

May 10, 2004

IN RE: DANIEL ABOYAN ET AL

This Opinion pertains to the following petitioners and corresponding Tax Review Board docket numbers.

Daniel Aboyan	- 36EAREFZZ9748
Ann Weber-Ammar	- 36EAREFZZ9785
Kent L. Babcock, III	- 36EAREFZZ9743
Ronald L. Bacon	- 36EAREFZZ9759
James H. Brooks	- 36EAREFZZ9752
James Calla	-36EAREFZZ9769
Christopher Carey	- 36EAREFZZ9782
David C. Carney	-36EAREFZZ9779
Diego (Dan) A. Chila, CPA	-36EAREFZZ9780
Charles Coltman	-36EAREFZZ9760
Charles Connolly	-36EAREFZZ9781
Charles H. Dietrich	-36EAREFZZ9754
Vincent T. DiPatre	-36EAREFZZ9744
Susan Fedele	-36EAREFZZ9778
Kenneth J. Flade	-36EAREFZZ9762
Donald Frankenfield	-36EAREFZZ9755
Robert N. Gilmore	-36EAREFZZ9745

Rosemarie Greco	-36EAREFZZ9777
Paul D. Geraghty	-36EAREFZZ9763
Michael P. Heavener	-36EAREFZZ9747
Dorothy L. Jaworski	-36EAREFZZ9768
Thomas J. Kaplan	-36EAREFZZ9756
Lawrence B. Kramer	-36EAREFZZ9775
Terrence A. Larsen	-36EAREFZZ9750
Carol A. Leisenring	-36EAREFZZ9784
Jorge A. Leon	-36EAREFZZ9761
Robert F. McCammon	-36EAREFZZ9765
Thomas McDonnell	-36EAREFZZ9751
Dorothy T. Motz	-36EAREFZZ9787
John P. (Jack) Neary	-36EAREFZZ9772
Edward C. O'Donnell	-36EAREFZZ9764
Thomas B. O'Rourke	-36EAREFZZ9774
Robert B. Palmer	-36EAREFZZ9773
James Pope	-36EAREFZZ9753
John Principe	-36EAREFZZ9771
Maureen E. Pugh	-36EAREFZZ9783
Joel H. Schwartz	-36EAREFZZ9776

Donn G. Scott	-36EAREFZZ9766
Ernest B. Smith	-36EAREFZZ9746
Mark E. Stalnecker	-36EAREFZZ9757
Frank P. Sweeny	-36EAREFZZ9736
David Swoyer	-36EAREFZZ9767
Michael A. Varzally	-36EAREFZZ9758
Joseph M. Vayda	-36EAREFZZ9770
Carol Williams	-36EAREFZZ9749

FINDINGS OF FACT:

The Tax Review Board (hereafter “TRB” or “Board”) hereby incorporates by reference the undated Stipulation of Facts entered into by the attorney for Petitioners, Peter J. Picotte, III, Esquire, Dilworth Paxson LLP and Jack M. Panitch, Esquire, Deputy City Solicitor, attorney for the City of Philadelphia, including Exhibits J-I through J-35, inclusive, and accepted by the Tax Review Board at the public hearing on March 11, 2003.

CONCLUSIONS OF LAW:

The question before the TRB is the matter of whether First Union National Bank (hereafter “First Union”) was required to plead with specificity all possible defenses to their claim that gains realized from the exercise of employee stock options were not subject to Wage Tax, at the time they filed either the refund petitions with the Department of Revenue or the appeals with the Tax Review Board.

In August 1998, First Union filed refund petitions with the Philadelphia Department of Revenue on behalf of employees of its predecessor, CoreStates, N.A. (hereafter “Corestates”). These petitions were filed within the limitations set forth in The Philadelphia Code Chapter 19-1703(1)(d) requiring that a tax refund claim “be filed with the Department within 3 years from the date of payment to the City... or the due date, whichever is later.”

The original petitions set forth the facts of the case, which remain the same through today and are recited in the Stipulation of Facts attached hereto.

Certain employees of CoreStates received stock options from the employer- bank. These options were exercised over the years 1995, 1996 and 1997. At the time of exercise, Philadelphia Wage Tax was withheld on the dollar value of the “spread” between the value of the stock when the option was issued and the value of the stock when the option was exercised.

In 1998, the Pa. Commonwealth Court had the opportunity to rule on two separate cases addressing the question of the taxability of employee stock options. In Newbrey v. Township and School District of Upper St. Clair, 710 A.2d 96 (Cmwlth. Ct. 1998) and Marchlen v. Township of Mt. Lebanon, 707 A.2d 631 (Cmwlth. Ct. 1998), the Court held that the gain on the exercise of employee stock options was not earned income and therefore not subject to earned income tax as defined in the Local Tax Enabling Act of December 31, 1965, P.L. 1257, as amended, 53 P.S. §6901 et seq (Hereafter “LTEA”).

As a result of these Commonwealth Court decisions, First Union filed the initial requests for refunds with the Philadelphia Department of Revenue, citing its position that the gains realized on these stock options were not subject to Wage Tax and that the Wage Tax that had been remitted as a result of the exercise of stock options by the former CoreStates employees should be refunded by the City of Philadelphia. First Union relied on the Marchlen and Newbrey decisions.

Although the City’s taxing authority for Wage Tax derives from the Sterling Act of 1933, not the LTEA, the terms and language are identical. Therefore, Petitioner’s filed their refund claims on the basis of the two Commonwealth Court decisions.

The original refund petitions put forth the argument that as a result of Newbrey and Marchlen the gains were not taxable and a full refund was warranted. The refund petitions filed with the Department of Revenue provided employee identification information and the tax years involved. These petitions were denied by the City of Philadelphia Revenue Department on the basis that the Marchlen decision did not speak to the City’s treatment of employee stock options since the City’s taxing authority was not derived from the LTEA.

First Union filed timely petitions for appeal with the Tax Review Board following the Revenue Department’s denial of the refund requests. The petitions were filed within 90 days of the denials, as required by The Philadelphia Code Chapter 19-1703 (7).

During the course of the petitioners refund appeal process, the Pa. Supreme Court took up the issue and held that such stock options could be taxed as earned income at the time of exercise. In Marchlen v. Mt. Lebanon Township, 746 A.2d 566 (Pa. 2000), the Pa. Supreme Court held that the employee stock options at issue constituted compensation to the employees and as such were subject to the township’s earned income tax. The employee stock options considered by the Court in Marchlen were identical to those under appeal to the Tax Review Board in the present case.

During the course of these various appeals, the Department of Revenue had agreed to resolve this very issue with taxpayers other than these petitioners before the Tax Review Board by agreeing to value employee stock options as of the date of receipt using a formula known as the Black-Scholes stock option pricing formula.

When Petitioners requested use of this same formula, they were denied by the Department of Revenue on the basis that they had not put the request to use this formula in their original refund petitions and therefore were now precluded by the three year statute of limitations on refunds stated in Chapter 19-1703(1)(d) of The Philadelphia Code, from raising it at the Department of Revenue or before the TRB.

It is the finding of the Tax Review Board that Petitioners' claims for refunds based on use of the Black-Scholes formula were not barred from consideration by the Board because Petitioners failed to specifically list this as an alternate theory in their original petitions.

The original refund petitions filed by First Union were sufficient to put the City on notice as to the taxes being challenged and the nature of the challenge. Counsel for the Petitioners was in communication with both counsel for the City and with the Board. Additionally, the City was in negotiation with other taxpayers regarding the very same issue of the taxability of employee stock options. All parties were closely following the Marchen & Newbrey cases and it was at both parties' request that these cases were placed in a suspended status pending the outcome of the review of these cases by the Pa. Supreme Court. Therefore any claim by the City of Philadelphia that it was caught unaware of the true nature of the claims being made by these taxpayers and would be at an unfair disadvantage if forced to consider the Black-Scholes formula for these claims does not carry credibility.

A review of The Philadelphia Code, Local Agency Law and standard Tax Review Board practice reveals that there are no express requirements supporting the City's position that the Petitioners cannot add to or amend their petitions to include a new change in the law that impacts their position.

Refund requests to the City of Philadelphia Department of Revenue are governed by The Philadelphia Code. Refund claims are to be filed "with the Department within 3 years from the date of payment to the City... or the due date, whichever is later." The Philadelphia Code Chapter 19-1703(1)(d). There is no dispute that at the time that CoreStates filed the refund petitions with the Department of Revenue, they were within the 3-year filing requirement and were, as such, properly accepted by the Department of Revenue.

Chapter 19-1703(2) of the Code also requires that a refund petition filed with the Department of Revenue "state the reasons upon which the petitioner relies and... include a certification by the petitioner that the facts set forth therein are true." The reasons stated on these refund requests were that the employees were entitled to a full refund of the Wage Tax withheld when they exercised their stock options because under the Commonwealth Court's Marchlen and Newbrey decisions the gains realized were not subject to tax as earned income. The remedy requested and the legal theory may have changed as a result of the Supreme Court decision, but the underlying facts of the petitioners' claims have remained the same.

Although these cases were under appeal to the Pa. Supreme Court, First Union did not put forth in its petitions any argument in anticipation that the Commonwealth Court's decisions might be reversed. Nor does the Tax Review Board find that they were obligated to do so.

After being denied their refunds by the Department of Revenue, First Union filed the appeals to the Tax Review Board in a timely manner as set forth in The Philadelphia Code Chapter 19-1703(7).

Had the Tax Review Board proceeded to hear these cases in its normal course of practice, at the time of the hearing, it is presumable that the two Commonwealth Court decisions would have been the final word on the taxability of employee stock options, albeit under the LTEA not the Sterling Act. The issue before the Board would have been whether the reasoning of the Commonwealth Court was applicable to the instant cases.

It was at the request of both Counsel for Petitioners and Counsel for the City that these cases were placed in a suspended status pending the outcome of the Supreme Court review. And it was during this time that the City began exploring the use of the Black-Scholes pricing formula with other similarly situated taxpayers, knowing full well that there were these 45 taxpayers looking for a fair resolution to this matter. Even though the original refund requests may not have argued for the use of the Black-Scholes formula, the City can hardly claim surprise as to the existence of these taxpayers or their claims.

The proceeding before the Tax Review Board is an administrative proceeding and as such is not held to the standards of civil procedure that one must adhere to in a court of law. The Board has never adopted rules or regulations that require a petition before it to conform to a complaint or any other pleading as may required by the Rules of Civil Procedure. To do so would, in many ways, defeat the purpose of the administrative process as a less formal, less costly and more accessible means for both taxpayers and the City alike to seek a remedy to a tax dispute.

Most taxpayers seeking relief from the Tax Review Board have tax bills in the hundreds of dollars; amounts that preclude hiring a professional representative to pursue their claims. The less formal process of the Tax Review Board allows these taxpayers to have a forum for review and redress that would be denied them if the Board were to adopt the more formal rules of procedure. Most taxpayers before the Tax Review Board appear Pro Se. Adopting rules that would, in essence require an attorney for compliance would foreclose this avenue of appeal to many. The Board has never adopted or enforced such standards. This posture is supported by the Pa. Local Agency Law, 2 Pa.C.S.A. §501 et seq.

The City argues that the TRB is not part of the administrative review process, not an administrative appeal panel, but rather is a court of law. The City argues that the administrative process ends with the Department of Revenue action. The City hinges its argument, in part, on the signs in the TRB hearing room say “No food or drink permitted in the courtroom”. See Notes of Testimony, October 22, 2003, Page 22. The TRB will be the first to say that the signs hung in the hearing room for the convenience of staff and patrons bear no relation to the Board’s status as an administrative review panel.

In addition, a review of Local Agency Law, 2 Pa. C.S.A. §501 et seq makes clear that adjudications by administrative agencies are expressly held to a different evidentiary standard than would be required of a court of law.

Local Agency Law sets forth practice and procedure for local agency hearings, with only very general parameters. For example, section 504 requires due process in the form of “reasonable notice and an opportunity to be heard.” While section 505 states that agency hearings may proceed without strict adherence to the technical rules of evidence. “(A)ll relevant evidence of reasonably probative value may be received... (and) (r)easonable examination and cross examination shall be permitted.” These sections stand in contrast to the specificity of the Rules of Civil Procedure that govern proceedings in a court of law.

There are no pleading standards nor rules of procedure that would prohibit the taxpayers in this proceeding from going forward based on the petitions filed and seeking to amend their legal argument at the TRB based on subsequent changes in the law.

The City also claims that the TRB should hold these taxpayers to a higher standard of proof because the case is before the Board in a refund posture and therefore any decision favoring the taxpayers’ position would cause the city to give back money it had already spent. There is no foundation in The Philadelphia Code or any case law cited by the parties for this premise and it is not one subscribed to by the TRB.

Each petitioner before the TRB gets the same attentive consideration for the position set forth in his or her presentation to the Board and is held to the same burden of proof regardless of whether their claim is a refund or deficiency situation.

Therefore, it is the decision of the TRB that the petitions filed by these petitioners were sufficient to state their case and be permitted to proceed with their refund claims.

The City concedes that should the taxpayers prevail on this timeliness issue regarding their claims, they will be able to avail themselves of the Department of Revenue settlement policy of valuing their employee stock options using the Black-Scholes pricing formula.

Thus the parties have not asked to Board to review the issue of whether this is the required or correct valuation for pricing employee stock options.

It is the decision of the Tax Review Board that the petitions filed by Petitioners for a refund of certain wage tax liabilities incurred by the exercise of stock options granted by their employer, CoreStates, N.A., in 1995, 1996 and 1997 were filed within the required time limits and with the required information. As such, they are rightfully before the TRB for consideration and review.

The correct Wage Tax for the employee stock options exercised in 1995, 1996 and 1997 should be calculated using the Black-Scholes Option Pricing Formula and that Petitioners should be issued any refunds that may be due and owing following the calculations.

Concurred:

Derrick Johnson, CPA, Chair
Christopher Booth, Jr., Esq.
Una Vee Bruce
Joseph Ferla