

REGULATORY IMPACT STATEMENT

DEPARTMENT OF TAXATION AND FINANCE

1. Statutory authority: Tax Law, sections 171, subdivision First; 631(g); 638(c); 697(a); and Section 3 of Part N of Chapter 62 of the Laws of 2006. Section 171, subdivision First, authorizes the Commissioner of Taxation and Finance to make such reasonable rules consistent with law, which may be necessary for the exercise of the Commissioner's powers and the performance of the Commissioner's duties under the Tax Law. Sections 631(g) and 638(c) of the Tax Law, added by Part N of Chapter 62 of the Laws of 2006, provide that nonresident and part-year resident taxpayers, who performed services within New York State during the grant period, allocate to New York State their compensation income attributable to stock options, restricted stock or stock appreciation rights according to rules prescribed by the Commissioner. Section 3 of Part N of Chapter 62 of the Laws of 2006 directs that such rules be proposed within 180 days of the effective date of the act, which took effect April 26, 2006. Section 3 further provides that the rules may apply to taxable years beginning on or after January 1, 2006, and shall be controlling notwithstanding any Tax Appeals Tribunal decision to the contrary (see discussion of recent Tax Appeals Tribunal decision in Matter of E. Randall Stuckless and Jennifer Olson in section 8 below). Section 697(a) provides the authority for the Commissioner to make such rules as are necessary to enforce the personal income tax.

2. Legislative objectives: The rule is being proposed pursuant to such legislative authority to provide specific allocation rules applicable to compensation attributable to stock options, stock appreciation rights and restricted stock for nonresident and part-year resident taxpayers for taxable years beginning on or after January 1, 2006.

3. Needs and benefits: Sections 631(g) and 638(c) of the Tax Law, added by Chapter 62 of the Laws of 2006, provide that the allocation of New York source income for nonresident and part-year resident taxpayers

who received compensation income attributable to stock options, restricted stock or stock appreciation rights and who performed services within New York State during the grant period for the corporation granting such option, stock or right be determined pursuant to rules to be developed by the Department of Taxation and Finance. This rule will provide a specific method for such allocation. The rule provides for a grant-to-vest allocation period for statutory stock options, nonstatutory stock options without a readily ascertainable fair market value at the time of grant and stock appreciation rights. The rule will benefit taxpayers by providing clear guidance for the computation of New York source income from compensation income attributable to stock options, restricted stock and stock appreciation rights. It will eliminate double recordkeeping for many nonresident aliens as it is similar to the method used by the Internal Revenue Service for the sourcing of stock option income to the United States. Furthermore, because taxpayers may have relied on a 1995 technical memorandum issued by the Department (TSB-M-95(3)I) to compute their estimated tax and/or withholding requirements for 2006, the rule allows taxpayers an election to use either the method in the rule or the method outlined in the technical memorandum in 2006, so as not to leave taxpayers at a disadvantage.

4. Costs:

(a) Costs to regulated parties: There is no cost to regulated parties for implementation and continued compliance with the proposed amendments. The impact on the tax liability of a particular taxpayer, which could be positive or negative, will depend largely on the individual circumstances of the nonresident/part-year resident taxpayer and could vary significantly depending on such factors as the amount of compensation income and the number of days worked in New York State during the allocation period. Using the grant-to-vest allocation period for statutory stock options, nonstatutory stock options without a readily ascertainable fair market value at the time of grant, and stock appreciation rights will result in a fair allocation to New York State of the compensation for services performed in New York State and determination of the tax due to New York

State pursuant to statute as, when the option or right is vested, the taxpayer has performed all the service-related conditions necessary to exercise the option.

(b) Costs to the State and its local governments including this agency: It is estimated that the implementation and continued administration of these amendments will not impose any costs on the State and its local governments, including this agency. In the aggregate, the fiscal impact on the State will be nominal and there will be no effect on local government revenues.

(c) This analysis is based on a review of the statutory provisions and on discussions among personnel from the Department's Technical Services Division, Office of Counsel, Office of Tax Policy Analysis, Office of Budget and Management Analysis, and Management Analysis and Project Services Bureau.

5. Local government mandates: This rule imposes no mandates upon any local governments.

6. Paperwork: The rule imposes no reporting requirements, forms, or other paperwork upon regulated parties beyond those required by existing law and regulations. The allocation method in the rule contains a workday fraction obtained by including days worked in New York State and days worked within and without the state. But this does not involve a new reporting or paperwork requirement, as to compute wage income derived from New York State sources, nonresident employees and officers are already required to keep track of their working days both within and without New York State (20 NYCRR132.18). Additionally, the rule will generally lessen the time period necessary to keep workday records for calculation of New York source income from compensation income attributable to stock options, restricted stock and stock appreciation rights as compared to the method outlined in the 1995 technical memorandum.

7. Duplication: These amendments do not duplicate any other requirements. The rule eliminates double recordkeeping for many nonresident aliens as it is similar to the method used by the Internal Revenue Service for the sourcing of stock option income to the United States.

8. Alternatives: Other allocation methods were considered in our preparation of these amendments. The allocation method given the most serious consideration was the method outlined in a 1995 technical memorandum issued by the Department regarding New York source income from stock options, restricted stock and stock appreciation rights. This memorandum provided for a grant-to-exercise allocation period for statutory stock options, nonstatutory stock options without a readily ascertainable fair market value at the time of grant and stock appreciation rights. Another allocation method considered for statutory stock options, nonstatutory stock options without a readily ascertainable fair market value at the time of grant and stock appreciation rights was an allocation method based on work days within the tax year of exercise of the option or right. On August 17, 2006, the New York State Tax Appeals Tribunal issued a decision in Matter of E. Randall Stuckless and Jennifer Olson. The Tribunal concluded that the multi-year allocation method outlined in the 1995 technical memorandum was not a valid interpretation of the rules in effect during the taxable years at issue. The Tribunal interpreted the existing rules as generally requiring an allocation based on the work days within and without New York State in the taxable year in which the income is realized (during the tax year of exercise of the option or right), subject to the flexibility afforded by sections 132.4(c) and 132.24 of 20 NYCRR. In considering this allocation method, which is based solely on the year of exercise, we determined that the work days in the year of exercise do not necessarily correlate to the individual's performance of services with respect to the option or right. It was decided, instead of either of these two methods, to use a grant-to-vest allocation period for statutory stock options, nonstatutory stock options without a readily ascertainable fair market value at the time of grant and stock appreciation rights because, when an option or right is vested, the individual has performed all the service-related conditions necessary to exercise the option or right.

The amendments will provide the benefits listed in section 3 above.

9. Federal standards: The rule does not exceed any minimum standards of the Federal government for the same or similar subject area.

10. Compliance schedule: As stated above, the rule imposes no reporting requirements, forms or other paperwork upon regulated parties beyond those required by existing law and regulations. The rule applies to tax years beginning on or after January 1, 2006. But, in recognition that taxpayers may have relied on the 1995 technical memorandum to compute their estimated tax and/or withholding requirements for 2006, the rule affords taxpayers a choice in this transitional year to use either the new method or the method outlined in the 1995 technical memorandum, so as not to leave taxpayers at a disadvantage.