No. ________

In The
Supreme Court of the United States

JEFFERSON ALLEN AND EVITA ALLEN,

Petitioners,

v.

COMMISSIONER OF REVENUE SERVICES
OF THE STATE OF CONNECTICUT,

Respondent.

**On Petition For A Writ Of Certiorari
To The Supreme Court
Of The State Of Connecticut**

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

The Internal Revenue Code makes "realization of income . . . the taxable event rather than the acquisition of the right to receive it[,]" *Helvering v. Horst*, 311 U.S. 112, 115 (1940), and the Due Process Clause forbids a state to tax a nonresident's income unless "earned within the jurisdiction." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 463 n. 11 (1995). Did the Connecticut Supreme Court violate these principles and widen a conflict among the lower courts when it held that Connecticut may tax income from a nonresident's exercise of stock options because he supposedly realized that income when he received the options as compensation for work in Connecticut and not when, as a nonresident, he exercised the options?

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PETITION FOR A WRIT OF CERTIORARI

The Petitioners respectfully petition for a writ of certiorari to review the judgment of the Connecticut Supreme Court because it runs afoul of the rules that taxable income requires "complete dominion and control over money or other property[.]" *Gunkle v. C.I.R.*, 753 F.3d 502, 508 (5th Cir. 2014), *cert. denied*, ___ U.S. ___, 135 S.Ct. 1442 (2015), and that the Due Process Clause "forbid[s] the States to tax extraterritorial values." *MeadWestvaco Corp. ex rel. Mead Corp. v. Illinois Dep't of Revenue*, 553 U.S. 16, 19 (2008) (quotation marks omitted).

OPINIONS BELOW

The opinion of the Connecticut Supreme Court is reported at 324 Conn. 292, ___ A.3d ___ (2016). It is in the Appendix at A1.

The opinion of the Connecticut Superior Court (Aronson, J.), dated April 29, 2015, is unreported. It is in the Appendix at A39.

JURISDICTION

The Connecticut Supreme Court issued its judgment on December 28, 2016. This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a), and Supreme Court Rule 13.1.

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

The constitutional provision at issue is the Due Process Clause of the Fourteenth Amendment: "[N]or shall any State deprive any person of life, liberty, or property, without due process of law. . . ." U.S. Const., amend. XIV.

The primary relevant statute is 26 U.S.C. § 83(a):

> If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of –
>
> (1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over
>
> (2) the amount (if any) paid for such property,
>
> shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length

> transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

STATEMENT OF THE CASE

Although stock options are a "common form of compensation" for executives, *S.E.C. v. Shanahan*, 646 F.3d 536, 540 (8th Cir. 2011), this Court has not addressed their taxability since *C.I.R. v. LoBue*, 351 U.S. 243 (1956). *LoBue* measures the "taxable gain" from nonqualified stock options "as of the time the options were exercised and not the time they were granted[,]" *id.* at 249, and most courts sing from the *LoBue* hymnal. See, e.g., *Davis v. C.I.R.*, 716 F.3d 560, 566 (11th Cir. 2013) ("[t]he grant of an option to purchase certain property does not constitute a transfer of such property . . . the transfer occurs when the option is exercised"); *Palahnuk v. United States*, 475 F.3d 1380, 1382 (Fed. Cir. 2007) ("the financial gain realized . . . upon exercising stock options is taxable as gross income in the year that the options were exercised").

However, the Connecticut Supreme Court concluded that the mere receipt of "stock options while performing services in Connecticut[,]" Pet. App., A31, allows Connecticut to tax the income from a nonresident's subsequent exercise of those options. *Id.* This holding conflicts with decisions of the First Circuit, Second Circuit, Eighth Circuit and Ninth Circuit, flies in the face of the "realization" test, see *Helvering*, 311 U.S. at 115, and confuses compensation with taxable

income. It has been six decades since this Court opined about the taxability of option income. The Connecticut Supreme Court's mistaken view of the law and the ubiquity of stock options in our modern economy make now the time for further guidance.

FACTS AND PROCEDURAL HISTORY

A stock option "grants a recipient the right to purchase a specified number of shares of the company's stock at a specified price. . . . When the market price of a publicly traded stock is equal to an option's [specified] price . . . it will only enrich the recipient if the stock price rises in the future." *Shanahan*, 646 F.3d at 540. An option is "nonqualified," if general Internal Revenue Code principles govern its taxability. See *United States v. Tuff*, 469 F.3d 1249, 1251 n. 3 (9th Cir. 2006).

From 1990 to 2001, the Petitioners lived in Connecticut and Jefferson Allen worked in Connecticut as the President and Chief Financial Officer of Tosco Corporation. Pet. App., A3. A portion of Mr. Allen's compensation from Tosco was nonqualified stock options. *Id.* The options did not have a readily ascertainable fair market value when Tosco granted them to Mr. Allen. *Id.* at 3 n. 4. As such, the Petitioners did not realize any income from the options until Mr. Allen exercised them. See 26 U.S.C. § 83. Mr. Allen exercised the Tosco options in January 2002. Pet. App., A3. The Petitioners,

who did not reside in Connecticut in 2002, earned $7,633,027 from the exercise of the Tosco options.[1] *Id.*

Mr. Allen did not work in Connecticut, and the Petitioners did not reside there, in 2002, 2003, and 2004. *Id.* From January 1, 2005, to August 31, 2005, Mr. Allen was CEO of Premcor, Inc. *Id.* Mr. Allen worked for Premcor "solely within Connecticut" (the location of Premcor's executive offices), and the Petitioners lived in Connecticut for those eight months. *Id.* at A3-A4, A64. In addition to his salary, Premcor compensated Mr. Allen for his work by granting him 595,300 nonqualified stock options. Pet. App., A3, A65-A66. Like the Tosco options, the Premcor options did not have a readily ascertainable fair market value when granted to Mr. Allen. *Id.* at A3 n. 4. Valero Energy Corp. acquired Premcor in August 2005, and Valero split its common stock in December 2005. *Id.* at A3-A4 n. 5. As a result, Mr. Allen ended up with 1,178,694 options. *Id.* at A65, A67.

The Petitioners did not live in Connecticut in 2006 or 2007. *Id.* at A4. Mr. Allen exercised 1,128,694 of the Premcor options in 2006, from which the Petitioners earned $43,360,812. *Id.* at A4, A65-A67. Mr. Allen exercised the remaining 50,000 options in 2007, from which the Petitioners earned $2,247,745. *Id.* at A4, A70, A72.

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[1] The Petitioners also earned $5,541,600 in 2002 from the exercise of other nonqualified stock options. Pet App., A58 n. 1.

In July 2006, the Respondent[2] began an audit of the Petitioners' 2005 tax return. *Id.* at A6. The Petitioners cooperated with the audit and voluntarily provided the Respondent with copies of their federal tax returns for 2002, 2003, and 2004. *Id.* at A75. In March 2007, the Respondent informed the plaintiffs that it had expanded the audit to include those three years and 2001. *Id.* at A6. The Respondent believed, despite overwhelming evidence to the contrary, that the Petitioners actually had lived in Connecticut from 2002-2005. *Id.* at A75.

However, the Respondent soon shifted gears: Its tentative audit findings treated as taxable any income from Mr. Allen's exercise of options that were compensation for work he had performed in Connecticut. Though the Petitioners did not agree, in March 2007, they filed a Connecticut Nonresident/Part-Year Resident Return for 2002. Pet. App., A6, A62. The return reports $15,946,626 in Connecticut income, on which the Petitioners paid $717,307 in income tax. *Id.* at A55. A month later, the Petitioners timely filed a Nonresident/Part-Year Resident Return for 2006, on which they reported $43,360,812 in Connecticut income and paid $2,167,637 in income tax. *Id.* at A62. On April 11, 2008, the plaintiffs timely filed a Nonresident/Part-Year Resident Return for 2007, on which they reported

[2] Technically, the Respondent is the Commissioner of the Department of Revenue Services, but the parties and the lower courts treated the Department as the *de facto* party. All references in the Petition to the Respondent are to the Department.

$2,247,745 in Connecticut income and paid $112,229 in income tax. *Id.* at A69.

In October 2009, the Petitioners filed amended returns for 2002, 2006, and 2007. *Id.* at A4, A56, A63, A69-A70. The amended returns claimed refunds for the income tax that the Petitioners had paid in each of those three years, *id.*, because they were nonresidents when Mr. Allen earned taxable income by exercising his stock options. *Id.* The Respondent's Audit Division denied the Petitioners' claim for 2002 on the basis of Connecticut's three-year statute of limitations for tax refunds. *Id.* at A6; see Conn. Gen. Stat. § 12-732. The Audit Division denied the Petitioners' claims for 2006 and 2007 because the income "resulted from the exercise of nonqualified stock options . . . [that were] compensation for services he [Mr. Allen] performed in Connecticut. . . ." *Id.* at A68, A73. The Respondent's Appellate Division subsequently upheld all three denials. *Id.*

The Petitioners appealed the Respondent's final determination of their claims for a refund to the Connecticut Superior Court. *Id.* at A4, A39; see Conn. Gen. Stat. § 12-730. The Superior Court accepted the parties' stipulation of facts and decided the appeal on their cross-motions for summary judgment. Pet. App., A4, A39-A40.

The Superior Court first held that the three-year limitations period in § 12-732(a)(1) barred the Petitioners' claim for 2002. *Id.* at A6, A43. The Court then

held that the Due Process Clause did not bar the Respondent from taxing income on Mr. Allen's exercise of options in 2006 and 2007. *Id.* at A14, A51-A52. The Court found that the "options had no readily ascertainable fair market value" when Mr. Allen received them, *id.* at A44, A52, and that the Petitioners did not live in Connecticut when Mr. Allen exercised them. *Id.* at A44. Nonetheless, the Court held that the options' "value, as compensation, was earned in Connecticut[,]" *id.* at A52, and that taxing the income from the exercise of them "does not impinge on the plaintiffs' Due Process rights under the U.S. Constitution." *Id.*

The Connecticut Supreme Court affirmed.[3] *Id.* at A2. The Court recognized that "[t]he [d]ue [p]rocess [c]lause demands . . . some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax[.]" *Id.* at A28-29 (quoting *MeadWestvaco*, 553 U.S. at 24) (second, third and fourth brackets in original). However, the Supreme Court equated "stock options [as] compensation for services performed for the employer[,]" Pet. App., A32, with taxable income, and held that a "definite link" existed between the Petitioners' option income and Connecticut because

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[3] The Supreme Court also held that: (1) the Petitioners' refund claim for 2002 was untimely, and (2) the language of Connecticut's regulation that governs taxation of nonqualified stock options "requires only that the taxpayer have been performing services in Connecticut at the time the options were granted." Pet. App., A2, A13. The Petitioners do not seek certiorari on those two issues.

> [i]t has been well settled for nearly one century that, without offending the due process clause, the state may tax incomes accruing to nonresidents from . . . occupations carried on therein. . . . When Allen earned the stock options as compensation, he was performing services in the state of Connecticut. During the course of his service within the state, he enjoyed the benefits and protections attendant to employment within this state.

Id. at A31 (ellipses in original; citation omitted).

The Court rejected the Petitioners' reliance on "the fact that Allen exercised the stock options after he had ceased performing services in Connecticut and began residing outside of Connecticut[.]" Pet. App., A33. In the Court's view, "the benefits provided by the state [must] be contemporaneous with earning the income[,]" but do not have to "solely antedate *realization* of the income[.]" *Id.* at A34 (emphasis in original). The Supreme Court also rejected the Petitioners' contention that their option income was "a result of the appreciation in value of the underlying stock, which is not connected to Allen's performance of services within the state" as mere "difficulty . . . in quantifying the[ir] value[.]" *Id.* at A34-A35. Even though the options "had no reasonably ascertainable fair market value at the time the options were awarded . . . [they] ha[d] value at the time of award. Nonqualified stock options would not be contemplated as a form of compensation if they did not constitute value to the parties of an employment contract." *Id.* at A35.

REASONS FOR GRANTING THE WRIT

I. The decision of the Connecticut Supreme Court conflicts with decisions of four Courts of Appeals and sows confusion about the realization of income from stock options.

The Connecticut Supreme Court recognized that the Due Process Clause permits a state to tax a nonresident's income only if his "enjoyment of the benefits provided by the state [was] contemporaneous with *earning* the income." Pet. App., A34 (emphasis in original). It is undisputed that the Petitioners were not living, and Mr. Allen was not working, in Connecticut when he exercised the stock options. Pet. App., A3-A4. As such, the Connecticut Supreme Court's judgment depends on its erroneous conclusion that the Petitioners earned taxable income when Mr. Allen was granted the options, rather than when he exercised them. Pet. App., A34-A35.

A. The Connecticut Supreme Court's holding that the mere grant of stock options is a taxable event conflicts with decisions of the First Circuit, Second Circuit, Eighth Circuit and Ninth Circuit.

In *Helvering*, *supra*, this Court held:

> [N]ot all economic gain of the taxpayer is taxable income. From the beginning the revenue laws have been interpreted as defining 'realization' of income as the taxable event rather

> than the acquisition of the right to receive it. *And 'realization' is not deemed to occur until the income is paid*. . . . Where the taxpayer does not receive payment of income in money or property realization may occur *when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him*.

Helvering, 311 U.S. at 115 (emphasis added); see 26 U.S.C. § 61(a). Consequently, "[w]hen it [income] is that, it may be taxed, though it was in the making long before." *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99 (1936).

The "realization" test makes "a gain . . . taxable not when the taxpayer acquires the right to receive it, but rather when the taxpayer receives the benefit of it." *Raymond v. United States*, 355 F.3d 107, 111 (2d Cir. 2004); see *Karns Prime & Fancy Food, Ltd. v. C.I.R.*, 494 F.3d 404, 408 (3d Cir. 2007) ("'income' [i]s 'undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion'"). By contrast, "[a] mere expectancy does not constitute income." *First Mechanics Bank of Trenton, N.J. v. Comm'r of Internal Revenue*, 91 F.2d 275, 279 (3d Cir. 1937). The "key is whether the taxpayer has some *guarantee* that he will be allowed to keep the money." *C.I.R. v. Indianapolis Power & Light Co.*, 493 U.S. 203, 210 (1990) (emphasis added).

Nonqualified stock options are a gamble, not a guarantee: If the stock does not gain value between the grant date and the exercise date, the options are

worthless. Indeed, "the disadvantages of stock options as a form of employee compensation are only too well known in the aftermath of the global financial crisis." U. Varottil, "Microfinance and the Corporate Governance Conundrum," 9 BERKELEY BUS. L.J. 242, 270-71 (2012). Receipt of options does not result in a single penny of gain for the recipient – only the possibility of future gain contingent on events outside of the optionholder's control.

The Internal Revenue Code accommodates the contingent nature of option income by designating the exercise date as the taxable event. See 26 U.S.C. § 83; *Racine v. C.I.R.*, 493 F.3d 777, 778 (7th Cir. 2007). Though the Code allows a taxpayer to elect the grant date as the taxable event; see 26 U.S.C. § 83(b); this is a distinction without a difference to Uncle Sam: A taxpayer must pay federal income taxes regardless of where or when he "gains complete dominion and control over money or property[.]" *Gunkle*, 753 F.3d at 508. For state income taxes, however, "where" and "when" matter a great deal because "[t]axation of the income of a non-resident, earned outside of th[e] [s]tate, is constitutionally beyond the [s]tate's reach." *State v. Thompson*, 958 A.2d 887, 893 (Me. 2008).

