became an operation vice president of Corning and was responsible for several facilities that manufactured various lines of Corning products. While employed at Corning, petitioner acquired certain skills, as well as trade secret and proprietary knowledge.

4. During his employment at Corning, petitioner participated in two Incentive Stock Plan Agreements ("ISO's") dated April 24, 1986 and December 3, 1986, respectively. Corning offered the incentive stock plans to a limited number of executives as a means of retaining such executives in the employ of the company. Pursuant to each ISO, petitioner was awarded a certain number of shares of incentive stock, a portion of which vested annually according to a schedule. The incentive shares were subject to forfeiture if an employee voluntarily left the employ of Corning or if he or she retired before reaching age 60. In the event an employee's

---

[1] Anna C. Colitti is a party to this proceeding solely because she and Michael J. Colitti filed joint income tax returns for the year at issue. Accordingly, unless otherwise indicated, all references to "petitioner" herein shall refer to Michael J. Colitti.

employment was terminated by Corning for any reason other than "gross deviation" from his duties and responsibilities, the ISO's provided that such employee "shall be entitled to receive" the number of incentive shares vested at the time of such termination.

5. In 1989, Corning terminated petitioner's employment for reasons other than "gross deviation" from his duties and responsibilities. Petitioner's vested incentive shares had a value of approximately $80,000.00 at the time of his termination.

6. Petitioner and Corning reached an agreement dated June 21, 1989 regarding the terms of petitioner's departure from Corning. The agreement bears the caption "Private and Confidential" and its introductory paragraph states:

> The purpose of this document is to formalize the understandings that you [petitioner] and . . . [petitioner's supervisor] have reached regarding your departure from employment with Corning Incorporated. The intent is to more fully describe the provisions that relate to your two years paid leave of absence and the unpaid leave of absence which will follow and continue until you reach age 55 at which time you will retire from Corning Incorporated.

7. The agreement sets forth petitioner's rights with respect to salary and benefits upon his termination from Corning. With respect to petitioner's rights with respect to the April 24, 1986 and December 3, 1986 ISO's, paragraph VIII of the agreement provides in relevant part:

> Subject to the approval of the Board of Directors and the satisfaction of the conditions contained in paragraph XII of this agreement, you will receive a pro-rata distribution of the shares granted to you on April 24, 1986 and December 3, 1986 under the 1983 and 1986 Incentive Stock Plans free of restrictions, as soon as practical after the July 1995 meeting of the Board of Directors. Assuming you retire on July 1, 1995 and that the conditions mentioned above are met, you could receive 6,673 of the 10,000 shares originally granted.

8. The final paragraph of the June 21, 1989 agreement, Paragraph XII, captioned "General," states in relevant part:

> Additionally, we remind you of your obligation to hold in confidence all proprietary information relating to Corning Incorporated and its operation. In addition to whatever other remedies Corning may have for breach of such

> obligation, Corning will discontinue its payments to you, or cease the benefits extended to you under this agreement, in the event you accept employment with a competitor of Corning within the next six years.

9. Petitioner fulfilled his obligations under paragraph XII of the agreement, and pursuant to paragraph VIII of the agreement, petitioner received a pro-rata distribution of shares granted to him under the ISO's. Petitioner realized ordinary income of $647,500.00 from Corning in 1995 as a result.

10. Petitioner filed a 1995 nonresident return (Form IT-203) which reported zero New York income and sought a refund in the amount of income tax withheld by Corning on the $647,500.00 paid by Corning to petitioner pursuant to the June 21, 1989 agreement. On audit the Division determined that this income was subject to New York State income tax and subsequently issued the December 9, 1999 statutory notice.

CONCLUSIONS OF LAW

A. The New York source income of a nonresident individual, such as petitioner, is subject to New York personal income tax (Tax Law § 601[e]). Such income 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" (Tax Law § 631[a]). Insofar as relevant herein, the phrase "derived from or connected with New York sources" means income attributable to a business, trade, profession or occupation carried on in New York or income from intangible personal property "only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on" in New York (Tax Law § 631[b][1][B]; [2]).

B. In order to determine whether income is "derived from or connected with New York sources" within the meaning of the statute:

> it is necessary to identify the activity upon which the income was secured or earned . . . [and that] in making this determination, *the consideration given by petitioner* in exchange for the right to the income at issue *is the controlling factor* (***Matter of Laurino***, Tax Appeals Tribunal, May 20, 1993; emphasis added).

In other words, "it is necessary to examine what petitioner gave up in exchange for the right to the income at issue" (***Matter of Haas***, Tax Appeals Tribunal, April 17, 1997).

