

**Revised New York Tax Treatment of Stock Options, Restricted Stock and
Stock Appreciation Rights Received by Nonresidents
And Part-Year Residents**

Section 601(e) of the New York State Tax Law imposes a personal income tax on a nonresident individual's taxable income that is derived from New York sources. The tax is equal to the tax computed as if the individual were a New York State resident for the entire year, reduced by certain credits, multiplied by the income percentage.

The numerator of the fraction used to compute the income percentage is the individual's New York source income. The New York source income of a nonresident is the sum of the items of income, gain, loss and deduction entering into federal adjusted gross income derived from or connected with New York sources, and any New York addition and subtraction modifications under sections 612(b) and 612(c) of the Tax Law that relate to income derived from New York sources (i.e., New York adjusted gross income from New York sources). The denominator of the fraction used to compute the income percentage is the nonresident's New York adjusted gross income from all sources for the entire year.

In 1995, the Tax Department issued TSB-M-95(3)I, which explained the methods to be used by nonresidents and part-year residents to determine the amount of compensation income related to stock options, restricted stock and stock appreciation rights that is includable in New York source income (the numerator of the income percentage.) However, in *Matter of Stuckless* (Tax Appeals Tribunal, August 17, 2006), the New York State Tax Appeals Tribunal held that the allocation method based on the days worked in and out of New York during the period from the date of grant to date of exercise, as described in the TSB-M, could not be applied as a general rule. Instead, the Tribunal ruled that section 132.18 of the personal income tax regulations requires, in general, that the days-in-and-out allocation for the year the option is exercised is to be used to determine the amount of the compensation related to an option that is includable in New York source income. The Tribunal decision does not affect the amount of compensation related to an option, restricted stock or stock appreciation rights as described in TSB-M-95(3)I.

Section 132.24 of the regulations provides that if the allocation methods provided for in sections 132.15-132.23 of the regulations do not provide for a fair and equitable allocation, the Tax Department may prescribe, or the taxpayer may request, that an alternative allocation method be used.

As a result of the *Stuckless* decision, it is the Tax Department's position that the following rules will apply in determining the amount of compensation related to an option, restricted stock or stock appreciation right that is includable in New York source income for tax year 2005 and any prior year where the statute of limitations is still open.

- Statutory options, nonstatutory options that do not have a readily ascertainable fair market value at the time of grant, restricted stock plans where the election under section 83(b) of the Internal Revenue Code has **not** been made (except for dividend income related to the stock), and stock appreciation rights

For full-year nonresidents, the general rule is that the nonresident uses the days-in-and-out allocation for the tax year the options or rights were exercised or the restricted stock vested (or, if earlier, the year the stock was sold) as set forth in section 132.18 of the regulations. The Department will accept, however, the use of the grant to exercise method explained in TSB-M-95(3)I as an alternative allocation method. There may be special circumstances where the allocation for the year of exercise or vesting does not result in a fair and equitable allocation. For example, the Department recognizes that where an employee exercises stock options and leaves the employment of the company that granted the options early in that year, using the allocation in effect for the year the options are exercised may not result in a fair and equitable allocation of the option income. In this situation, it may be necessary to use an alternative allocation such as the one set forth in the TSB-M-95(3)I.

For part-year residents where the compensation is recognized in the nonresident period, the same rules apply as for nonresidents. The allocation for the tax year the options or rights were exercised or the restricted stock vested or, if earlier, was sold is determined as if the individual were a nonresident for the entire year. If the compensation is recognized in the resident period, it must be included in New York source income as explained in TSB-M-95(3)I.

- Nonstatutory stock options that have a readily ascertainable market value at the time of grant, restricted stock where the 83(b) election **has** been made, and dividends related to restricted stock where the 83(b) election has been made

For both full-year nonresidents and part-year residents, the allocation methods, including the alternative method, described in TSB-M-95(3)I, will continue to apply.

Effective Date

The rules discussed in this memorandum are applicable to tax year 2005 and prior years where the statute of limitations is still open (generally, three years from the date the return was filed.) As a result, taxpayers who have previously filed returns may file amended returns. The Tax Department, pursuant to the authority granted it by Chapter 62 of the Laws of 2006, is proposing new regulations concerning the allocation of compensation related to stock options, restricted stock and stock appreciation rights. The allocation methods for tax year 2006 and subsequent years will be the subject of future guidance.