In keeping with the realization test, four United States Courts of Appeals have held that the recipient of a stock option realizes no taxable income from it until "the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him." *Helvering*, 311 U.S. at 115 (emphasis added). In *Pagel, Inc. v. C.I.R.*, 905 F.2d 1190 (8th Cir.

1990), the plaintiff argued that the sale of a nonqualified stock option was not ordinary income. The Eighth Circuit disagreed; pursuant to the language and context of § 83(e), "if an option does not have a readily ascertainable fair market value when granted, the recipient must recognize ordinary income at the time of exercise or disposal *but not at the time of grant*." *Id.* at 1191 (emphasis added).

In *Robinson v. C.I.R.*, 805 F.2d 38 (1st Cir. 1986), the plaintiff received an option to purchase stock of his employer. *Id.* at 39. The option agreement contained "a provision that required Robinson to sell his shares back to [his employer], at his original cost, if he wished to dispose of them in less than one year from the day he exercised the stock option." *Id.* The plaintiff exercised the option in May 1974 and then challenged the Tax Court's determination that he had "realized a benefit from the option agreement and . . . should have paid Federal income taxes on it" in 1974. *Id.* at 40.

The First Circuit agreed and reversed the Tax Court because the shares were "subject to a substantial risk of forfeiture until the sellback provision elapsed." *Id.* at 41. The First Circuit noted that 26 U.S.C. § 83 – the provision at issue in this case – delays taxation of "the value of property transferred in connection with the performance of services[,]" until the taxpayer no longer faces a "substantial risk" that he will forfeit his "beneficial interest in the stock transfer[.]" *Id.* at 40 (quoting § 83(a)). The sellback provision was such a risk; *id.* at 41; as a result, the plaintiff

should not have been taxed until the year-long sellback period expired. *Id.* at 42.

In *Victorson v. C.I.R.*, 326 F.2d 264 (2d Cir. 1964), the plaintiffs received options to purchase shares of stock at a steep discount on February 1, 1955, but did not exercise the options until May 23, 1955. *Id.* at 265. The plaintiffs claimed that the "miniscule" price meant that they had earned the income from the options on February 1st. *Id.* at 266. However, the Second Circuit refused to "introduce unnecessary uncertainty into future cases" and held "that the income in question was realized on May 23, 1955, the date the option was exercised." *Id.* at 266.

Finally, in *Van Dusen v. C.I.R.*, 166 F.2d 647 (9th Cir. 1948), the plaintiff received stock options at a price less than the market price on the grant date. *Id.* at 650. The Ninth Circuit nevertheless rejected the claim that income "was realized at the time the option was granted and not at the times the stock was purchased[,]" *id.*, because "there was an 'economic or financial benefit conferred on the employee as compensation' when petitioner exercised the option to make bargain purchases of the corporation's stock." *Id.* at 651; see also *Racine*, 493 F.3d at 778 ("the grant of an option to purchase stock . . . is not itself a transfer, which does not occur until the option is exercised"); *Palahnuk*, 475 F.3d at 1384 ("transaction was a taxable event in 2000, the tax year during which the stock options were exercised"); *Connolly's Estate v. Comm'r of*

Internal Revenue, 135 F.2d 64, 67 (6th Cir. 1943) (taxable income "when the employees exercised their options and purchased the stock").

The decision below conflicts with *Pagel*, *Robinson*, *Victorson*, and *Van Dusen*, and dims the bright line in 26 U.S.C. § 83. The decision treats the mere grant of stock options as an "undeniable accession[] to wealth," *Indianapolis Power*, 493 U.S. at 209, even though options do not allow "a highly beneficial use of the money by the taxpayer to be made immediately." *Kohler-Campbell Corp. v. United States*, 298 F.2d 911, 913 (4th Cir. 1962); accord *Cinergy Corp. v. United States*, 55 Fed. Cl. 489, 512 (2003) (income is "any undeniable accession to wealth . . . over which the taxpayer has 'complete dominion'"); *United States v. Toushin*, 899 F.2d 617, 622 (7th Cir. 1990) (a gain "constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it"); *Storz v. C.I.R.*, 583 F.2d 972, 976 (8th Cir. 1978) ("realization occurs when the taxpayer has a fixed right to a reasonably ascertainable sum"); *United States v. Swallow*, 511 F.2d 514, 519 (10th Cir.), *cert. denied*, 423 U.S. 845 (1975) ("[w]hen earnings are acquired . . . without consensual recognition of an obligation to repay or restriction on their disposition, there is income").

Though the Petitioners might have found no pot of gold at the end of the rainbow, the decision below concludes that Mr. Allen's options

> ha[d] value at the time of award. Nonqualified stock options would not be contemplated as a form of compensation if they did not constitute value to the parties of an employment contract. . . . [R]ather than taxing the speculative value of the options at the time of award, the better course of action is to calculate the taxable income on the basis of the "bargain element" at the time of exercise.

Pet. App., A35. Other courts likewise look to "the time of award[,]" and not the exercise date. See, e.g., *Rice v. Montgomery*, 663 N.E.2d 389, 392 (Ohio App. 1995)[4] ("in receiving stock options from Kroger, the Rices received compensation subject to tax by the city of Montgomery").

Ironically, the decision below relies on *C.I.R. v. Smith*, 324 U.S. 177 (1945), which notes that the "compensation for respondent's services . . . included the compensation obtainable by the exercise of the option given for that purpose." *Id.* at 181-82; see Pet. App., A33. However, the next few sentences of *Smith* explain what must occur for such compensation to be taxable income:

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[4] While an intermediate state appellate court carries a small stick for conflict purposes, the Ohio Supreme Court has not weighed in on the issue – and other districts of the Ohio Court of Appeals echo *Rice*. See, e.g., *Salibra v. Mayfield Hts. Mun. Bd. of Appeal*, 58 N.E.3d 452, 456 (Ohio App. 2016) ("employee's receipt of stock options was a form of compensation that was taxable"); *Hickey v. Toledo*, 758 N.E.2d 1228, 1232 (Ohio App. 2001) ("stock options are received by an employee as compensation, they may be properly taxed as compensation").

> It of course does not follow that in other circumstances not here present the option itself, *rather than the proceeds of its exercise*, could not be found to be the only intended compensation.
>
> The Tax Court thus found that the option was given to respondent as compensation for services, and implicitly that the compensation referred to was the excess in value of the shares of stock over the option price *whenever the option was exercised*. From these facts it concluded that the compensation was taxable as such[.]

324 U.S. at 182 (emphasis added).[5]

B. The Connecticut Supreme Court's holding blurs the line between taxable income and the potential to earn taxable income in the future.

As Justice Cardozo noted eighty years ago, "[i]ncome . . . is the fruit that is born of capital, not the

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[5] Courts also focus on the exercise date when they look back from the end of the transaction. See *Palahnuk*, 475 F.3d at 1381 ("income from stock options was taxable in the year [taxpayers] exercised their options rather than when they paid off the margin loan used to purchase the stock"); *Cidale v. United States*, 475 F.3d 685, 685-86 (5th Cir. 2007) ("taxable transfer occurred" on date of exercise, not when "the shares were sold"); *C.I.R. v. Ogsbury's Estate*, 258 F.2d 294, 295 (2d Cir. 1958) ("significant event tax-wise occurred" when taxpayer exercised option, not when he sold stock three years later).

potency of fruition." *Safety Car*, 297 U.S. at 99; see *Anson v. C.I.R.*, 328 F.2d 703, 705 (10th Cir. 1964) ("[t]ax is not imposed upon what income should be but upon what income actually is"). Consequently, courts "have been loath to assess any present tax consequences" to "contract[s] call[ing] for future payments . . . based on unmet conditions, contingencies, or speculation . . . and thus to require the beneficiary of the contract to pay an income tax upon a potential, as distinguished from a guaranteed receipt of those funds." *Vestal v. United States*, 498 F.2d 487, 490 (8th Cir. 1974); see *Bouterie v. C.I.R.*, 36 F.3d 1361, 1370 (5th Cir. 1994) (plaintiff's share of ex-husband's future commissions not taxable even though divorce judgment entitled her to 50% because "there is a very real possibility that she may never receive a penny of this income"); *Caswell's Estate v. C.I.R.*, 211 F.2d 693, 696 (9th Cir. 1954) (fruit growers' contingent interests in commercial reserve fund were not income because "the[] contingencies never happened").

The decision below stands this aspect of the realization test on its head. Stock options may prove lucrative, or worthless, depending on the vagaries of the market. The decision below brushes aside the "very real possibility that [an option-holder] may never receive a penny of this income[,]" *Bouterie*, 36 F.3d at 1370, because "stock options would not be contemplated as a form of compensation if they did not constitute value to the parties of an employment contract." Pet. App., A35.

This Court put paid to the false equivalence between compensation and realization of income in *LoBue*, *supra*. The plaintiff in *LoBue* received stock options from his employer and claimed that the options were not compensation; 351 U.S. at 246; but, if they were, "the gain should be measured either when the options were granted or when the notes were given."[6] *Id.* at 248-49. *LoBue* brushes aside the plaintiff's first claim because his employer "was not giving something away for nothing. . . . [I]t seems impossible to say that it was not compensation." *Id.* at 247. Nonetheless, there was "no reason for departing" from "the uniform Treasury practice" to calculate taxable income "by the difference between the option price and the market value of the shares at the time the option is exercised." *Id.* at 249.

The song remains the same six decades on: Compensation in the employment context is not synonymous with income. As the first employees of Google, Apple, and Microsoft know well, stock options have value as compensation even though it is uncertain whether they ever will generate taxable income. The fundamental premise of stock options – indeed, of the entire stock market – is that risk has value independent of taxable income. This Court should grant

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[6] The plaintiff in *LoBue* had given promissory notes for the first 300 shares, "but the shares were not delivered until the notes were paid in cash." 351 U.S. at 248. Though "delivery of a binding promissory note" could constitute "exercise" of stock options, *id.* at 250, *LoBue* treats the date of the cash payment as the "exercise" date because both the Tax Court and the Third Circuit had done so. *Id.*

certiorari to remind the Connecticut Supreme Court that until risk becomes reward, there is no "undeniable accession[] to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

CONCLUSION

For the foregoing reasons, the Petitioners respectfully ask this Court to issue a writ of certiorari to review the judgment of the Connecticut Supreme Court.

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Connecticut Supreme Court

JEFFERSON ALLEN ET AL. *v.*
COMMISSIONER OF REVENUE SERVICES
(SC 19567)

Palmer, Zarella, Eveleigh,
McDonald and Robinson, Js.

Argued October 13 –
officially released December 28, 2016[*]

Daniel J. Krisch, with whom was *Leslie E. Grodd*, for the appellants (plaintiffs).

Patrick T. Ring, assistant attorney general, with whom were *Matthew J. Budzik*, assistant attorney general, and, on the brief, *George Jepsen*, attorney general, for the appellee (defendant).

Opinion

EVELEIGH, J. The plaintiffs, Jefferson Allen and Evita Allen, appeal[1] from the trial court's award of summary judgment upholding the decision of the defendant, the Commissioner of Revenue Services, denying their request for a tax refund for the taxable years 2002, 2006, and 2007. In this appeal, the plaintiffs claim that the trial court improperly concluded that: (1) it lacked subject matter jurisdiction with respect to

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* December 28, 2016, the date that this decision was released as a slip opinion, is the operative date for all substantive and procedural purposes.

[1] The plaintiffs appealed to the Appellate Court, and we transferred the appeal to this court pursuant to General Statutes § 51-199(c) and Practice Book § 65-1.

the plaintiffs' claim for a refund for the taxable year 2002 on the basis of the three year limitation period to file an income tax refund pursuant to General Statutes § 12-732(a); (2) § 12-711(b)-18 of the Regulations of Connecticut State Agencies permitted the defendant to tax the plaintiffs' income derived from the exercise of options because the options were granted as compensation for performing services within the state; and (3) it is constitutional to impose a tax on income derived from the exercise of nonqualified stock options[2] by a nonresident who was granted the options as compensation for performing services within the state. We disagree with each of the plaintiff's claims. Because the form of the trial court's judgment with respect to the plaintiffs' claim relating to the taxable year 2002 was improper, we reverse the trial court's award of summary judgment with respect to that taxable year and remand the case with direction to render judgment dismissing that claim. We affirm the judgment of the trial court in all other respects.

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[2] "Stock options [also known as call options] allow an employee to buy the employer's stock at a specified future date at a price [know [sic] as the strike price or exercise price] fixed on the date that the stock is granted. Stock options are granted with the expectation that the stock will increase in price during the intervening period, thus allowing the grantee the right to buy the stock significantly below its market price." (Internal quotation marks omitted.) *Scully* v. *US WATS, Inc.*, 238 F.3d 497, 507 (3d Cir. 2001). "Statutory stock options are compensatory options that meet certain criteria and are treated differently under the Internal Revenue Code." *United States* v. *Tuff*, 469 F.3d 1249, 1251 n.2 (9th Cir. 2006). Options that do not meet these requirements are called "nonqualified" or "nonstatutory" stock options. Id.

The following undisputed facts and procedural history are relevant to this appeal. From 1990 to 2001, Jefferson Allen[3] served as president and chief financial officer of Tosco, Inc. (Tosco). During this period, Allen was domiciled in and performed services solely within Connecticut. As part of his compensation while employed with Tosco, he was awarded nonqualified stock options.[4] In 2002, while the plaintiffs were residing outside of Connecticut, Allen exercised the options he was granted by Tosco, resulting in $7,633,027 of income. The plaintiffs filed a Connecticut nonresident and part year resident income tax return reporting income from exercising these options in 2002 and paid the applicable tax.

After a period of nonresidency from 2002 to 2004, the plaintiffs returned to Connecticut in 2005. From January 1, 2005 to August 31, 2005, Allen served as the chief executive officer of Premcor, Inc. (Premcor), and performed services solely within Connecticut. As part of his compensation for performing services for Premcor, Allen was awarded nonqualified stock options.[5]

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[3] While both Jefferson Allen and Evita Allen are the plaintiffs in this appeal, only income earned by Jefferson Allen is relevant to this appeal. For the sake of simplicity, hereinafter we refer to Jefferson Allen, individually, by his surname.

[4] It is undisputed that all of the options pertinent to this appeal did not have a readily ascertainable fair market value at the time they were awarded to Allen.

[5] In August, 2005, Premcor was acquired by Valero, Inc. (Valero). As a consequence of the acquisition, Allen's stock options

The plaintiffs again moved out of Connecticut and resided outside the state in 2006 and 2007. In 2006, Allen exercised certain stock options he had earned performing services for Premcor, resulting in $43,360,812 of income. In 2007, Allen again exercised certain stock options that were earned as compensation for performing services for Premcor, resulting in $2,247,745 of income. The plaintiffs timely filed their tax returns and paid the applicable tax for the taxable years 2007 and 2008.

In October, 2009, the plaintiffs filed amended returns for the taxable years 2002, 2006, and 2007, claiming refunds for the income tax that the plaintiffs had paid in each of those years. The plaintiffs' claims for a refund were denied. In 2013, the Appellate Division of the Department of Revenue Services affirmed the denial. The defendant thereafter issued a final determination denying the plaintiffs' claims for refunds.

Pursuant to General Statutes § 12-730,[6] the plaintiffs timely filed an appeal from the defendant's determination in the Superior Court. The parties filed cross motions for summary judgment on stipulated facts,

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were converted to options for Valero stock For the sake of consistency, we refer to the options Allen earned in 2005 as Premcor options.

[6] General Statutes § 12-730 provides relevant part: "[A]ny taxpayer aggrieved because of any determination or disallowance by the commissioner under section 12-729, 12-729a or 12-732 may, within one month after notice of the commissioner's determination or disallowance is mailed to the taxpayer, take an appeal therefrom to the superior court for the judicial district of New Britain. . . ."

which the trial court granted in favor of the defendant. This appeal followed. Additional facts and procedural history will be set forth as necessary.

I

First we address the issue of whether the trial court properly concluded that it lacked subject matter jurisdiction regarding the plaintiffs' claim for a refund for the taxable year 2002 because they filed their claim after the lapse of the three year statute of limitations for such a claim pursuant to § 12-732(a)(1). The plaintiffs concede that their request for a refund was filed after the lapse of the three year period.[7] Nevertheless, relying principally upon *Williams* v. *Commission on Human Rights & Opportunities*, 257 Conn. 258, 777 A.2d 645 (2001), the plaintiffs argue that the three year statute of limitations is not jurisdictional and, therefore, should be equitably tolled. In response, the defendant claims that the statute of limitations, because it forms part of a statutory scheme that waives sovereign immunity, is jurisdictional and should not be tolled. We agree with the defendant.

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[7] The parties agree that the due date for filing an income tax return for the taxable year 2002 was April 15, 2003. See General Statutes § 12-719(a) ("[t]he income tax return required under this chapter shall be filed on or before the fifteenth day of the fourth month following the close of the taxpayer's taxable year"). Consequently, the last day that the plaintiffs could have filed a claim for a refund was April 15, 2006. The plaintiffs filed their claim for a refund for income tax paid for taxable year 2002 on or about October 13, 2009.

The following additional facts and procedural history are relevant to the resolution of this issue. The defendant commenced an audit of the plaintiffs' taxable year 2005 income tax return in July 2006. In March 2007, the defendant expanded the audit to include the taxable years 2001 through 2004. Around this same time, the plaintiffs filed a Connecticut nonresident and part year resident return reporting income from 2002 and paid the applicable tax. In October 2009, the plaintiffs filed amended returns for the taxable year 2002, claiming a refund for the income tax that the plaintiffs had paid. In October, 2012, the plaintiffs claim for a refund for the taxable year 2002 was disallowed. The defendant denied the request for a refund on the grounds that, pursuant to § 12-732(a)(1),[8] the claim for a refund was untimely. The trial court affirmed the determination of the defendant, concluding that it lacked subject matter jurisdiction to consider the plaintiffs' claim.

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[8] General Statutes § 12-732(a)(1) provides in relevant part: "If any tax has been overpaid, the taxpayer may file a claim for refund in writing with the commissioner within three years from the due date for which such overpayment was made, stating the specific grounds upon which the claim is founded, provided if the commissioner has extended the time for the filing of an income tax return by the taxpayer, the taxpayer may file a claim for refund within three years after the date on which the income tax return is filed by the taxpayer or within three years after the extended due date of the income tax return, whichever is earlier. . . . Failure to file a claim within the time prescribed in this section constitutes a waiver of any demand against the state on account of overpayment. . . ."

Our standard of review with respect to a trial court determination regarding subject matter jurisdiction is well settled. "A determination regarding a trial court's subject matter jurisdiction is a question of law. When . . . the trial court draws conclusions of law, our review is plenary and we must decide whether its conclusions are legally and logically correct and find support in the facts that appear in the record." (Internal quotation marks omitted.) *Citibank, N.A.* v. *Lindland*, 310 Conn. 147, 161, 75 A.3d 651 (2013).

"The principle that the state cannot be sued without its consent, or sovereign immunity, is well established under our case law. . . . It has deep roots in this state and our legal system in general, finding its origin in ancient common law. . . . Not only have we recognized the state's immunity as an entity, but [w]e have also recognized that because the state can act only through its officers and agents, a suit against a state officer concerning a matter in which the officer represents the state is, in effect, against the state." (Internal quotation marks omitted.) *DaimlerChrysler Corp.* v. *Law*, 284 Conn. 701, 711, 937 A.2d 675 (2007). The principle of sovereign immunity implicates the subject matter jurisdiction of the court. Id.; see also *Giannoni* v. *Commissioner of Transportation*, 322 Conn. 344, 349, 141 A.3d 784 (2016) ("sovereign immunity implicates [a court's] subject matter jurisdiction" [internal quotation marks omitted]); *Chief Information Officer* v. *Computers Plus Center, Inc.*, 310 Conn. 60, 79, 74 A.3d 1242 (2013) (same); *Nelson* v. *Dettmer*, 305 Conn. 654, 660,

46 A.3d 916 (2012) (same); *Miller* v. *Egan*, 265 Conn. 301, 313, 828 A.2d 549 (2003) (same).[9]

The principles governing statutory waivers of sovereign immunity are well established. "[A] litigant that seeks to overcome the presumption of sovereign immunity [pursuant to a statutory waiver] must show that . . . the legislature, either expressly or by force of a necessary implication, statutorily waived the state's sovereign immunity. . . . In making this determination, [a court shall be guided by] the well established principle that statutes in derogation of sovereign immunity should be strictly construed. . . . [When] there is any doubt about their meaning or intent they are given the effect which makes the least rather than the most change in sovereign immunity. . . . Furthermore, because such statutes are in derogation of the common law, [a]ny statutory waiver of immunity must be narrowly construed . . . and its scope must be confined

[9] With respect to the plaintiffs' claim that the prescribed three year limitation period set forth in § 12-732 is not jurisdictional, we find their reliance upon *Williams* v. *Commission on Human Rights & Opportunities*, supra, 257 Conn. 258, to be misplaced. The statute at issue in *Williams* did not implicate sovereign immunity. Thus, that case furnishes no persuasive *basis* to deviate from our firmly rooted principles of sovereign immunity. The plaintiffs' citation to *Wiele* v. *Board of Assessment Appeals*, 119 Conn. App. 544, 988 A.2d 889 (2010) is inapposite for much the same reason. That case concerned a municipal tax appeal, and, accordingly, did not implicate sovereign immunity. See *Vejseli* v. *Pasha*, 282 Conn. 561, 572, 923 A.2d 688 (2007) ("[W]e expressly have recognized that, [u]nlike the state, municipalities have no sovereign immunity from suit. . . . Rather, municipal governments have a limited immunity from liability." [Internal quotation marks omitted.]).

strictly to the extent the statute provides." (Citation omitted; internal quotation marks omitted.) *Housatonic Railroad Co.* v. *Commissioner of Revenue Services*, 301 Conn. 268, 288-89, 21 A.3d 759 (2011). "Whether the legislature has waived the state's sovereign immunity raises a question of statutory interpretation." Id. As such, we are guided by the principles of General Statutes § 1-2z.

A tax appeal is a two step process. With respect to a claim for a refund for income taxes, the plaintiff must first timely file a claim with the defendant. General Statutes § 12-732(a)(1); see *Federal Deposit Ins. Corp.* v. *Crystal*, 251 Conn. 748, 759, 741 A.2d 956 (1999). Section 12-732(a)(1), in establishing an administrative claim for a refund, is not itself an express or implicit waiver of sovereign immunity. See *DaimlerChrysler Corp.* v. *Law*, supra, 284 Conn. 715 (noting that sales and use tax refund statute, General Statutes § 12-425 is not waiver of sovereign immunity). The applicable appeal statute, § 12-730, does, however, statutorily waive sovereign immunity. Id. Compliance with the refund statute is a condition precedent to availing oneself of the limited statutory waiver of sovereign immunity provided by the appeal statute. See *Federal Deposit Ins. Corp.* v. *Crystal*, supra, 760 (noting that corporate tax refund statute "establishes an administrative request for a refund as the prescribed avenue of relief that the [plaintiff was] required to follow in order to take advantage of the state's limited waiver of its sovereign immunity" [internal quotation marks omitted]).

Our firmly rooted principles of sovereign immunity demand strict compliance with the procedures set forth in the relevant statutes. In determining the scope of the statutory waiver of sovereign immunity, we are mindful that the underlying refund claim may impose "a monetary obligation on the sovereign, and thus it is essential for its requirements to be satisfied." (Internal quotation marks omitted.) *Housatonic Railroad Co.* v. *Commissioner of Revenue Services*, supra, 301 Conn. 289, quoting *DaimlerChrysler Corp.* v. *Law*, supra, 284 Conn. 716. In *DaimlerChrysler Corp.*, we reasoned that the plaintiff had failed to fall within the ambit of the relevant appeal statute because, inter alia, the plaintiff invoked the relevant sales and use refund statute, § 12-425, "independent of the statutory prerequisites for its application . . . and without the ability to satisfy those prerequisites." *DaimlerChrysler Corp.* v. *Law*, supra, 716-17.[10] Accordingly, the plaintiff in that case did "not fall within the class of persons entitled to a refund pursuant to § 12-425 for whom the legislature waived sovereign immunity." Id., 717.

We have also addressed this issue in the context of corporate taxes in *Federal Deposit Ins. Corp.* v. *Crystal*, supra, 251 Conn. 759-60. In that case, we staed [sic]: "There is no question . . . that if [the plaintiff] were seeking . . . a refund of . . . corporation business taxes that the

[10] The plaintiff in *DaimlerChrysler Corp.* also did not qualify as a " 'taxpayer' " as that term was contemplated by the Connecticut Sales and Use Taxes Act, General Statutes § 12-406 et seq. *DaimlerChrysler Corp.* v. *Law*, supra, 284 Conn. 716.

banks[11] had allegedly overpaid for the years in question . . . failure to follow the procedures set forth in [General Statutes] § 12-225(b)(1)[12] would deprive the court of subject matter jurisdiction over such a claim." (Footnotes added.) Id., 759. We noted that the statute "establishes an administrative request for a refund as the prescribed avenue of relief that the [plaintiff was] required to follow in order to take advantage of the state's limited waiver of its sovereign immunity." Id., 750. "We have frequently held that where a statute has established a procedure to redress a particular wrong a person must follow the specified remedy and may not institute a proceeding that might have been permissible in the absence of such a statutory procedure. *Norwich* v. *Lebanon*, 200 Conn. 697, 708, 513 A.2d 77 (1986). When an adequate administrative remedy exists at law, a litigant must exhaust it before the Superior Court will obtain jurisdiction over an independent

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[11] The plaintiff in *Crystal*, the Federal Deposit Insurance Corporation, was appointed as receiver to two insolvent banks. *Federal Deposit Ins. Corp.* v. *Crystal*, supra, 251 Conn. 750-51 n.2. As a result, the plaintiff succeeded to the assets and liabilities of the insolvent banks, including the banks' claims against the Commissioner of Revenue Services in that case. Id.

[12] General Statutes § 12-225(b)(1) provides in relevant part: "Any company which fails to include in its return items of deductions or includes items of nontaxable income or makes any other error in such return may, within three years from the due date of the return, file with the commissioner an amended return, together with a claim for refund of taxes overpaid as shown by such amended return. Failure to file a claim within the time prescribed in this section constitutes a waiver of any demand against the state on account of overpayment. . . ."

action on the matter. . . . *Owner-Operators Independent Drivers Assn. of America* v. *State*, 209 Conn. 679, 686-87, 553 A.2d 1104 (1989). Thus, intertwined principles of sovereign immunity and exhaustion of administrative remedies would require that any claim for a refund of taxes allegedly overpaid . . . be preceded by a timely amended return and claim for such a refund pursuant to § 12-225. Id., 686." (Internal quotation marks omitted.) *Federal Deposit Ins. Corp.* v. *Crystal*, supra, 760. While the statute discussed in *Federal Deposit Ins. Corp.* v. *Crystal*, supra, 760, § 12-225(b)(1), implicated corporate taxes, both §§ 12-225(b)(1) and 12-732(a)(1) permit claims for refunds within only a prescribed three year period. In addition, both statutes provide that "[f]ailure to file a claim within the time prescribed in this section constitutes a waiver of any demand against the state on account of overpayment." General Statutes §§ 12-225(b)(1) and 12-732(a)(1).

In short, the refund statute and the appeal statute set forth precise procedures a taxpayer must follow in order to invoke the jurisdiction of the trial court to review their claim.[13] In the present case, the plaintiffs failed to comply with the requirements of § 12-732(a)(1). Because the plaintiffs failed to comply with the statutory prerequisites for their administrative refund claim for the 2002 taxable year, the trial court was

[13] Consistent with our principles with respect to sovereign immunity and subject matter jurisdiction, the three year period may not be equitably tolled. See *Williams* v. *Commission on Human Rights & Opportunities*, supra, 257 Conn. 277 (noting that "the notion of equitable tolling . . . is inconsistent with the concept of subject matter jurisdiction").

without subject matter jurisdiction to consider that claim.

II

We next address the plaintiffs' claims with respect to taxable years 2006 and 2007. The plaintiffs claim that the income derived from the exercise of the Premcor options by Allen in 2006 and 2007 is not properly taxable under § 12-711(b)-18(a) of the regulations. Specifically, the plaintiffs claim that § 12-711(b)-18(a) requires a taxpayer to be performing services in Connecticut at the time of exercising the options, as well as at the time the options were awarded, in order for the income derived therefrom to be subject to taxation. The defendant contends that § 12-711(b)-18(a) requires only that the taxpayer have been performing services in Connecticut at the time the options were granted. The plaintiffs further claim that taxation of the income derived from the exercise of the Premcor options violates the due process clause of the federal constitution. We disagree with the plaintiffs.

The following additional facts and procedural history are relevant to the resolution of these issues. In October 2009, the plaintiffs filed amended returns for the taxable years 2006 and 2007, claiming refunds for the income tax that the plaintiffs had paid for both of those years. The defendant denied the plaintiffs' claims for a refund for taxable years 2006 and 2007 on the grounds that the Premcor options were granted as

compensation for services Allen performed in Connecticut and, therefore, the income was properly reported as income from Connecticut sources. In 2013, the Appellate Division of the Department of Revenue Services affirmed the denial. The defendant thereafter issued a final determination denying the plaintiffs' claims for refunds. The plaintiffs timely appealed to the trial court, which affirmed the decision of the defendant and rejected the plaintiffs' constitutional claim.

A

Our resolution of this issue first requires a discussion of the legal framework applicable to the state and federal taxation of nonqualified stock options. General Statutes § 12-700(b) authorizes the taxation of income "derived from or connected with sources within this state of each nonresident. . . ." The tax upon nonresidents is determined by the application of a formula that includes the nonresident's "Connecticut adjusted gross income derived from or connected with sources within this state. . . ." General Statutes § 12-700(b). While the terms "adjusted gross income" and "Connecticut adjusted gross income" are defined by statute; see General Statutes § 12-701(a)(19) and (20);[14] the legislature delegated to the defendant ability to define the

[14] " 'Adjusted gross income' means the adjusted gross income of a natural person with respect to any taxable year, as determined for federal income tax purposes and as properly reported on such person's federal income tax return." General Statutes

term "'derived from or connected with sources within this state'. . . ." General Statutes § 12-701(c). Pursuant to this statutory authority, the defendant has promulgated a regulation that addresses nonqualified stock options that provides in relevant part as follows: "Connecticut adjusted gross income derived from or connected with sources within this state includes . . . income recognized under section 83 of the Internal Revenue Code in connection with a nonqualified stock option if, during the period beginning with the first day of the taxable year of the optionee during which such option was granted and ending with the last day of the taxable year of the optionee during which such option was exercised (or, if the option has a readily ascertainable fair market value, as defined in 26 C.F.R. § 1.83-7[b], at the time of grant, the taxable year during which such option was granted), the optionee was performing services within Connecticut. . . ." Regs., Conn. State Agencies § 12-711(b)-18(a).

Because § 12-711(b)-18 of the regulations incorporates § 83 of the Internal Revenue Code, we look to federal law for further guidance on the taxation of nonqualified stock options.[15] Under the federal law, the

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§ 12-701(a)(19). "'Connecticut adjusted gross income'" means adjusted gross income subject to modifications not relevant to this appeal. General Statutes § 12-701(a)(20).

[15] "We long have held that when our tax statutes refer to the federal tax code, federal tax concepts are incorporated into state law. . . . Although this rule does not require the wholesale incorporation of the entire body of federal tax principles into our state income tax scheme, where a reference to the federal tax code

transfer of property in exchange for the performance of services is generally subject to taxation. See 26 U.S.C. § 83(a). Not all transfers of property in exchange for the performance of services are taxable events at the time of transfer. One such transfer is the transfer of stock options without a readily ascertainable fair market value. 26 U.S.C. § 83(e)(3); see *Commissioner of Internal Revenue* v. *LoBue*, 351 U.S. 243, 249, 76 S. Ct. 800, 100 L. Ed. 1142 (1956). This, however, is by no means a tax shelter. Taxation is merely deferred until the taxpayer exercises the option. 26 C.F.R. § 1.83-7(a).[16] Indeed, "the uniform Treasury practice since

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expressly is made in the language of a statute, and where incorporation of federal tax principles makes sense in light of the statutory language at issue, our prior cases uniformly have held that incorporation should take place." (Citations omitted; internal quotation marks omitted.) *Berkley* v. *Gavin*, 253 Conn. 761, 773, 756 A.2d 248 (2000).

[16] Title 26 of the Code of Federal Regulations, § 1.83-7(a), provides in relevant part: "If there is granted to an employee or independent contractor (or beneficiary thereof) in connection with the performance of services, an option to which section 421 (relating generally to certain qualified and other options) does not apply, section 83(a) shall apply to such grant if the option has a readily ascertainable fair market value (determined in accordance with paragraph [b] of this section) at the time the option is granted. The person who performed such services realizes compensation upon such grant at the time and in the amount determined under section 83(a). If section 83(a) does not apply to the grant of such an option because the option does not have a readily ascertainable fair market value at the time of grant, sections 83(a) and 83(b) shall apply at the time the option is exercised or otherwise disposed of, even though the fair market value of such option may have become readily ascertainable before such time. If the option is exercised, sections 83(a) and 83(b) apply to the transfer

1923 has been to measure the compensation to employees given stock options subject to contingencies of this sort by the difference between the option price and the market value of the shares at the time the option is exercised." *Commissioner of Internal Revenue* v. *LoBue*, supra, 249. "[E]ver since *LoBue* it has been unquestioned that, except for statutory alleviation, when a compensatory option has no ascertainable market value as of the time of grant, the receipt of fruits of the option when exercised, fixes the time and measures the value of the economic benefit intended to be, and now, conferred upon the employee." *Rank* v. *United States*, 345 F.2d 337, 343 (5th Cir. 1965); see also *Sutardja* v. *United States*, 109 Fed. Cl. 358, 363 (2013) ("[T]he Supreme Court established half a century ago that, absent certain circumstances, the mere grant of employee stock options is not a taxable event. . . . A taxable event occurs only when the option is exercised, resulting in a sale of shares to the employee, the net value of which is immediately taxable." [Citations omitted.]).

B

With that background in mind, we now address the proper construction of § 12-711(b)-18(a) of the regulations. The plaintiffs claim that § 12-711(b)-18(a) requires a taxpayer to be performing services in Connecticut at the time of exercising the options, as well

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of property pursuant to such exercise, and the employee or independent contractor realizes compensation upon such transfer at the time and in the amount determined under section 83(a) or 83(b). . . ."

as at the time the options were awarded, in order for the income derived therefrom to be subject to taxation. The defendant contends that § 12-711(b)-18(a) requires only that the taxpayer have been performing services in Connecticut at the time the options were granted. We agree with the defendant.

"Administrative regulations have the 'full force and effect' of statutory law and are interpreted using the same process as statutory construction. . . ." (Internal quotation marks omitted.) *Sarrazin* v. *Coastal, Inc.*, 311 Conn. 581, 603, 89 A.3d 841 (2014); see also *Alexandre* v. *Commissioner of Revenue Services*, 300 Conn. 566, 578, 22 A.3d 518 (2011); *Hasychak* v. *Zoning Board of Appeals*, 296 Conn. 434, 443, 994 A.2d 1270 (2010). Accordingly, "[i]n conducting this analysis, we are guided by the well established principle that [i]ssues of statutory construction raise questions of law, over which we exercise plenary review. . . . We are also guided by the plain meaning rule for statutory construction. See General Statutes § 1-2z." (Internal quotation marks omitted.) *LaFrance* v. *Lodmell*, 322 Conn. 828, 833-34, 144 A.3d 373 (2016).

"When construing a statute, [the court's] fundamental objective is to ascertain and give effect to the apparent intent of the legislature. . . . In other words, [the court] seek[s] to determine, in a reasoned manner, the meaning of the statutory language as applied to the facts of [the] case, including the question of whether the language actually does apply. . . . In seeking to determine that meaning . . . § 1-2z directs [the court] first to consider the text of the statute itself and

its relationship to other statutes. If, after examining such text and considering such relationship, the meaning of such text is plain and unambiguous and does not yield absurd or unworkable results, extratextual evidence of the meaning of the statute shall not be considered. . . . The test to determine ambiguity is whether the statute, when read in context, is susceptible to more than one reasonable interpretation." (Citation omitted; internal quotation marks omitted.) *Price* v. *Independent Party of CT – State Central*, 323 Conn. 529, 539-40, 147 A.3d 529 (2016).

The starting point in the analysis is the language of § 12-711(b)-18(a) of the regulations itself, which is set forth in part II A of this opinion. The plaintiffs claim that ambiguity lies in the meaning of the word "during," as used in § 12-711(b)-18(a) of the regulations. Because that term is not defined by regulation or statute, we look to the dictionary for guidance. General Statutes § 1-1(a). "[D]uring" is defined as both "throughout the continuance or course of and "at some point in the course of. . . ." Webster's Third New International Dictionary (1961). By applying the first definition, § 12711(b)-18(a) of the regulations would subject option income to taxation only if the taxpayer had been performing services in the state throughout the period in which the options were granted and subsequently exercised. By applying the second definition, § 12-711(b)-18(a) of the regulations would require that the nonresident taxpayer only have been performing services in the state at the time the options were awarded. The parties disagree as to which definition of

"during" is proper. As we have repeatedly noted, however, statutory language "does not become ambiguous merely because the parties contend for different meanings." (Internal quotation marks omitted.) *Glastonbury Co.* v. *Gillies*, 209 Conn. 175, 180, 550 A.2d 8 (1988); see also *Luttrell* v. *Luttrell*, 184 Conn. 307, 310-11, 439 A.2d 981 (1981); *Caldor, Inc.* v. *Heffernan*, 183 Conn. 566, 571, 440 A.2d 767 (1981). We conclude that § 12-711(b)-18(a) of the regulations is unambiguous because application of the second definition of "during" leads to the only reasonable construction. See *Planning & Zoning Commission* v. *Freedom of Information Commission*, 316 Conn. 1, 12-13, 110 A.3d 419 (2015) ("it is a basic tenet of statutory construction that [w]e construe a statute as a whole and read its subsections concurrently in order to reach a reasonable overall interpretation" [internal quotation marks omitted]).[17]

Reading the term "during" in § 12-711(b)-18(a) of the regulations to mean "throughout the continuance or course of"; Webster's Third New International Dictionary, supra; is unreasonable for two reasons. First, this definition of "during" would create disharmony within the regulation itself. It is axiomatic that the legislature is presumed to have enacted a consistent and harmonious body of law. See *LaFrance* v. *Lodmell*, supra, 322 Conn. 837. It is a "cardinal" maxim of statutory interpretation "that statutes shall not be

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[17] Because we conclude that § 12-711(b)-18(a) of the regulations is unambiguous, the plaintiffs are not entitled to a construction in their favor. See *Sikorsky Aircraft Corp.* v. *Commissioner of Revenue Services*, 297 Conn. 540, 561, 1 A.3d 1033 (2010).

construed to render any sentence, clause, or phrase superfluous or meaningless." (Internal quotation marks omitted.) *Commissioner of Public Safety* v. *Freedom of Information Commission*, 312 Conn. 513, 543, 93 A.3d 1142 (2014); *Connecticut Podiatric Medical Assn.* v. *Health Net of Connecticut, Inc.*, 302 Conn. 464, 474, 28 A.3d 958 (2011) ("[I]t is a basic tenet of statutory construction that the legislature [does] not intend to enact meaningless provisions. . . . [I]n construing statutes, we presume that there is a purpose behind every sentence, clause, or phrase used in an act and that no part of a statute is superfluous." [Internal quotation marks omitted.]).

Subsection (a) of § 12-711(b)-18 of the regulations defines the income derived from stock options as includable in Connecticut adjusted gross income, subject to certain conditions. This subsection contains proviso language, "to the extent provided in this section," which indicates that other parts of the regulation further delineate how much of the income is includable in Connecticut adjusted gross income. Subsection (b) of § 12711(b)-18 requires the application of a formula to determine how much income is includable in Connecticut gross income for nonresident taxpayers who perform services wholly within Connecticut. Subsection (c) of § 12-711(b)-18 requires the application of a different formula to determine how much income is includable in Connecticut gross income for nonresident taxpayers who perform services partly within and

partly without the state of Connecticut.[18] If subsection (a) were construed to require the taxpayer to be performing services within Connecticut throughout the course of the relevant time period, then the option income of a taxpayer who performs services partially within and partially without Connecticut would, by definition, not be includable in Connecticut adjusted income. Consequently, the formula set forth in subsection (c) to be applied to such a taxpayer would be superfluous because such taxpayer's option income would not be includable in gross income pursuant to subsection (a). Likewise, under the plaintiffs' construction, there would be no need to distinguish between taxpayers performing services wholly in Connecticut and taxpayers performing services partially within and partially without Connecticut because the option income of the latter would not be includable in Connecticut adjusted gross income pursuant to subsection (a).

Second, the plaintiffs' proposed construction of the relevant regulation would lead to bizarre results. It is well established that "those who promulgate statutes . . . do not intend . . . absurd consequences or bizarre results." (Internal quotation marks omitted.) *State* v.

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[18] We disagree with the plaintiffs' contention that the contrast between subsections (a) and (c), i.e., the fact that the latter contains a formula while the former does not, highlights the ambiguity in § 12-711(b)-18 of the regulations. Subsection (c) delineates the quantum of income that, pursuant to subsection (a), is defined as includable in Connecticut adjusted gross income; it is not itself a definition of income includable in Connecticut adjusted gross income separate and apart from subsection (a).

Courchesne, 296 Conn. 622, 710, 998 A.2d 1 (2010). According to the plaintiffs' proposed construction, option income is includable in Connecticut adjusted gross income only if the optionee was performing services within Connecticut throughout the course of "the period beginning with the first day of the taxable year of the optionee during which such option was granted and ending with the last day of the taxable year of the optionee during which such option was exercised. . . ." Regs., Conn. State Agencies § 12-711(b)-18(a). The practical consequence of this construction is that a taxpayer may commence performing services after the first day of the taxable year in which the options are granted or cease performing services before the last day of the taxable year in which the options are exercised in order to escape taxation of the option income. By way of example, if a taxpayer commences performing services in Connecticut on February 1, is awarded options on June 30, exercises the options on March 1 of the following year, and continues employment thereafter, the income would not be includable in Connecticut adjusted gross income because the taxpayer was not performing services in Connecticut during January, the first month of the taxable year in which the options were granted. Other similar examples could be envisaged. In addition, this construction is without a limiting principle. A taxpayer who takes one month of leave could claim that he was not performing services "throughout the continuance or course of" the relevant period. Perhaps a similar claim could be made for a week of leave, or even a day. This construction of the regulation is unreasonable and does not give effect to

the intention of the defendant in promulgating the regulation.

Application of the second definition of "during," i.e., "at some point in the course of," furnishes a reasonable construction of the regulatory language at issue. Under this construction, if at any point during the taxable year in which the options were granted and the taxable year in which the options were exercised the taxpayer were performing services in Connecticut, the income derived from the exercise of the options would be includable in Connecticut adjusted gross income. In turn, subsections (b) and (c) of § 12-711(b)-18 of the regulations set forth the extent to which the income is includable in Connecticut adjusted gross income on the basis of whether the services were performed wholly or partially within Connecticut. This construction imposes no irrational or arbitrary conditions upon the taxation of option income and comports comfortably with the due process principle that a state may tax the compensation of nonresidents who perform services within the taxing state. See part II C of this opinion.

The plaintiffs' claim that the defendant's construction of the regulation would result in absurd results because a nonresident would be taxed upon the exercise of stock options but "income distributed from a pension or retirement plan to nonresidents" would not be subject to taxation. Regs., Conn. State Agencies § 12-711(b)-12. This is absurd, the plaintiffs claim, because while both forms of income are earned while performing services in the state, only the former is subject to taxation. We disagree that this is an absurd result.

First, we note that federal law prohibits state taxation of a nonresident's retirement income. See 4 U.S.C. § 114(a).[19] Second, it is well established that "[a] [s]tate may divide different kinds of property into classes and assign to each class a different tax burden so long as those divisions and burdens are reasonable." *Allegheny Pittsburgh Coal Co.* v. *County Commission*, 488 U.S. 336, 344, 109 S. Ct. 633, 102 L. Ed. 2d 688 (1989); cf. *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 526-27, 79 S. Ct. 437, 3 L. Ed. 2d 480 (1959) ("The [s]tate may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value."). This disparate treatment of two different forms of income reflects the policy judgment that the defendant may exercise pursuant to the authority vested in it by the legislature.

Allen was performing services solely within Connecticut when he earned the Premcor options in 2005. Accordingly, we conclude that the income derived from the exercise of the Premcor options by Allen in 2006 and 2007 is properly taxable under § 12-711(b)-18(a) of the regulations.

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[19] Title 4 of the United States Code, § 114(a), provides: "No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State)."

C

We next address whether the trial court properly concluded that the taxation of the income derived from Allen's exercise of the Premcor options in 2006 and 2007 while a nonresident of Connecticut violated the due process clause of the federal constitution. The plaintiffs claim that taxation of income derived from the exercise of stock options by a nonresident violates the due process clause because the options had no readily ascertainable value when they were granted and there was an insufficient nexus between Connecticut and the value attributable to the options at the time of exercise. The defendant claims that the fact that Allen was granted the stock options as compensation for performing services in Connecticut serves as a sufficient nexus to the state to satisfy the requirements of the due process clause. We agree with the defendant.

In this appeal challenging the constitutionality of a regulation, we apply the same standard of review for challenges to the constitutionality of a statute. "Determining the constitutionality of a statute presents a question of law over which our review is plenary. . . . It [also] is well established that a validly enacted statute carries with it a strong presumption of constitutionality, [and that] those who challenge its constitutionality must sustain the heavy burden of proving its unconstitutionality beyond a reasonable doubt. . . . The court will indulge in every presumption in favor of the statute's constitutionality. . . . Therefore, [w]hen a question of constitutionality is raised, courts must approach it

with caution, examine it with care, and sustain the legislation unless its invalidity is clear." (Internal quotation marks omitted.) *Doe* v. *Hartford Roman Catholic Diocesan Corp.*, 317 Conn. 357, 405, 119 A.3d 462 (2015).

The power of Connecticut to impose a tax is a firmly rooted inherent sovereign power. See *Shaffer* v. *Carter*, 252 U.S. 37, 51, 40 S. Ct. 221, 64 L. Ed. 445 (1920) ("[t]he rights of the several [s]tates to exercise the widest liberty with respect to the imposition of internal taxes always has been recognized in the decisions of [the Supreme Court of the United States]"); *M'Culloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316, 429, 4 L. Ed. 579 (1819) ("It is obvious, that it is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a [s]tate extends, are objects of taxation. . . ."). This sovereign power, however, is not unbounded. The due process clause of the fourteenth amendment to the United States constitution[20] places a limit upon Connecticut's power to impose a tax.[21] "A state is free to

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[20] "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." U.S. Const., amend. XIV, § 1.

[21] In addition to the due process clause, the commerce clause of the federal constitution places an additional limit upon the state's power to impose a tax. *MeadWestvaco Corp.* v. *Illinois Dept. of Revenue*, 553 U.S. 16, 24, 128 S. Ct. 1498, 170 L. Ed. 2d 404 (2008) ("[t]he [c]ommerce [c]lause forbids the [s]tates to levy taxes that discriminate against interstate commerce or that burden it

pursue its own fiscal policies, unembarrassed by the [c]onstitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." (Internal quotation marks omitted.) *Chase Manhattan Bank* v. *Gavin*, 249 Conn. 172, 184, 733 A.2d 782, cert. denied, 528 U.S. 965, 120 S. Ct. 401, 145 L. Ed. 2d 312 (1999), quoting *Wisconsin* v. *J. C. Penney Co.*, 311 U.S. 435, 444, 61 S. Ct. 246, 85 L. Ed. 267 (1940).

"[T]he due process clause denies to the state power to tax or regulate the [entity's] property and activities elsewhere." *Connecticut General Life Ins. Co.* v. *Johnson*, 303 U.S. 77, 80-81, 58 S. Ct. 436, 82 L. Ed. 673 (1938). In order to determine whether a state tax comports with the constraints of the due process clause, a reviewing court shall examine "whether the taxing power exerted by the state bears a fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." (Internal quotation marks omitted.) *Chase Manhattan Bank* v. *Gavin*, supra, 249 Conn. 184.

The standard has been refined to a two part test. "The [d]ue [p]rocess [c]lause demands that [1] there exist some definite link, some minimum connection, between a state and the person, property or transaction

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by subjecting activities to multiple or unfairly apportioned taxation").

it seeks to tax, as well as [2] a rational relationship between the tax and the values connected with the taxing [s]tate." (Internal quotation marks omitted.) *MeadWestvaco Corp.* v. *Illinois Dept. of Revenue*, 553 U.S. 16, 24, 128 S. Ct. 1498, 170 L. Ed. 2d 404 (2008); see also *Quill Corp.* v. *North Dakota*, 504 U.S. 298, 306, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 436-37, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980); *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 272-73, 98 S. Ct. 2340, 57 L. Ed. 2d 197 (1978).

The first prong of the test, the minimum connection requirement, may be satisfied in a number of circumstances. "It is well established that a state may tax all of the income of one of its domiciliaries, irrespective of the source of that income, geographical or otherwise." *Chase Manhattan Bank* v. *Gavin*, supra, 249 Conn. 188, citing *Oklahoma Tax Commission* v. *Chickasaw Nation*, 515 U.S. 450, 462-63, 115 S. Ct. 2214, 132 L. Ed. 2d 400 (1995). It is equally well established that a state may tax the income of nonresidents earned within the taxing state. See *Shaffer* v. *Carter*, supra, 252 U.S. 52 ("just as a [s]tate may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to [nonresidents] from their property or business within the [s]tate, or their occupations carried on therein; enforcing payment, so far as it can, by the exercise of a just control over persons and property within its

borders"); see also *Zelinsky* v. *Tax Appeals Tribunal*, 1 N.Y.3d 85, 97, 801 N.E.2d 840, 769 N.Y.S.2d 464 (2003) (concluding that Connecticut resident "clearly has a 'minimum connection' to New York by virtue of his employment" at New York law school). Additionally, as we have previously noted, the United States Supreme Court has incorporated principles from its judicial jurisdiction line of cases into the "minimum connection" analysis by rejecting the formalistic test of taxpayer " 'presence' " in the jurisdiction and analyzing whether the taxpayer's contacts with the state make the exercise of jurisdiction reasonable. See *Chase Manhattan Bank* v. *Gavin*, supra, 186-87 (discussing *Quill* v. *North Dakota*, supra, 504 U.S. 306-308).[22]

With respect to the second prong of the test, a rational relationship between the tax and the values connected with the taxing state, "its principal application has been in cases in which a state seeks to attribute to its tax base some portion of the property or income of a multistate business enterprise that does business in the state. In such cases, the 'values' to which the test refers are numerical, economic or fiscal values – property values in a broad sense; not values in a social science sense – and the cases require, in general terms, that only a fair proportion of the property or income of

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[22] In *Quill*, the United States Supreme Court concluded that the due process requirements were satisfied by the fact that the taxpayer "engaged in continuous and widespread solicitation of business within [the] [s]tate" such that the taxpayer "clearly ha[d] fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign." (Internal quotation marks omitted.) *Quill* v. *North Dakota*, supra, 504 U.S. 308.

the total enterprise be attributed to the taxing state. See, e.g., *Mobil Oil Corp.* v. *Commissioner of Taxes of Vermont*, supra, 445 U.S. 425; *Moorman Mfg. Co.* v. *Bair*, supra, 437 U.S. 267; *Norfolk & Western* [*Railway*] *Co.* v. *Missouri Tax Commission*, [390 U.S. 317, 88 S. Ct. 995, 19 L. Ed. 2d 1201 (1968)]." *Chase Manhattan Bank* v. *Gavin*, supra, 249 Conn. 185 n.14.

We conclude that taxation of the income derived from Allen's exercise of the Premcor options comports with the due process clause of the federal constitution. The jurisdictional fact that Allen earned the stock options while performing services in Connecticut serves, for purposes of the due process clause, as a sufficient "minimum connection, between a state and the person, property or transaction it seeks to tax. . . ." (Internal quotation marks omitted.) *MeadWestvaco Corp.* v. *Illinois Dept. of Revenue*, supra, 553 U.S. 24. It has been well settled for nearly one century that, without offending the due process clause, the state may tax "incomes accruing to nonresidents from . . . occupations carried on therein. . . ." *Shaffer* v. *Carter*, supra, 252 U.S. 52. When Allen earned the stock options as compensation, he was performing services in the state of Connecticut.[23] During the course of his service within the state, he enjoyed the benefits and protections attendant to employment within this state. See id., 50 ("[t]hat the [s]tate, from whose laws property and business and industry derive the protection and security

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[23] We note also that the plaintiffs also enjoyed the benefits and protections afforded domiciliaries while Allen was performing the services for which he was granted the stock options.

without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement").

It is without question that, in both substance and form, stock options are compensation for services performed for the employer. As one scholar who has examined the use of stock option grants as compensation described them, "[o]ptions are the best compensation mechanism we have for getting managers to act in ways that ensure the long-term success of their companies and the well-being of their workers and stockholders." B. Hall, "What You Need to Know About Stock Options," 78 Harv. Bus. Rev. (March-April 2000), pp. 121-22. Indeed, by the late 1990s, "the grant-date value of stock options accounted for 40 percent of total pay for [chief executive officers of companies listed on the Standard and Poor's 500 index]. . . ." B. Hall & K. Murphy, "Optimal Exercise Prices for Executive Stock Options," 90 Am. Econ. Rev. 209 (2000).[24] Both federal and state tax law acknowledge this practical reality regarding the compensatory nature of stock options and the income derived therefrom. The United States Supreme Court noted in *LoBue,* "it seems impossible to

[24] While it is true that use of stock option awards as a form of executive compensation has declined recently; S. Hannes & A. Tabbach, "Executive Stock Options: The Effects of Manipulation on Risk Taking," 38 J. Corp. L. 533, 539-40 (2013); this in no way alters the fact that such awards are compensation for services performed.

say that [the bargain transfer at the exercise of the stock option] was not compensation." *Commissioner of Internal Revenue* v. *LoBue*, supra, 351 U.S. 247; see also *Commissioner of Internal Revenue* v. *Smith*, 324 U.S. 177, 181-82, 65 S. Ct. 591, 89 L. Ed. 830 (1945) ("[h]ence the compensation for respondent's services, which the parties contemplated, plainly was not confined to the mere delivery to respondent of an option of no present value, but included the compensation obtainable by the exercise of the option given for that purpose"); *Rice* v. *Montgomery*, 104 Ohio App. 3d 776, 782-83, 663 N.E.2d 389 (1995) ("[the] plaintiff's exercise of the stock option did not yield income from stock as [the] plaintiff maintains, but rather yielded him earned compensation which took the form of stock attained at lower than market price" [internal quotation marks omitted]); 26 C.F.R. § 1.83-7(a) ("[i]f the option is exercised . . . the employee or independent contractor realizes *compensation* upon such transfer" [emphasis added]). Because Allen was awarded the stock options as compensation for performing services in Connecticut, there is a sufficient jurisdictional nexus for Connecticut to impose a tax on the compensation.

The plaintiffs claim, however, that the fact that Allen exercised the stock options after he had ceased performing services in Connecticut and began residing outside of Connecticut severs the jurisdictional nexus. The plaintiffs, in support of their argument, rely on *Chase Manhattan Bank* v. *Gavin*, supra, 249 Conn. 202-203, in which this court reasoned as follows: "We think that it is implicit in the due process test that the

benefits afforded by the state to a domiciliary, or its functional equivalent, justifying the taxation of its income, must generally span the time period during which the income was earned, and not solely antedate that time period without any continuing effect."[25] (Internal quotation marks omitted.) This principle does not stretch so far as to require that the benefits afforded by the state "must generally span . . . and not solely antedate" *realization* of the income as the plaintiffs suggest; rather, it demands that enjoyment of the benefits provided by the state be contemporaneous with *earning* the income. Thus, the intervening passage of time between Allen's cessation of employment in the state and the exercise of the stock options he earned performing services in the state does not deprive the state of jurisdiction to tax the income derived from the exercise of the stock options.

The plaintiffs further contend that the income realized from the exercise of the stock options is not a result of the performance of services in Connecticut; but rather that the income is a result of the appreciation in value of the underlying stock, which is not

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[25] The plaintiffs also rely on a recent Ohio Supreme Court case which stated that, "[u]nder [*Shaffer* v. *Carter*, supra, 252 U.S. 37], the income of a nonresident is the 'res,' or thing, that lies within the taxing jurisdiction by virtue of the activity being performed within that jurisdiction. Thus, local taxation of a nonresident's compensation for services must be based on the location of the taxpayer when the services were performed." *Hillenmeyer* v. *Cleveland Board of Review*, 144 Ohio St. 3d 165, 176, 41 N.E.3d 1164, cert. denied, ___ U.S. ___, 136 S. Ct. 491, 193 L. Ed. 2d 352 (2015).

connected to Allen's performance of services within the state. We disagree with this characterization of the income derived from the exercise of stock options.[26] The plaintiffs rightly point out that the stock options had no reasonably ascertainable fair market value at the time the options were awarded and, consequently, were not subject to taxation at the time they were granted. See 26 U.S.C. § 83(e)(3). Stock options do, however, have value at the time of award. Nonqualified stock options would not be contemplated as a form of compensation if they did not constitute value to the parties of an employment contract. The difficulty lies in quantifying the value of the stock options.[27] By implementing the applicable regulations, both the United States Internal Revenue Service and the defendant determined

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[26] The plaintiffs' reliance upon the "secondary holding" in *Molter* v. *Dept. of Treasury*, 443 Mich. 537, 551-52, 505 N.W.2d 244 (1993), is also misplaced. In that case, the Michigan Supreme Court held that interest earned, and subsequently disbursed to a nonresident, as part of a deferred compensation plan was not attributable to services performed in the taxing state. Id. That case, however, turned on the interpretation of a state statute that subjected interest income to taxation, not on the due process clause. See id., 552 n.13 (distinguishing Michigan statute from related New Jersey statute).

[27] There is a methodology for ascertaining the present value of stock options. "The Black-Scholes option-pricing model is a standard model used by analysts for pricing options. Fisher Black and Myron Scholes, the developers of the model, won Nobel Prizes in economics following the development of the model. The existence of variables (the risk free rate, volatility of the underlying stock, expiration date of the option, etc.) may cause the model to have less reliability, however, in certain circumstances." *In re Coleman Co. Inc. Shareholders*, 750 A.2d 1202, 1208 n.13 (Del. Ch. 1999).

that, rather than taxing the speculative value of the options at the time of award, the better course of action is to calculate the taxable income on the basis of the "bargain element" at the time of exercise. See *Rice* v. *Montgomery*, supra, 104 Ohio App. 3d 781 ("[Federal law] resolves the difficulty of valuing a nontransferable stock option by waiting until the option is exercised, at which time there is a recognition of income equal to the difference between the option price and the fair market value of the stock at the time of the exercise. At the moment that the income is recognized, a fair market value can be assigned to the stock option."). For compensation in the form of stock options, the intended compensation for services performed within the state is measured and taxed at the time the options are exercised. See *Rank* v. *United States*, supra, 345 F.2d 343 ("[a]nd whatever the conceptual shortcomings might be to a theory which attributes to a right then having no ascertainable value the value of its fruits when and as they acquire demonstrable worth, it makes tax sense if not common sense"). Due process does not demand that compensation be taxed by the application of a formula that utilizes economic values that are ascertainable only contemporaneously with the performance of services in the taxing state. Rather, it is sufficient to satisfy due process requirements that, for a state to impose a tax on the compensation of a nonresident, the taxpayer has performed

the services in the taxing state. *Shaffer* v. *Carter*, supra, 252 U.S. 52.[28]

Finally, we briefly address the second prong of the due process test, which requires "a rational relationship between the tax and the values connected with the taxing [s]tate." (Internal quotation marks omitted.) *MeadWestvaco Corp.* v. *Illinois Dept. of Revenue*, supra, 553 U.S. 24. As the plaintiffs concede, this prong's "principal application has been in cases in which a state seeks to attribute to its tax base some portion of the property or income of a multistate business enterprise that does business in the state. . . . [T]he cases require, in general terms, that only a fair proportion of the property or income of the total enterprise be attributed to the taxing state." *Chase Manhattan Bank* v. *Gavin*, supra, 249 Conn. 185 n.14. Because it is undisputed that Allen was awarded the stock options for performing services only in Connecticut and this issue does not implicate a multistate business enterprise, we

[28] We are unmoved by the plaintiffs' warning that "horribles would parade" as a result of our conclusion. Contrary to the plaintiffs' claim, a state of prior residence would not be able to impose a tax on a nonresident taxpayer living and working in another state simply because the taxpayer enjoyed benefits and protection during his time of residence in that state. Jurisdiction is not predicated on whether a taxpayer has ever enjoyed the benefits or protections of a state "that made the executive's income possible"; instead, "the benefits afforded by the state . . . must generally span the time period during which the income was *earned*. . . ." (Emphasis added.) *Chase Manhattan Bank* v. *Gavin*, supra, 249 Conn. 202-203.

perceive this prong to be inapplicable to the constitutional analysis.

Accordingly we conclude that § 12-711(b)-18 of the regulations applies to the plaintiffs in this case and, as applied, does not violate the due process clause of the fourteenth amendment.

The form of the judgment with respect to the 2002 taxable year is improper, the judgment is reversed with respect to that taxable year and the case is remanded with direction to dismiss the plaintiffs' corresponding appeal for lack of subject matter jurisdiction; the judgment is affirmed in all other respects.

In this opinion the other justices concurred.

NO. CV 11 6010197	:	SUPERIOR COURT
JEFFERSON ALLEN, EVITA ALLEN	:	TAX SESSION
	:	JUDICIAL DISTRICT OF NEW BRITAIN
v.	:	
KEVIN SULLIVAN, COMMISSIONER OF REVENUE SERVICES	:	APRIL 29, 2015

MEMORANDUM OF DECISION

The plaintiffs, Jefferson and Evita Allen (the Allens) filed this appeal pursuant to General Statutes § 12-730 contesting the commissioner of revenue services' (commissioner) disallowance of the plaintiffs' claims for a refund of individual income taxes for the taxable years of 2002, 2006 and 2007. Both the Allens and the commissioner filed cross motions for summary judgment.

The two issues in this appeal are:

1) whether the Allens timely filed their claim for refund of taxes paid for the taxable year of 2002 and

2) whether the state of Connecticut has the right to tax a nonresident on income he or she realizes from the exercise of nonqualified stock options granted for services rendered in Connecticut.

The parties have entered into the following stipulations:

As to taxable year 2002

1. The plaintiffs were required to file and pay their Connecticut individual income tax for the taxable year of 2002 by April 15, 2003.

2. On or about March 8, 2007, the plaintiffs filed with the commissioner a Connecticut Nonresident and Part-Year Resident Income Tax Return for the taxable year of 2002 reporting income from Connecticut sources in the amount of $15,946,626 and paid a Connecticut income tax in the amount of $717,307.

3. On or about October 13, 2009, the plaintiffs filed an Amended Connecticut Income Tax Return for Individuals with the commissioner and requested a refund of their Connecticut individual income tax for taxable year 2002 in the amount of $717,307.

4. The last day that the plaintiffs could have filed for a refund of their Connecticut individual income tax for taxable year of 2002 was April 15, 2006, pursuant to General Statutes § 12-732.

5. The commissioner denied the plaintiffs' request for a refund and issued a final determination letter for taxable year 2002 on or about June 11, 2013.

See joint stipulation of facts, Entry No. 150.

The plaintiffs claim that income for the year 2002, originally reported as Connecticut source income, was income from the exercise of nonqualified stock options erroneously reported as Connecticut source income. In fact, the Allens were nonresidents of Connecticut at the time the options were exercised. The reason for this claim is that Mr. Allen, formerly the president and chief financial officer of Tosco Corp., was given nonqualified stock options in the taxable year of 2002 which he subsequently exercised when he was a nonresident of Connecticut.

The commissioner's main reason for denying the plaintiffs' refund request on their 2002 tax return is that the plaintiffs failed to file their claim for a tax refund within the statute of limitations in General Statutes § 12-732.

Section 12-732(a)(1) provides, in relevant part, as follows:

"If any tax has been overpaid, the taxpayer may file a claim for refund in writing with the commissioner within three years from the due date for which such overpayment was made, stating the specific grounds upon which the claim is founded. . . . Failure to file a claim within the time prescribed in this section constitutes a waiver of any demand against the state on account of overpayment."

Recognizing that the plaintiffs filed their claim for a refund for the 2002 tax year beyond three years from April 15, 2003, the commissioner maintains that, on

this basis alone, the plaintiffs are not entitled to a refund for taxes paid for the tax year of 2002.

The plaintiffs argue that the statute of limitations should not run from "within three years from the due date for which such overpayment was made. . . ." The plaintiffs contend that because the commissioner conducted an audit of the plaintiffs' tax returns, the statute of limitations should run from the completion of the audit, with an opportunity for the plaintiffs to appeal to the appellate division of the Department of Revenue Services before seeking a refund.

The plaintiffs have not identified any authority that would provide an exception to § 12-732 and permit the plaintiffs to wait until the final determination of the commissioner following an audit. Section 12-732 is clear on its face that where, as here, the taxpayer claims to be entitled to a refund of taxes, that such a claim for refund must be made in writing to the commissioner within three years from the due date of April 15, 2003, i.e., April 15, 2006.[1]

It is well settled that Connecticut is immune from suit unless it has statutorily waived its sovereign immunity. *DaimlerChrysler Corp. v. Law*, 284 Conn. 701,

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[1] General Statutes § 1-2z, also known as the plain meaning rule, provides as follows: "The meaning of a statute shall, in the first instance, be ascertained from the text of the statute itself and its relationship to other statutes. If, after examining such text and considering such relationship, the meaning of such text is plain and unambiguous and does not yield absurd or unworkable results, extratextual evidence of the meaning of the statute shall not be considered."

711, 937 A.2d 675 (2007). It is also well established that the failure to comply with the statute of limitations governing claims for refund deprives the Court of subject matter jurisdiction. See *Chatterjee v. Commissioner of Revenue Services*, 277 Conn. 681, 691, 894 A.2d 919 (2006). On this basis, the court grants the commissioner's motion for summary judgment as to the plaintiffs' claim for a refund of the income taxes paid for the year of 2002.

As to taxable years 2006 and 2007

On the second issue, the plaintiffs acknowledge that Mr. Allen's employers compensated him with nonqualified stock options earned while he was a resident of Connecticut. Nevertheless, the plaintiffs maintain that Mr. Allen was beyond the jurisdiction of the state of Connecticut to tax the income resulting from the exercise of the stock options since he was a nonresident of Connecticut at that point in time.

As to Taxable Year 2006

Mr. Allen was employed by Tosco Corp. from 1990 through 2001 as its president and chief financial officer. During this period of time, the plaintiffs were residents of the state of Connecticut. Mr. Allen was also a Connecticut resident while he was employed by Premcor, Inc. (Premcor) from January 1, 2005 through August 31, 2005 as chief executive officer. All of the services Mr. Allen performed for Premcor occurred in

Connecticut. As part of his compensation with Premcor, Mr. Allen was granted certain nonqualified stock options for services performed for Premcor. It was stipulated between the parties that these nonqualified stock options had no readily ascertainable fair market value on the date they were granted to Mr. Allen. See Stip. ¶ 43. It was also stipulated that the plaintiffs were nonresidents of Connecticut in the taxable years of 2006 and 2007.

In the taxable year of 2006, Mr. Allen earned $43,360,812 of income from the exercise of nonqualified stock options granted to him by Premcor as compensation for services performed solely in Connecticut.

On or about April 4, 2007, the plaintiffs filed their 2006 original state tax return reporting income earned from the exercise of nonqualified stock options as income from Connecticut sources in accordance with Conn. Agencies Regs. § 12-711(b)-18. Stip. ¶ 51.

On October 13, 2009, the plaintiffs filed their 2006 Amended Connecticut State Tax Return claiming a refund of all of the taxes paid for the taxable year of 2006. Stip. ¶ 52.

The audit division and the appellate division denied the plaintiffs' 2006 tax year claim for a refund on the basis that the income from the exercise of the nonqualified stock options were for compensation for services performed in Connecticut. A final determination letter was issued to the plaintiffs for the taxable year of 2006 on or about June 11, 2013. Stip. ¶ 56.

As to Taxable Year 2007

On April 11, 2008, the plaintiffs filed their Connecticut Nonresident and Part-Year Resident Income Tax Return for the taxable year of 2007 reporting income from Connecticut sources in the amount of $2,247,745. The plaintiffs paid a Connecticut income tax for the taxable year 2007 of $112,229. On or about October 13, 2009, the plaintiffs filed an Amended Connecticut Income Tax Return for Individuals seeking a refund of $112,229 for the taxable year of 2007.

The basis for the plaintiffs' claim of a refund of taxes paid on the 2007 Connecticut tax return is that Mr. Allen, as CEO of Premcor, received nonqualified stock options from Premcor during his period of employment from January 1, 2005 to August 31, 2005 when the plaintiffs were Connecticut residents and Mr. Allen's services for Premcor were performed in Connecticut. However, Mr. Allen was a nonresident of Connecticut when he exercised the options.

On October 12, 2012, the audit division denied the plaintiffs' claim for a refund for the taxable year of 2007 on the basis Mr. Allen received the income from the exercise of nonqualified stock options granted to him by Premcor as compensation for services performed in Connecticut. See Stip. ¶ 72.

Claims of the Parties

The plaintiffs argue that they should not be subjected to Connecticut income tax on the income realized

upon the exercise of Mr. Allen's nonqualified stock options for two alternate reasons: (1) Conn. Agencies Regs. § 12-711(b)-18(a) is unconstitutional and (2) that the income derived by the exercise of the nonqualified stock options outside of the state of Connecticut by a nonresident of Connecticut is beyond the reach of Connecticut to tax.

Addressing the issue of whether Conn. Agencies Regs. § 12-711(b)-18(a) is unconstitutional, the plaintiffs recognize that General Statutes § 12-711(c)(1)[2] authorizes the commissioner to issue rules and regulations to carry out the intent of the legislature as expressed in this statute. The authorization permits the commissioner to determine and apportion that income which is derived from Connecticut sources.

The plaintiffs make a constitutional argument that the Due Process Clause of the United States Constitution forbids the States from taxing extraterritorial values.[3]

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[2] General Statutes § 12-711(c)(1) provides as follows: "If a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under rules or regulations of the commissioner, the items of income, gain, loss and deduction derived from or connected with sources within this state shall be determined by apportionment under such rules or regulations and the provisions of this subsection."

[3] See plaintiffs' 11/14/14 memorandum of law, pp. 3-4, citing *MeadWestvaco Corp. v. Illinois*, 553 U.S. 16, 19 (2008); *Container Corp. of America v. FTB*, 463 U.S. 159, 164 (1983); *Allied-Signal Inc. v. N.J.*, 504 U.S. 768, 777 (1992) and *Mobil Oil Corp. v. Vt.*, 445 U.S. 425, 441-442 (1980).

The Due Process Clause of the Fourteenth Amendment to the U.S. Constitution prohibits the state of Connecticut from imposing a tax on the profits of a transaction taking place beyond it [sic] borders. See *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 184, 733 A.2d 782 (1999): "As a general principle, a State may not tax value earned outside its borders." (Internal quotation marks omitted.) As discussed above, Mr. Allen's earning of compensation occurred in Connecticut.

In construing Conn. Agencies Regs. § 12-711(b)-18(a), as applied to the field of taxation, our courts have "long . . . held that when our tax statutes refer to the federal tax code, federal tax concepts are incorporated into state law. . . . [W]here incorporation of federal tax principles makes sense in light of the statutory language at issue, our prior cases uniformly have held that incorporation should take place." (Citations omitted; internal quotation marks omitted.) *Berkley v. Gavin*, 253 Conn. 761, 773, 756 A.2d 248 (2000).

In the present case, income earned in Connecticut is taxed pursuant to General Statutes § 12-700, regarding the imposition of tax on income of each resident of this state, and General Statutes § 12-701(19) which describes "'adjusted gross income'" (AGI) to mean "the [AGI] of a natural person with respect to any taxable year, as determined for federal income tax purposes and as properly reported on such person's federal income tax return." Given the fact that the Connecticut AGI of a Connecticut resident begins with the taxpayer's federal AGI, it is appropriate to incorporate federal tax principles in so far as they relate to the

taxation of and the valuation of nonqualified stock options. See *Bell Atlantic NYNEX Mobile, Inc. v. Commissioner of Revenue Services*, 273 Conn 240, 261, 869 A.2d 611 (2005): "We long have held that when tax statutes refer to the federal tax code, federal tax concepts are incorporated into state law. . . ." (Internal quotation marks omitted.) Notably, § 12-701(19) provides such an express reference to the federal tax code.

On the federal level, nonqualified stock options are taxed as ordinary compensation because, pursuant to Internal Revenue Code (IRC) § 83(a)-(b), nonqualified stock options result in additional taxable income to the recipient at the time that they are granted, provided that there is a market for the stock of the company and it has an ascertainable market value. However, if the value of the nonqualified stock options cannot be determined because there is no market for the company stock and its value cannot be determined, then under the IRC, it is not taxed until the stock options have been exercised.[4]

According to the U.S. Tax Court in *Sheedy v. Commissioner*, T.C. Memo. 201269 (2012): "Where a taxpayer receives a nonqualified stock option without a readily ascertainable fair market value, mere receipt of the option is generally a nontaxable event. See [IRC §] 83(e)(3). Instead, the taxpayer is taxed upon his or her exercise of the option and receipt of the shares

[4] 26 U.S.C. § 83 – Property transferred in connection with performance of services. See also Taxation of nonqualified stock options, Treasury Regulations § 1.83-7(a)-(b).

where two conditions are met: First, where the shares are transferred to the taxpayer such that he or she acquires beneficial ownership interest therein. See [§] 1.83-3(a)(1), Income Tax Regs. Second, where the shares are substantially vested in the taxpayer such that they are transferable or not subject to a substantial risk of forfeiture. See [§] 1.83-3(b), Income Tax Regs. Where both conditions are met the taxpayer must recognize gross income in the amount by which the fair market value of the shares exceeds the exercise price paid to acquire them. See [§] 83(a)." Both conditions in *Sheedy* have been met by Mr. Allen in the exercise of his nonqualified stock options.

When an employee exercises his or her nonqualified stock options and retains the stock received from exercising the options, the value of the stock is the difference between the market value of the stock on the date of the exercise and the value of the option price set out in the option agreement. See *Commissioner v. Lo Bue*, 351 U.S. 243, 249, 76 S. Ct. 800, 100 L. Ed. 1142 (1956). This difference in value is the amount of wages earned by the employee and reportable as income and the amount deducted by the employer as a business expense.

It is the commissioner's position, pursuant to § 12-711(b)-18(a) of the regulations, that nonqualified stock options are taxable as ordinary income rendered for performing services to an employer if "during the period beginning with the first day of the taxable year of the optionee during which such option was granted and ending with the last day of the taxable year of the

optionee during which such option was exercised . . . the optionee was performing services within Connecticut." In other words, if Mr. Allen was granted the nonqualified stock options by his employers for services performed in Connecticut, at which time the stock options had no readily ascertainable fair market value, even though Mr. Allen had established residence outside Connecticut when he exercised his stock options, Connecticut had the right to tax the gain as Connecticut source income.

Contrary to the commissioner's position, the Allens contend that a stock option exercised beyond the borders of the state of Connecticut cannot be taxed because Connecticut would have no jurisdiction to tax a transaction occurring outside the state of Connecticut in violation of the Due Process Clause of the Fourteenth Amendment.

It is the Allens' position that the exercise of the stock options that were originally granted in Connecticut are only taxable in the jurisdiction where the stock options are exercised. However, neither party disagrees that the origination of the stock options was the granting of the options as a form of compensation to Mr. Allen for work performed in the state of Connecticut. It was also stipulated by the parties that, at the time of the granting of the nonqualified stock options, that there was no readily ascertainable fair market value on the date that they were granted. See Stip. ¶ 43.

As previously noted above, *Lo Bue* held that where there was no ascertainable fair market value on the date the stock options were granted, the taxable gain to the employee should be measured from the time the stock options were exercised. *Commissioner v. Lo Bue*, 351 U.S. 249.

In order to agree with the Allens that Connecticut has no jurisdiction to tax the proceeds of the exercise, one would have to conclude that the exercise of the stock options was not related to compensation but was in the nature of the sale of a capital asset.[5] If the exercise of the stock options were the payment of wages, the payment would have to relate back to the earning of the wages that took place in Connecticut. Otherwise, the exercise of the stock options taking place in another state would permit that state to tax wages earned in Connecticut.

As recognized in *McBroom v. Department of Revenue*, 14 OTR 239, 242 (Ore. 1997), "[a]n option granted as compensation for personal services is not a capital asset, and the exercise of such an option is not the sale of a capital asset." If the exercise was that of the sale of a capital asset that took place outside of the jurisdiction of Connecticut, then Connecticut, of course, would have no authority to tax that transaction taking place beyond its borders. As previously noted in *Chase*

[5] A capital asset has been defined in 26 U.S. Code § 1221(a) to mean "property held by the taxpayer (whether or not connected with his trade or business), but does not include . . . (4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered. . . ."

Manhattan Bank v. Gavin, 249 Conn. 184, it is a general principle that "a State may not tax value earned outside its borders." (Internal quotation marks omitted.) In the present case, however, the value, as compensation, was earned in Connecticut.

Recognizing that § 12-711(b)-18(a) of the regulations only pertains to the taxation of wages earned in Connecticut, the language of this regulation does not impinge on the plaintiffs' Due Process rights under the U.S. Constitution.

In the area of taxable income, it is a federal tax concept recognized in § 83 of IRC that where the nonqualified stock option has no market value, the stock option cannot be taxed as income until it has been exercised. This same concept must similarly be applied to nonqualified stock options granted to a Connecticut resident for services rendered in Connecticut but exercised at a time when the employee no longer was a resident of Connecticut.

The court agrees with the commissioner that Mr. Allen was required to report the exercise of the nonqualified stock options to the commissioner as part of his obligation to file a Connecticut income tax return for the taxable years of 2006 and 2007, reporting the earnings of Connecticut source wages.

Accordingly, for the reasons stated above, the commissioner's motion for summary judgment is granted and the plaintiffs' motion for summary judgment is denied. Judgment may enter in favor of the commissioner, without costs to any party.

/s/ Arnold W. Aronson
Arnold W. Aronson
Judge Trial Referee

DOCKET NO. CV-11-6010197-S

JEFFERSON & EVITA ALLEN	:	SUPERIOR COURT TAX SESSION
v.	:	JUDICIAL DISTRICT OF NEW BRITAIN
COMMISSIONER, DEPARTMENT OF REVENUE SERVICES	:	OCTOBER 24, 2014

JOINT STIPULATION OF FACTS

It is hereby stipulated that, for the purpose of the above-referenced matter, the following statements may be accepted as facts and all exhibits referenced herein and attached hereto may be accepted as authentic and are incorporated in this stipulation and made a part hereof, provided however, that either party has the right to object to the admission of any such facts or exhibits into evidence on the grounds of relevancy, but not other grounds unless expressly reserved herein, and provided further, that either party may introduce other evidence not inconsistent with the facts herein stipulated.

1. This action is an appeal brought by the Plaintiffs, Jefferson and Evita Allen, pursuant to Conn. Gen. Stat. § 12-730 contesting the Commissioner's denial of the Plaintiffs' claims for refund of Connecticut individual income tax for taxable years 2002, 2006, and 2007.

Facts Applicable to the Plaintiffs' Claim for Refund for Taxable Year 2002 – Threshold Jurisdictional Issue

2. The threshold issue with respect to the Plaintiffs' claim for refund for taxable year 2002 is whether the Court has subject matter jurisdiction to consider said claim.

3. For taxable year 2002, the due date for filing and paying the Connecticut individual income tax was April 15, 2003 in accordance with the provisions of Conn. Gen. Stat. § 12-719.

4. The Plaintiffs did not file a **Form CT-1040 EXT**, *Application for Extension of Time to File Connecticut Income Tax Return for Individuals*, to request an extension of time to file their Connecticut individual income tax for taxable year 2002.

5. As such, the Plaintiffs were required to file and pay their Connecticut individual income tax for taxable year 2002 by April 15, 2003.

6. On or about March 8, 2007, the Plaintiffs filed with the Defendant, Commissioner of Revenue Services ("Commissioner") a **Form CT-1040NR/PY**, *Connecticut Nonresident and Part-Year Resident Income Tax Return*, for taxable year 2002 whereon they reported income from Connecticut sources in the amount of $15,946,626 and paid Connecticut income tax in the amount of $717,307 ("2002 Original Return"). A copy of the Plaintiffs' 2002 Original Return is attached hereto and marked as Exhibit A.

7. The last day the Plaintiffs could file a claim for refund of their Connecticut individual income tax for taxable year 2002 was April 15, 2006 in accordance with the provisions of Conn. Gen. Stat. § 12-732.

8. On or about October 13, 2009, the Plaintiffs filed a **Form CT-1040X**, *Amended Connecticut Income Tax Return for Individuals*, with the Department requesting a refund of their Connecticut individual income tax for taxable year 2002 in the amount of $717,307 ("2002 Amended Return"). A copy of the Plaintiffs' 2002 Amended Return is attached hereto and marked as Exhibit B.

9. On or about October 12, 2012, the Department's Audit Division denied the Plaintiffs' claim for refund with respect to their Connecticut individual income tax liability for taxable year 2002 on the basis that said claim had been filed beyond the statute of limitations for filing such a claim.

10. By letter dated November 20, 2012, the Plaintiffs protested the Department's Audit Division's denial of their claim for refund with respect to their Connecticut individual income tax liability for taxable year 2002 to the Department's Appellate Division.

11. The Department's Appellate Division upheld the Audit Division's denial of the Plaintiffs' claim for refund with respect to their Connecticut individual income tax liability for taxable year 2002 on the basis that said claim had been filed beyond the statute of limitations for filing such a claim.

12. The Department's Appellate Division issued a final determination letter for taxable year 2002 on or about June 11, 2013.

Facts Applicable to the Plaintiffs' Claim for Refund for Taxable Year 2002 – Nonqualified Stock Option Issue

13. As referenced above, the threshold issue with respect to the Plaintiffs' claim for refund for taxable year 2002 is whether the Court has jurisdiction to consider said claim. In the event that the Court determines that it does have jurisdiction over said claim, facts applicable to the Plaintiffs' claim for refund for taxable year 2002 are listed below.

14. On the Plaintiffs' 2002 Amended Return, the Plaintiffs reported that the $15,946,626 of income that they had reported as income from Connecticut sources on their Original Return was not taxable in Connecticut.

15. The Plaintiffs claim that $13,174,626.99 of the income that had originally been reported as income from Connecticut sources on the Plaintiffs' 2002 Original Return was income from the exercise of nonqualified stock options that they erroneously sourced to Connecticut.

16. Documentation from the Plaintiff's, Jefferson F. Allen's, former employer, Tosco Corp. shows that in taxable year 2002 the Plaintiffs earned $7,633,027 from the exercise of nonqualified stock options granted

to the Plaintiff, Jefferson F. Allen, by Tosco Corp. as compensation for services performed in Connecticut.[1] The Defendant disputes the Plaintiffs' claim that said income was erroneously sourced to Connecticut, as the stock options were compensation for services the Plaintiff, Jefferson F. Allen, performed in Connecticut for his employer, Tosco Corp. Specific facts regarding the Plaintiff's, Jefferson F. Allen's, employment at Tosco Corp. and the compensation he received in connection with said employment are listed below.

17. The Plaintiff, Jefferson F. Allen, was employed by Tosco Corp. for the period beginning in 1990 and ending in 2001 as its President and Chief Financial Officer. The Plaintiffs were domiciled in Connecticut during this entire period.

18. The services that the Plaintiff, Jefferson F. Allen, performed for Tosco Corp. as its President and Chief Financial Officer were performed solely in Connecticut.[2]

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[1] This figure is based on the participant statement provided to the Defendant by Tosco Corp., Jefferson F. Allen's former employer, a copy of which is attached hereto as Exhibit C. The documentation provided by Tosco Corp. does not account for $5,541,600 of the $13,174,626.49 the Plaintiffs claim was from the exercise of nonqualified stock options.

[2] The Plaintiffs claim that the Plaintiff, Jefferson F. Allen, made certain business trips outside of Connecticut during his period of employment with Tosco Corp., but as these trips were "casual, isolated and inconsequential" in accordance with the provisions of Conn. Agencies Regs. § 12-711(b)-4, none of the compensation the Plaintiff, Jefferson F. Allen, received from Tosco Corp. in connection with these trips was ever sourced outside of

19. As part of the compensation the Plaintiff, Jefferson F. Allen, received for the. services he performed for Tosco Corp. as its President and Chief Financial Officer in Connecticut, Tosco Corp. granted the Plaintiff, Jefferson F. Allen, certain nonqualified stock options.

20. Specifically, on the following dates Tosco Corp. granted the Plaintiff, Jefferson F. Allen, nonqualified stock options as compensation for the services he performed for Tosco Corp. in Connecticut: January 26, 1993, January 19, 1994, January 17, 1995, June 9, 1995, and January 16, 1996. None of the nonqualified stock options Tosco Corp. granted the Plaintiff, Jefferson F. Allen, had a readily ascertainable fair market value on the date they were granted to the Plaintiff.

21. As described in more detail below, the Plaintiffs exercised these nonqualified stock options in taxable year 2002. The Plaintiffs were nonresidents of Connecticut in taxable year 2002.

22. On January 26, 1993, Tosco Corp. granted the Plaintiff, Jefferson F. Allen, seventy-two thousand (72,000) nonqualified stock options. The Plaintiff, Jefferson F. Allen, exercised these options on January 15, 2002 and earned $25.1375 per option.

Connecticut. To this end, Plaintiffs have never paid tax to another state on any portion of the salary that the Plaintiff, Jefferson F. Allen, received from Tosco Corp. More specifically, the Plaintiffs have never paid tax to another state on any portion of the income they earned from the exercise of the nonqualified stock options at issue in this appeal.

23. As such, the Plaintiffs earned one million eight hundred nine thousand nine hundred dollars ($1,809,900) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 26, 1993 as compensation for services he performed for Tosco Corp. in Connecticut.

24. On January 19, 1994, Tosco Corp. granted the Plaintiff, Jefferson F. Allen, twenty-two thousand seven hundred eighty (22,780) nonqualified stock options. The Plaintiff, Jefferson F. Allen, exercised these options on January 15, 2002 and earned $23.5625 per option.

25. As such, the Plaintiffs earned five hundred thirty-six thousand seven hundred fifty-four dollars ($536,754) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 19, 1994 as compensation for services he performed for Tosco Corp. in Connecticut.

26. On January 17, 1995, Tosco Corp. granted the Plaintiff, Jefferson F. Allen, fifty-five thousand five hundred fifty (55,550) nonqualified stock options. The Plaintiff, Jefferson F. Allen, exercised these options on January 15, 2002 and earned $23.5775 per option.

27. As such, the Plaintiffs earned one million time hundred nine thousand seven hundred thirty dollars ($1,309,730) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 17, 1995 as compensation for services he performed for Tosco Corp. in Connecticut.

28. On June 9, 1995, Tosco Corp. granted the Plaintiff, Jefferson F. Allen, one hundred twenty thousand (120,000) nonqualified stock options. The Plaintiff, Jefferson F. Allen, exercised sixty thousand (60,000) of these options on January 23, 2002 and earned $22.3725 per option. The Plaintiff, Jefferson F. Allen, exercised sixty thousand (60,000) of these options on January 31, 2002 and earned $22.330 per option.

29. As such, the Plaintiffs earned two million six hundred eighty-two thousand one hundred fifty dollars ($2,682,150) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on June 9, 1995 as compensation for services he performed for Tosco Corp. in Connecticut.

30. On January 16, 1996, Tosco Corp. granted the Plaintiff, Jefferson F. Allen, fifty-nine thousand one hundred sixteen (59,116) nonqualified stock options. The Plaintiff, Jefferson P. Allen, exercised these options on January 15, 2002 and earned $21.8975 per option.

31. As such, the Plaintiffs earned one million two hundred ninety-four thousand four hundred ninety-three dollars ($1,294,493) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 16, 1996 as compensation for services he performed for Tosco Corp. in Connecticut.

32. As referenced above, on or about March 8, 2007 the Plaintiffs filed their 2002 Original Return reporting the income described above in paragraphs 22-31 that they earned from the exercise of nonqualified stock options as income from Connecticut sources.

33. As also referenced above, on October 13, 2009, the Plaintiffs filed their 2002 Amended Return claiming a refund of all of the tax that they paid for taxable year 2002.

34. If the Court determines that it has jurisdiction to consider the Plaintiffs' claim for refund for taxable year 2002, the central issue in this appeal with respect to taxable year 2002 will be whether the income from the exercise of nonqualified stock options was properly reported as income from Connecticut sources pursuant to Conn. Agencies Regs. § 12-711(b)-18 on the Plaintiffs' 2002 Original Return.

Facts Applicable to the Plaintiffs' Claim for Refund for Taxable Year 2006

35. On or about April 7, 2007, the Plaintiffs filed with the Commissioner a **Form CT-1040NR/PY**, *Connecticut Nonresident and Part-Year Resident Income Tax Return*, for taxable year 2006 whereon they reported income from Connecticut sources in the amount of $43,360,812 and paid Connecticut income tax in the amount of $2,167,637 ("2006 Original Return"). A copy of the Plaintiffs' 2006 Original Return is attached hereto and marked as Exhibit D.

36. On or about October 13, 2009, the Plaintiffs filed a **Form CT-1040X**, *Amended Connecticut Income Tax Return for Individuals*, with the Department requesting a refund of their Connecticut individual income tax for taxable year 2006 in the amount of $2,167,637 ("2006 Amended Return"). A copy of the Plaintiffs' 2006 Amended Return is attached hereto and marked as Exhibit E.

37. On the Plaintiffs' 2006 Amended Return the Plaintiffs reported that the $43,360,812 of income that they had reported as income from Connecticut sources on their Original Return was done so in error.

38. The Plaintiffs claim that $43,360,812 of the income that had originally been reported as income from Connecticut sources on the Plaintiffs' 2006 Original Return was not taxable in Connecticut.

39. Documentation from the Plaintiff's, Jefferson F. Allen's, former employer, Premcor Inc. shows that in taxable year 2006 the Plaintiffs earned $43,360,812 of income from the exercise of nonqualified stock options granted to the Plaintiff, Jefferson F. Allen, by Premcor. Inc. as compensation for services performed in Connecticut.[3] The Defendant disputes the Plaintiffs' claim that said income was erroneously sourced to Connecticut, as the stock options were compensation for services the Plaintiff, Jefferson F. Allen, performed in Connecticut for his employer, Premcor

[3] This figure is based on the exercise summary statement provided to the Defendant by Premcor Inc., Jefferson F. Allen's former employer, a copy of which is attached hereto as Exhibit F.

Inc. Specific facts regarding the Plaintiff's, Jefferson F. Allen's, employment at Premcor Inc. and the compensation he received in connection with said employment are listed below.

40. The Plaintiff, Jefferson F. Allen, was employed by Premcor Inc. for the period beginning on January 1, 2005 and ending on August 31, 2005 as the Chief Executive Officer. The Plaintiffs were domiciled in Connecticut during this entire period.

41. The services that the Plaintiff, Jefferson F. Allen, performed for Premcor Inc. as the Chief Executive Officer were performed solely in Connecticut.[4]

42. As part of the compensation the Plaintiff, Jefferson F. Allen, received for the services he performed for Premcor Inc. as the Chief Executive Officer in Connecticut, Premcor Inc. granted the Plaintiff, Jefferson F. Allen, certain nonqualified stock options.

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[4] The Plaintiffs claim that the Plaintiff, Jefferson F. Allen, made certain business trips outside of Connecticut during his period of employment with Premcor Inc., but as these trips were "casual, isolated and inconsequential" in accordance with the provisions of Conn. Agencies Regs. § 12-711(b), none of the compensation the Plaintiff, Jefferson F. Allen, received from Premcor Inc. in connection with these trips was ever sourced outside of Connecticut. To this end, Plaintiffs have never paid tax to another slate on any portion of the salary that the Plaintiff, Jefferson F. Allen, received from Premcor Inc. More specifically, the Plaintiffs have never paid tax to another state on any portion of the income they earned from the exercise of the nonqualified stock options at issue in this appeal.

43. Specifically, on the following dates Premcor Inc. granted the Plaintiff, Jefferson F. Allen, nonqualified stock options as compensation for the services he performed for Premcor Inc. in Connecticut: January 1, 2005 and July 26, 2005. None of the nonqualified stock options Premcor Inc. granted the Plaintiff, Jefferson F. Allen, had a readily ascertainable fair market value on the date they were granted to the Plaintiff.

44. As described in more detail below, the Plaintiffs exercised certain of these nonqualified stock options in taxable year 2006. The Plaintiffs were nonresidents of Connecticut in taxable year 2006.

45. On January 1, 2005, Premcor Inc. granted the Plaintiff, Jefferson. F. Allen, four hundred ninety-five thousand three hundred (495,300) nonqualified stock options. In August of 2005, Premcor Inc. was acquired by Valero Energy Corp. As a result of this acquisition, Premcor Inc, stock was converted to Valero Energy Corp. stock. As such, the four hundred ninety-five thousand three hundred (495,300) nonqualified stock options the Plaintiff, Jefferson F. Allen, was granted by Premcor Inc. as compensation for services he performed in Connecticut were converted to be four hundred ninety thousand three hundred forty-seven (490,347) nonqualified stock options.

46. In December of 2005, the Valero Energy Corp. split its common stock. As such, the Plaintiff, Jefferson F. Allen, was left with nine hundred eighty thousand six hundred ninety four (980,694) nonqualified

stock options. The Plaintiff, Jefferson F. Allen, exercised one hundred thousand (100,000) of these options on June 12, 2006 and earned $36.2542 per option. The Plaintiff, Jefferson F. Allen, exercised thirty thousand six hundred ninety-four (30,694) of these options on June 15, 2006 and earned $38.01 per option. The Plaintiff, Jefferson F. Allen, exercised two hundred thousand (200,000) of these options on June 29, 2006 and earned $44.6016 per option, The Plaintiff, Jefferson F. Allen, exercised two hundred thousand (200,000) of these options on July 17, 2006 and earned $41.3274 per option. The Plaintiff; Jefferson F. Allen, exercised two hundred thousand (200,000) of these options on July 21, 2006 and earned $41.4123 per option. The Plaintiff, Jefferson F. Allen, exercised two hundred thousand (200,000) of these options on August 3, 2006 and earned $46.2284 per option.[5]

47. As such, the Plaintiffs earned thirty nine million five hundred six thousand thirty-eight dollars and ninety-four cents ($39,506,038.94) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 1, 2005 as compensation for services he performed for Premcor Inc. in Connecticut.

48. On July 26, 2005, Premcor Inc. granted the Plaintiff, Jefferson F. Allen, one hundred thousand (100,000) nonqualified stock options, In August of

[5] The Plaintiff, Jefferson F. Allen, exercised the remaining fifty thousand (50,000) stock options on August to, 2007, as will be described in the next section.

2005, Premcor Inc. was acquired by Valero Energy Corp. As a result of this acquisition, Premcor Inc. stock was converted to Valero Energy Corp. stock. As such, the one hundred thousand (100,000) nonqualified stock options the Plaintiff, Jefferson F. Allen, was granted by Premcor Inc. as compensation for services he performed in Connecticut were converted to be ninety-nine thousand (99,000) nonqualified stock options.

49. In December of 2005, the Valero Energy Corp. split its common stock. As such, the Plaintiff, Jefferson F. Allen, was left with one hundred ninety-eight thousand (198,000) nonqualified stock options. The Plaintiff; Jefferson F. Allen, exercised seventy-five thousand (75,000) of these options on March 13, 2006 and earned $16.33 per option. The Plaintiff, Jefferson F. Alien, exercised one hundred twenty-three thousand (123,000) of these options on May 15, 2006 and earned $21.3823 per option.

50. As such, the Plaintiffs earned three million eight hundred fitly-four thousand seven hundred seventy-two dollars and ninety cents ($3,854,772.90) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 1, 2005 as compensation for services he performed for Premcor Inc. in Connecticut.

51. As referenced above, on or about April 4, 2007 the Plaintiffs filed their 2006 Original Return reporting the income described above in paragraphs 45-50 that they earned from the exercise of nonqualified

stock options as income from Connecticut sources in accordance with the provisions of Conn. Agencies Regs. § 12-711(b)-18.

52. As also referenced above, on October 13, 2009 the Plaintiffs filed their 2006 Amended Return claiming a refund of all of the tax they paid for taxable year 2006.

53. On or about October 12, 2012, the Department's Audit Division denied the Plaintiffs' claim for refund with respect to their Connecticut individual income tax liability for taxable year 2006 on the basis that the income that resulted from the exercise of the nonqualified stock options the Plaintiff, Jefferson F. Allen, was granted by Premcor Inc. as compensation for services he performed in Connecticut was properly reported as income from Connecticut sources on the Plaintiffs' 2006 Original Return.

54. By letter dated November 20, 2012, the Plaintiffs protested the Department's Audit Division's denial of their claim for refund with respect to their individual income tax liability for taxable year 2006 to the Department's Appellate Division.

55. The Department's Appellate Division upheld the Audit Division's denial of the Plaintiffs' claim for refund with respect to their Connecticut individual income tax liability for taxable year 2006 on the basis that the income that resulted from the exercise of the nonqualified stock options the Plaintiff, Jefferson F. Allen, was granted by Premcor Inc. as compensation for

services he performed in Connecticut was properly reported as income from Connecticut sources on the Plaintiffs' 2006 Original Return.

56. The Department's Appellate Division issued a final determination letter for taxable year 2006 on or about June 11, 2013.

57. The central issue in this appeal with respect to taxable year 2006 is whether the income from the exercise of nonqualified stock options was properly reported as income from Connecticut sources pursuant to Conn. Agencies Regs. § 12-711(b)-18 on the Plaintiffs' 2006 Original Return.

Facts Applicable to the Plaintiffs' Claim for Refund for Taxable Year 2007

58. On or about April 11, 2008, the Plaintiffs filed with the Commissioner a **Form CT-1040NR/PY**, *Connecticut Nonresident and Part-Year Resident Income Tax Return*, for taxable year 2007 whereon they reported income from Connecticut sources in the amount of $2,247,745 and paid Connecticut income tax in the amount of $112,229 ("2007 Original Return"). A copy of the Plaintiffs' 2007 Original Return is attached hereto and marked as Exhibit G.

59. On or about October 13, 2009, the Plaintiffs filed a **Form CT-1040X**, *Amended Connecticut Income Tax Return for Individuals*, with the Department requesting a refund of their Connecticut individual income tax for taxable year 2007 in the amount of

$112,229 ("2007 Amended Return"). A copy of the Plaintiffs' 2007 Amended Return is attached hereto and marked as Exhibit H.

60. On the Plaintiffs' 2007 Amended Return the Plaintiffs reported that the $2,247,745 of income that they had reported as income from Connecticut sources on their Original Return was done so in error.

61. The Plaintiffs claim that $2,247,745 of the income that had originally been reported as income from Connecticut sources on the Plaintiffs' 2007 Original Return was income from the exercise of nonqualified stock options that they erroneously sourced to Connecticut.

62. Documentation from the Plaintiffs, Jefferson F. Allen's, former employer, Premcor Inc, shows that the Plaintiffs earned $2,247,745 of income from the exercise of nonqualified stock options granted to the Plaintiff, Jefferson F. Allen, by Premcor Inc. as compensation for services performed in Connecticut.[6] The Defendant disputes the Plaintiffs' claim that said income was erroneously sourced to Connecticut, as the stock options were compensation for services the Plaintiff, Jefferson F. Allen, performed in Connecticut for his employer, Premcor Inc. Specific facts regarding the Plaintiff's, Jefferson F. Allen's, employment at Premcor Inc.

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[6] This figure is based on the exercise summary statement provided to the Defendant by Premcor Inc., Jefferson F. Allen's former employer, a copy of which is attached hereto as Exhibit I.

and the compensation he received in connection with said employment are listed below.

63. The Plaintiff, Jefferson F. Allen, was employed by Premcor Inc. for the period beginning on January 1, 2005 and ending on August 31, 2005 as the Chief Executive Officer. The. Plaintiffs were domiciled in Connecticut during this entire period.

64. The services that the Plaintiff, Jefferson F. Allen, performed for Premcor Inc. as the Chief Executive Officer were performed solely in Connecticut.[7]

65. As part of the compensation the Plaintiff, Jefferson F. Allen, received for the services he performed for Premcor Inc. as the Chief Executive Officer in Connecticut, Premcor Inc. granted the Plaintiff, Jefferson F. Allen, certain nonqualified stock options.

66. Specifically, on the following dates Premcor Inc. granted the Plaintiff, Jefferson F. Allen, nonqualified stock options as compensation for the services he performed for Premcor Inc. in Connecticut: January 1,

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[7] The Plaintiffs claim that the Plaintiff, Jefferson F. Allen, made certain business trips outside of Connecticut during the period of his employment with Premcor Inc., but as these trips were "casual, isolated and inconsequential" in accordance with the provisions of Conn. Agencies Regs. § 12-71 1(b)-4, none of the compensation the Plaintiff, Jefferson F. Alien, received from Premcor Inc. in connection with these trips was ever sourced outside of Connecticut. To this end, Plaintiffs have never paid tax to another state on any portion of the salary that the Plaintiff, Jefferson F. Allen, received from Premcor Inc. More specifically, the Plaintiffs have never paid tax to another state on any portion of the income they earned from the exercise of the nonqualified stock options at issue in this appeal.

2005 and July 26, 2005. None of the nonqualified stock options Premcor Inc. granted the Plaintiff; Jefferson F. Allen, had a readily ascertainable fair market value on the date they were granted to the Plaintiff.

67. As described in more detail below, the Plaintiffs exercised certain of these nonqualified stock options in taxable year 2007. The Plaintiffs were nonresidents of Connecticut in taxable year 2007.

68. As described above, most of the nonqualified stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 1, 2005 were exercised in taxable year 2005 and all of the nonqualified stock options that were granted to the Plaintiff, Jefferson F. Allen, on July 26, 2005 were exercised in taxable year 2006. However, on August 10, 2007, the Plaintiff, Jefferson F. Allen, exercised fifty thousand of the stock options that were granted to him on January 1, 2005 and earned $44.9549 per option.

69. As such, the Plaintiffs earned two million two hundred forty-seven thousand seven hundred forty-five dollars ($2,247,745) of income from the exercise of the stock options that were granted to the Plaintiff, Jefferson F. Allen, on January 1, 2005 as compensation for services he performed for Premcor Inc. in Connecticut.

70. As referenced above, on or about April 11, 2008 the Plaintiffs filed their 2007 Original Return reporting the income described above in paragraphs 68-69 that they earned from the exercise of nonqualified stock options as income from Connecticut sources in

accordance with the provisions of Conn. Agencies Regs. § 12-711(b)-18.

71. As also referenced above, on October 13, 2009, the Plaintiffs filed their 2007 Amended Return claiming a refund of all of the tax they paid for taxable year 2007.

72. On or about October 12, 2012, the Department's Audit Division denied the Plaintiffs' claim for refund with respect to their Connecticut individual income tax liability for taxable year 2007 on the basis that the income that resulted from the exercise of the nonqualified stock options the Plaintiff, Jefferson F. Allen, was granted by Premcor Inc. as compensation for services he performed in Connecticut was properly reported as income from Connecticut sources on the Plaintiffs' 2007 Original Return.

73. By letter dated November 20, 2012, the Plaintiffs protested the Department's Audit Division's denial of their claim for refund with respect to their Connecticut individual income tax liability for taxable year 2007 to the Department's Appellate Division.

74. The Department's Appellate Division upheld the Audit Division's denial of the Plaintiffs' claim for refund with respect to their Connecticut individual income tax liability for taxable year 2007 on the basis that the income that resulted from the exercise of the nonqualified stock options the Plaintiff, Jefferson F. Allen, was granted by Premcor Inc. as compensation for

services he performed in Connecticut was properly reported as income from Connecticut sources on the Plaintiffs' 2007 Original Return.

75. The Department's Appellate Division issued a final determination letter for taxable year 2007 on or about June 11, 2013.

76. The central issue in this appeal with respect to taxable year 2007 is whether the income from the exercise of nonqualified stock options was properly reported as income from Connecticut sources pursuant to Conn. Agencies Regs. § 12-711(b)-18 on the Plaintiffs' 2007 Original Return.

DEFENDANT, COMMISSIONER OF REVENUE SERVICES	PLAINTIFFS, Jefferson and Evita Allen
By /s/ Louis P. Bucari Louis P. Bucari Erica C. McKenzie Department of Revenue Services 25 Sigourney Street – 19th Floor Hartford, Connecticut 06106 (860) 297-5798 Juris No. 421627	By /s/ Leslie E. Grodd Leslie E. Grodd, Esq. Halloran & Sage, LLP 315 Post Road West Westport, Connecticut 06880

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March 28, 2007

Melissa Pescetelli
Revenue Examiner
Department of Revenue Services
Income Tax Audit Unit
25 Sigourney Street
Hartford, CT 06106

RE: JEFFERSON F. ALLEN, TIN: [redacted]
EVITA M. ALLEN, TIN: [redacted]

Dear Ms. Pescetelli:

I have been retained by Mr. & Mrs. Allen to represent them together with their present representatives, because it is apparent to those involved reviewing your correspondence and verbal statements that you have made up your mind regarding the Allen's status as Connecticut residents during 2002-2005, and, therefore, an appeal will be necessary. Attached hereto please find the Allen's authorization for me to represent them before the DRS in this proceeding.

In accordance with your latest request, enclosed please find the Allen's federal income tax returns for the

years which were not previously provided. As to the year 2001, we believe that year is closed since Mr. & Mrs. Allen filed a 2001 return which only excluded one-twelfth of their interest income, hardly an understatement which would extend the applicable three-year statute of limitations.

Parenthetically, it is also interesting to me that you have selected returns for audit which have not even been filed since Mr. & Mrs. Allen were clearly Nevada residents during those periods with no Connecticut source income. You have previously been provided bank records for those years together with summary schedules which give Connecticut presence every benefit of the doubt and still show Mr. & Mrs. Allen to be in the state less than 183-days in each of those years. Despite this and other information which has also been provided, your continued requests for more and more information displays a clear bias toward a finding of Connecticut residence despite overwhelming facts to the contrary and, in my opinion, borders on unacceptable harassment.

The filing of the 2002 return declaring the non-qualified option income was the result of our advising Mr. Allen that your regulations mandate that treatment even though he was a nonresident at the time of exercise, which factor Mr. Allen believed would exclude that income from Connecticut taxation as in the case of other retirement income.

If we are correct in our assumption that you have decided that Mr. & Mrs. Allen were residents during

some or all of the periods in question, I would ask that you formally assess the tax which you believe is due so that we can proceed with an appeal. If we are wrong in that assumption, I would ask that you contact me so that we can complete this examination as soon as possible. I would also specifically request that you quickly make whatever assessment you deem appropriate with regard to 2005 which was the original year examined.

Very truly yours,

/s/ Leslie E. Grodd

Leslie E. Grodd

LEG:ll