C. In accordance with these principles, the Tax Appeals Tribunal has held, in ***Matter of Haas***, that where a nonresident taxpayer receives income in exchange for giving up his or her right to pursue employment in his or her field of expertise - that is, income in exchange for a covenant not to compete - such income is not derived from or connected with New York sources and is therefore not subject to New York income tax. In ***Haas***, the Tribunal found that the income in question was "earned by refraining from performing competing services in New York and elsewhere" and that such income was not attributable to a business, trade, profession or occupation carried on in New York within the meaning of Tax Law § 631(b)(1)(B).

D. In the instant matter, petitioner's right to the income at issue was contingent upon his fulfillment of the non-compete provision in the June 21, 1989 agreement. Paragraph XII of the agreement unambiguously provides that Corning would discontinue its payments to petitioner or cease all benefits extended to petitioner under the agreement if he accepted employment with a competitor of Corning for a period of six years. Petitioner thus gave up the right to accept employment with a competitor of Corning for six years in exchange for the right to the income at issue. In the language of ***Haas***, petitioner earned the income at issue by "refraining from performing competing services in New York and elsewhere." The instant matter is thus factually indistinguishable from ***Haas*** and the income at issue was not derived from or connected with New York sources.

In addition to giving up his right to employment in his field of expertise, by entering into the June 21, 1989 agreement, petitioner also gave up his rights to incentive shares under the April 24, 1986 and December 3, 1986 ISO agreements. As noted, petitioner was not terminated for "gross deviation" from his duties and responsibilities (***see***, Finding of Fact "5"). Accordingly, the ISO agreements provided that petitioner was entitled to receive the number of incentive shares vested at the time of such termination. Petitioner's vested incentive shares had a value of approximately $80,000.00 at that time. Had petitioner received such incentive shares at the time of his termination, such payment would have been attributable to his past employment at Corning. Petitioner, however, entered into the June 21, 1989 agreement and thereby gave up his rights under the ISO agreements. At the same time, petitioner acquired new rights to incentive stock under the June 21, 1989 agreement and, pursuant to Paragraph VIII thereof, such rights were contingent upon his fulfillment of the non-compete provision in Paragraph XII. Payment of the income at issue was thus made pursuant to the agreement and not pursuant to the ISO's. Such income was therefore not attributable to petitioner's former New York employment, but was attributable to his non-compete agreement with Corning.

E. The Division contends that the June 21, 1989 agreement was not a covenant not to compete because "there was no money given directly in exchange for the petitioner choosing not to compete." The Division argues that absent a "separately bargained for benefit in exchange for the covenant not to compete" the income at issue must be attributable to petitioner's former New York employment. This contention is inconsistent with both the law and the facts of this case. The courts have long recognized as covenants not to compete agreements by which employees agree not to work for a competitor for a certain period of time or in a certain geographical area (***see***, Balke, *Employee Agreements Not to Compete*, 73 Harv L

Rev 625). The June 21, 1989 agreement was such an agreement, for, as discussed, petitioner gave up both his right to employment with a competitor of Corning and his rights under the ISO agreements in exchange for income under the June 21, 1989 agreement. Moreover, as discussed, the June 21, 1989 agreement specifically ties petitioner's rights to the incentive stock to his compliance with the non-compete provision.

The Division also contends that the non-compete provision of the June 21, 1989 agreement was a de minimis part of an agreement in anticipation of retirement. The Division notes that the agreement has no title other than "Private and Confidential" and also notes that the non-compete provision is contained in the last sentence of the last paragraph of the agreement. The Division thus contends that the June 21, 1989 agreement was not intended to be a covenant not to compete.

This contention is rejected. The lack of a title or the placement of the non-compete provision in the agreement's last sentence insignificant in light of the unambiguous language which makes the payment of the income at issue contingent upon petitioner's fulfillment of the non-compete provision. In other words, the entire agreement hinges upon the non-compete provision. Such a provision cannot be considered de minimis.

F. Additionally, as a payment made pursuant to a covenant not to compete, the income at issue is not subject to tax under Tax Law § 631(b)(2) as income from intangible personal property employed by petitioner in a business, trade, profession, or occupation carried on in New York (***Matter of Haas***, ***supra***).

G. Finally, the Division objected to the admission in evidence of a memorandum from Corning dated May 18, 1999 and the testimony of petitioner. The Division asserted that the June 21, 1989 agreement was "the final embodiment of the understandings between Corning

and the petitioner" and that "the parol evidence rule does not allow for additional evidence to be admissible to contradict or qualify [such a] complete written contract."

The conclusion herein that the income at issue was not derived from or connected with New York sources was premised on the unambiguous language of the June 21, 1989 agreement and not on the May 18, 1999 Corning memorandum or the testimony of petitioner. The Division's objection is therefore moot.

H. The petition of Michael J. and Anna C. Colitti is granted and the Notice of Deficiency dated December 9, 1999 is canceled.

DATED: Troy, New York
April 18, 2002

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE