STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LAWRENCE GLEASON	:	DECISION DTA NO. 823829
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Year 2006.	:	

Petitioner, Lawrence Gleason, filed an exception to the determination of the Administrative Law Judge issued on October 25, 2012. Petitioner, appeared by WF McNamee & Co., LLC (Sean P. McNamee, CPA). The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a letter brief in lieu of a formal brief in opposition. Petitioner did not file a reply brief. Oral argument was heard on September 18, 2013, in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner has proven that the issue of the performance award, or deferred compensation, was resolved prior to the petition being filed and, therefore, not part of the present matter.

II. Whether, under the facts and circumstances herein, the Division of Taxation properly determined that compensation received by petitioner, a nonresident, from the exercise and liquidation of certain stock options was allocable to New York and thus subject to New York personal income tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact 12, which has been modified to more accurately reflect the record. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

1. At all times relevant herein, petitioner, Lawrence Gleason, was a resident of Connecticut.

2. Petitioner was employed by American Airlines, Inc., for many years until his retirement on April 30, 2005.

3. While so employed, petitioner performed services both within New York State and elsewhere.

4. American Airlines granted incentive nonstatutory stock options to petitioner on various dates during the years 1996 through 2001 and 2003.

5. As of the date of petitioner's retirement, the options at issue had a negative aggregate value.

6. Petitioner exercised and liquidated the subject options on various dates during 2006.

7. American Airlines issued a Wage and Tax Statement (Form W-2) to petitioner, reporting $465,752.72 in compensation for 2006. Of this total, $348,677.42 was attributable to petitioner's exercise of stock options and the balance, $117,075.30, was attributable to performance awards paid to petitioner in April 2006. Petitioner included his American Airlines

compensation in his federal wage income as reported on his 2006 New York nonresident return. Petitioner did not allocate any of his American Airlines income to New York on his 2006 nonresident return.

8. By letter dated March 12, 2008, the Division of Taxation (Division) advised petitioner that his 2006 New York nonresident return was under review and requested that petitioner explain the computation of the New York wage allocation as reported on the return.

9. In response to the Division's request, petitioner advised that his federal income as reported on his 2006 nonresident return included income from the exercise of stock options and claimed that such income was not subject to New York income tax.

10. The Division subsequently issued to petitioner a Statement of Proposed Audit Changes dated October 16, 2008, by which the Division proposed to allocate a portion of petitioner's 2006 stock option income to New York as follows:

> We have allocated the stock option income using the wage allocation for the last full year we show you worked for the granting company.
>
> The last full year you worked for the granting company was tax year 2004.
>
> The allocation used in 2004 was .6033 % [*sic*].
>
> | | |
> |---|---|
> | Stock Options | $345,677.00[1] |
> | | x 0.6033 |
> | [NY] Taxable Income from Stock Options | $208,547.00 |
>
> The deferred compensation you received from American Airlines is taxable to New York State. We used the same allocation we used for your stock options.

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[1] As noted in finding of fact 7, petitioner received $348,677.42 in compensation attributable to the exercise of stock options. The 2006 W-2 specifically reports this amount as income from the exercise of nonstatutory stock options (identified in box 12 on the form by Code V [***see*** 2006 Instructions for Forms W-2 and W-3]), as do other documents in the record. The income amount for stock options on the Statement of Proposed Audit Changes may have been taken from petitioner's Summary of Federal Form W-2 Statements (Form IT-2), filed as part of petitioner's nonresident return, which reports $345,677.00 in box 12, also identified on that form by Code V.

Deferred Compensation[2]	$120,876.00[3]
	x 0.6033
[NY] Taxable Income from Deferred Compensation	$72,442.00

11. As a consequence of these changes, the statement proposed an increase to petitioner's New York taxable income of $280,989.00 (that is, $208,547.00 + $72,442.00) and a resulting New York State income tax deficiency of $18,956.84, plus interest, for the year 2006.

12. On March 9, 2009, the Division issued a Notice of Deficiency to petitioner asserting $18,956.84 in tax due, plus interest, for the year 2006. On June 24, 2010, a Conciliation Order was issued sustaining the Notice of Deficiency in its entirety.

13. In its letter-brief filed in this matter, the Division advised that, using option grant and exercise date information provided in the petition (and as set out below), it had reallocated petitioner's 2006 income attributable to the subject options using a date of grant to date of termination (retirement) allocation period and had revised the asserted deficiency accordingly. A review of the Division's calculations indicates that, for the options granted in 1996 through 2001, the Division multiplied the compensation at exercise by workday fractions, the numerator of which was total New York work days from year of grant through (and including) tax year 2001 and the denominator of which was total work days from year of grant to date of retirement. The workday fractions for the 1996-2001 options as so calculated range from 31.09 % to 12.06 %. For the options granted in 2003, the Division multiplied the compensation at exercise by total

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[2] "Deferred compensation" is apparently the Division's characterization of income referenced as "performance award" on an American Airlines W-2 reconciliation statement provided by petitioner with his petition (deferred performance award).

[3] The W-2 and the W-2 reconciliation statement, both indicate $117,075.30 as the amount of such deferred performance award. The source of this $120,876.00 amount is not in the record.

New York workdays from 2003 to date of retirement divided by total work days from 2003 to retirement. The workday fraction for the 2003 options as so calculated is 66.12 %. The Division's revised calculations resulted in an increase of $99,468.67 to petitioner's New York taxable income attributable to the stock options and ultimately reduced the asserted deficiency herein to $15,316.34, plus interest. The Division made no changes to the portion of the subject deficiency attributable to "deferred compensation" or "performance award" (***see*** footnote 2) in its calculation of this revised deficiency.

14. The grant and exercise dates and W-2 compensation at exercise of the stock options at issue are as follows:

Grant Date	Exercise Date	W-2 Compensation at Exercise[4]
10/03/1996	05/01/2006	$ 9,344.23
10/07/1997	11/27/2006	81,784.20
10/12/1998	11/27/2006	5,770.83
10/12/1999	11/27/2006	66,433.07
01/24/2000	11/27/2006	45,397.63
12/05/2001	11/28/2006	88,032.00
07/21/2003	01/30/2006	33,064.80
07/21/2003	10/09/2006	18,850.66

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Relying on Tax Law § 631 (g) and 20 NYCRR 132.24, the Administrative Law Judge determined that New York properly taxed a portion of petitioner's 2006 income derived from his

[4] The W-2 compensation at exercise as listed in the table totals $348,677.42 and is consistent with the W-2 (***see*** finding of fact 7). In its recomputation, the Division continued to use $345,677.00 as petitioner's total W-2 compensation from the options. In its calculation of the revised deficiency, the Division appears to account for this difference by using $9,294.95 as the W-2 compensation from the 1996 options and $48,964.32 for the combined total of W-2 compensation for the 2003 options.

stock options and deferred performance award. The Administrative Law Judge also held that the Division reasonably calculated the taxable amount based upon all available information. The Administrative Law Judge held that the Division did not violate petitioner's due process rights by applying 20 NYCRR 132.24, which became effective December 27, 2006,[5] to tax years beginning on or after January 1, 2006. The Administrative Law Judge specifically considered the following factors: (1) due to the state of flux of the law in 2006, it was foreseeable that the applicable law in effect on January 1, 2006 would not remain so at the conclusion of the year; (2) the period of retroactivity of the regulation, from December 27, 2006 back to January 1, 2006, is within an acceptable range; and, (3) the retroactive application of the regulation served the public purposes of clarifying the rules regarding nonresident stock option income and raising revenues (***see WL, LLC v Department of Economic Dev.***, 97 AD3d 24 [3d Dept 2012] ***lv granted*** 20 NY3d 853 [2012], ***order affd sub nom James Sq. Assoc. v Mullen*** 21 NY3d 233 [2013]).

The Administrative Law Judge held that neither the Legislature nor the Division usurped this Tribunal's authority. In so holding, the Administrative Law Judge noted that it was within the Legislature's authority to adopt § 631 (g), providing for the adoption of regulations to set forth clear guidelines for the treatment of stock options by nonresidents.

The Administrative Law Judge further held that the Division's calculations of the amount of petitioner's stock option income that was taxable to New York, both the original calculations on audit and the revised calculations based upon information in the petition filed herein, were reasonable.

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[5] In his brief in support of his exception, petitioner correctly notes that the regulation was adopted on December 12, 2006, not December 27, 2006 as indicated in the determination of the Administrative Law Judge. December 27, 2006 was the date the regulation became effective.

Finally, the Administrative Law Judge sustained, with a minor computational adjustment, that portion of the Notice of Deficiency based upon the deferred performance award because petitioner provided no evidence as to the nature or amount of this income.

ARGUMENTS ON EXCEPTION

Petitioner continues to assert that the deferred performance award is not at issue herein, and on exception, specifically argues that this portion of the Notice of Deficiency was resolved with the Division prior to his petition being filed in this matter.

Petitioner contends that income derived from his stock options cannot be attributed to a business, trade, profession or occupation carried on in New York because the stock did not appreciate in value until after the termination of his employment at American Airlines. Therefore, on exception, petitioner resubmits his argument that the application of the Division's regulation, resulting in the sourcing of a portion of such income to New York, violates the Due Process Clause of the United States Constitution because his New York employment bears no connection to the income.

Petitioner also states that he is not arguing that the Division could not have imposed its regulation retroactively, as implied by the Administrative Law Judge's determination. Rather, he contends that the adopted regulation was an improper exercise of the Division's authority because it retroactively overturned decisions of this Tribunal.

On exception, petitioner further argues that imposing tax on the income derived from his stock options violates the Commerce Clause of the United States Constitution because interstate commerce is negatively affected when nonresidents of New York are taxed under circumstances where such nonresidents would have "no understanding that a tax may in fact exist."

Finally, on exception, petitioner does not contest the Division's calculation of the asserted tax due.

With regard to the deferred performance award, the Division states that there is no evidence in the record that this matter was settled prior to the filing of the petition herein, as asserted by petitioner.

With regard to the stock option income, the Division determined that its regulations permit a portion to be allocated to New York because petitioner received the options in the course of his New York employment. It further contends that the regulation was properly adopted. Therefore, the Division asserts that the fact that all of the appreciation of the stock occurred after petitioner was no longer employed by American Airlines is not relevant in reviewing the correctness of the Division's Notice of Deficiency.

OPINION

We affirm the determination of the Administrative Law Judge.

Initially, we note that petitioner's income from his deferred performance award is properly at issue. The evidence in the record supporting this conclusion is: (1) the Statement of Proposed Audit Changes clearly referencing the deferred performance award income; (2) the Notice of Deficiency setting forth the same amount of tax due as the Statement of Proposed Audit Changes; and, (3) the Conciliation Order sustaining the Notice of Deficiency in its entirety. The record contains no evidence of any settlement, stipulation or other agreement regarding the deferred performance award income that would support petitioner's contention that the deferred performance award issue was resolved with the Division. Furthermore, as petitioner makes no other arguments regarding the deferred performance award, we affirm this portion of the

determination because the Administrative Law Judge accurately and adequately addressed this issue.

Petitioner argues that his income derived from the exercise and liquidation of his stock options cannot be income attributable to a business, trade, profession or occupation carried on in New York because the stocks's entire appreciation in value occurred after his employment with American Airlines had terminated. Therefore, petitioner argues that such income lacks the minimal connection to this State that would allow New York to subject it to tax under the Due Process Clause of the United States Constitution.

Thus, petitioner mischaracterized his argument as challenging the apportionment scheme that the Division seeks to apply to his income. Rather, petitioner raises the question of whether or not this income is properly subject to tax under Tax Law § 601 (e) in the first instance.[6] We answer in the affirmative and conclude that petitioner's income derived from his stock options is subject to New York taxation.

The Court of Appeals decision in ***Matter of Michaelsen v New York State Tax Commission*** (67 NY2d 579 [1986]) controls in this matter. As in the present case, ***Michaelsen*** involved a nonresident who was granted certain stock options by his corporate employer when he was working for that employer in New York. Similar to the instant matter, the nonresident exercised and liquidated those stock options after his work for that corporate employer was terminated (***Michaelsen*** at 581). In reviewing those facts, the Court of Appeals in ***Michaelsen***

[6] The issue of whether the enactment of Tax Law § 631 (g), or the adoption of 20 NYCRR 132.24, usurped this Tribunal's authority is not relevant to the question of whether petitioner's income derived from his stock options is properly subject to tax by New York. In any event, we affirm the portion of the determination related to this issue because the Administrative Law Judge accurately and adequately addressed the authority issue below.

first noted the preference in New York to follow federal law in the personal income tax arena, and then explained that:

> "For Federal income tax purposes, in addition to the tax on any gain that petitioner may have realized from the sale of the stock - - the fair market value of the stock when sold less the fair market value of the stock on the date the option was exercised - - there is also a tax imposed to reflect the compensation the employee received by virtue of having the ability to purchase the stock at less than its fair market value by exercising the option. This principle was firmly established by the Supreme Court in ***Commissioner v LoBue*** (351 US 243) and petitioner concedes the point" (***Michaelsen*** at 583).

In determining how to value the compensation derived from the stock options, the Court of Appeals explained that:

> "Taxing only the difference between the fair market value of the stock on the date the option is first exercisable and the option price differs from Federal law and leaves much of the compensation to the employee untaxed. Plainly the option on the date it becomes exercisable is worth more than merely the difference between the fair market value of the stock at that time and the option price. Indeed, they are usually the same. The employee's compensation comes from employer's willingness to let the employee benefit from market appreciation in the stock without risk to his own capital . . . . [T]his extra value cannot be adequately measured on the date the option becomes exercisable . . . . [W]e conclude that the proper method of valuing the compensation derived from an option that has no readily ascertainable fair market value on the date it is granted is to subtract the option price from the fair market value of the stock on the date the option is exercised" (***Michaelsen*** at 584-585).

The Court of Appeals concluded that the income from the stock options was attributable to New York because the nonresident received the options for his employment in New York. In determining the value of the compensation attributable to the stock options, the Court found it reasonable to include the market appreciation of the stock up until the time when the options were exercised (***id.***).

In this case, petitioner performed services in New York for American Airlines during the period the stock options were granted. Therefore, in 2006, when petitioner exercised such

options and sold the stock, petitioner had New York source income derived from the stock options. Furthermore, such income was properly valued to include the market appreciation of the stock through 2006 when the options were exercised (***see id.***; ***see also Cerf v Lynch*** 237 App Div 283 [1932], ***affd*** 262 NY 549 [life insurance renewal commissions received after retirement]; ***Matter of Halloran***, Tax Appeals Tribunal, August 2, 1990 [sick leave payments]).

Finally, petitioner argues that under the present circumstances, the imposition of tax upon the income of a nonresident violates the "dormant" Commerce Clause of the United States Constitution. The Commerce Clause affirmatively gives Congress the authority to enact legislation regulating commerce between the states. The "dormant" Commerce Clause implies that the states do not have the authority to adopt laws or regulations that would "unjustifiably . . . discriminate against or burden the interstate flow of articles of commerce" (***Oregon Waste Sys. v Dept of Envtl. Quality***, 511 US 93, 98 [1994]).

In ***Matter of Tamagni v Tax Appeals Trib. of State of N.Y.*** (91 NY2d 530 [1998], ***cert denied*** 525 US 931 [1998]), the Court of Appeals addressed a similar Commerce Clause challenge to the imposition of New York State personal income tax to a nonresident. The first step in a dormant Commerce Clause analysis is to "identify the interstate market that is being subjected to discriminatory or unduly burdensome taxation" (***Tamagni*** at 540). To meet this requirement, a party would have to identify similarly situated in-state and out-of-state interests that are treated differently under the same circumstances herein. In ***Tamagni***, the Court of Appeals found that the nonresidents' connection to New York supported the imposition of personal income tax, and concluded that Tax Law § 601 "does not operate to the disadvantage of any identifiable interstate market" (***id.***). Indeed, petitioner here does not even make such an allegation, but merely asserts that nonresidents may be negatively affected by a tax that they

might not realize exists. Having not identified any interstate market disadvantaged by the application of Tax Law § 601 (e) in the present circumstances, petitioner's argument must fail.

As petitioner does not take exception to either the Division's calculation of the Notice of Deficiency, or the Division's retroactive application of 20 NYCRR 132.24, we affirm the determination on these issues because the Administrative Law Judge accurately and adequately addressed these issues in his determination.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Lawrence Gleason is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition is granted to the extent indicated in finding of fact 13 and Conclusion of Law V of the Administrative Law Judge's determination, but is otherwise denied; and

4. The Notice of Deficiency dated March 9, 2009, as modified in paragraph 3 above, is sustained.

DATED: Albany, New York
March 18, 2014

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner