

STATE OF NEW YORK

STATE TAX COMMISSION

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| In the Matter of the Petition | : | |
| of | : | |
| EINER NIELSEN and MILDRED C. NIELSEN | : | DECISION |
| for Redetermination of a Deficiency or for | : | |
| Refund of Personal Income Tax under Article 22 | : | |
| of the Tax Law for the Year 1964. | : | |

Einer Nielsen and Mildred C. Nielsen, residing at 4215 Harding Road, Nashville, Tennessee 37205, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1964. (File No. 11037).

A formal hearing was held on April 28, 1976, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, before Nigel G. Wright, Hearing Officer. The petitioners appeared by Everett, Johnson & Breckenridge (Eugene Chester, Esq. and Peter K. Lathrop, Esq. of counsel). The Income Tax Bureau appeared by Peter Crotty, Esq. (Solomon Sies, Esq. of counsel).

ISSUES

I. Whether the method of allocating income and expenses attributable to New York State, including the method of allocating primary or underwriting profits by petitioner, Einer Nielsen's partnership, J. C. Bradford & Co., an underwriter and dealer in securities was proper, when as part of a public offering, the aforementioned partnership, as a member of an underwriting syndicate managed by a New York-based underwriter, enters into an underwriting commitment for the purchase of securities of an issuing corporation.

II. What is the resultant effect of such allocations on petitioners', Einer Nielsen and Mildred C. Nielsen, personal income tax liability?

FINDINGS OF FACT

1. Petitioners, Einer Nielsen and Mildred C. Nielsen, filed New York State nonresident income tax returns for the year 1964.

2. On October 12, 1972, the Income Tax Bureau issued a Notice of Deficiency against the petitioners, Einer Nielsen and Mildred C. Nielsen for the year 1964. Said Notice of Deficiency was based on Einer Nielsen's share, as a partner, of partnership income from primary or underwriting profits and stock brokerage commission and trading income earned by J. C. Bradford & Co., during the year in issue. Since the disposition of the petition of Einer Nielsen and Mildred C. Nielsen is contingent on the State Tax Commission's determination in the Petition of J. C. Bradford & Co., the "Findings of Fact" in said decision are hereby adopted.

3. It was stipulated at the hearing in the Matter of J. C. Bradford & Co., that the auditor's Schedule C - "Distribution to Partners" correctly reflects the total Federal income each partner of J. C. Bradford & Co. earned and/or received from said partnership during the years 1964 through 1970. It was further stipulated that the aforementioned amount of income of each partner which is allocable to New York State shall be equal to the amount determined by multiplying the amount of such income by the percentage of income allocable to New York as is ultimately determined in the proceedings relating to J. C. Bradford & Co.'s unincorporated business tax.

CONCLUSIONS OF LAW

A. That the "Conclusions of Law" stated in the State Tax Commission decision in the Petition of J. C. Bradford & Co., a copy of which is attached hereto, are hereby adopted.

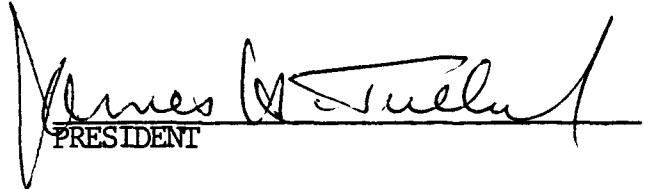
B. That the petitioners are liable for personal income tax due on Einer Nielsen's proportionate share of the partnership, J. C. Bradford & Co.'s primary or underwriting and brokerage commission and trading profits allocated to New York State for the year in issue, in the State Tax Commission decision in the Petition of J. C. Bradford & Co., except as stated therein.

C. That the petition of Einer Nielsen and Mildred C. Nielsen is granted to the extent indicated in Conclusion "A" of the Petition of J. C. Bradford & Co., and is in all other respects denied.

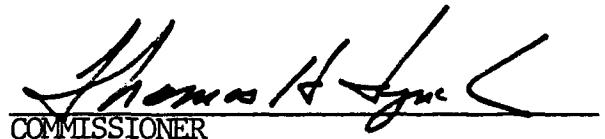
DATED: Albany, New York

February 1, 1977

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
J. C. BRADFORD & CO. : DECISION
for Redetermination of a Deficiency or for :
Refund of Unincorporated Business Tax under :
Article 23 of the Tax Law for the Years 1964:
through 1970. :
:

J. C. Bradford & Co., 170 Fourth Avenue North, Nashville, Tennessee 37219, filed a petition under Article 23 of the Tax Law for redetermination of a deficiency or for refund of unincorporated business tax under Article 23 of the Tax Law for the years 1964 through 1970.

A hearing was held on April 28, 1976, at 9:15 A.M. at the offices of the State Tax Commission, Two World Trade Center, New York, New York, before Nigel G. Wright, Hearing Officer. The petitioner appeared by Everett, Johnson & Breckenridge, Esqs., (Eugene Chester, Esq. and Peter K. Lathrop, Esq. of counsel). The Income Tax Bureau appeared by Peter Crotty, Esq., (Solomon Sies, Esq. of counsel).

ISSUES

1. Whether the petitioner, an underwriter and dealer in securities, used the proper method of allocating primary or underwriting profits, when as part of a public offering, petitioner, as a member of an underwriting syndicate managed by a New York-based underwriter, enters into an underwriting commitment for the

purchase of securities of an issuing corporation.

a. The Income Tax Bureau asserts that such primary and underwriting profit is allocable to New York State in those instances where the underwriting activity occurred in this State and is to be distinguished from the secondary profit which is measured by the amount of profit made by an independent dealer on shares sold to the public and which are allocated to the branch office from which the securities were sold.

b. Petitioner asserts that the total profit from both the underwriting and sale of the securities (the primary and secondary profits) alternatively should be allocated to the office where the shares were sold, or that the underwriting or primary profit should be allocated to Nashville, Tennessee where its principal office is located.

II. Whether the petitioner properly allocated income by using the three factor formula as provided in subsection (c) section 707 of the Tax Law or whether the Income Tax Bureau properly allocated petitioner's income by using the direct method of accounting by petitioner's books, as provided in subsection (b) of section 707 of the Tax Law.

III. Whether the percentage allocation of stock brokerage commission income as provided for in the Income Tax Regulations was proper.

IV. Whether the allocation of direct and indirect expenses was proper.

FINDINGS OF FACT

1. The petitioner, J. C. Bradford & Co., filed partnership and unincorporated business income tax returns for the years 1964 through 1970. The petitioner executed consents extending the time within which to issue assessments to October 31, 1972. On October 12, 1972, the Income Tax Bureau issued a Statement of Audit Changes against the partnership in the amount of \$188,480.00 plus interest in the amount of \$38,986.42 for a total of \$227,466.42, and accordingly issued a Notice of Deficiency therefor.

2. J. C. Bradford & Co. is a limited partnership consisting of 15 general partners and one limited partner with its principal office located in Nashville, Tennessee and branch offices located in Memphis, Knoxville, Kingsport, Johnson City, Jackson, Clarksville and Chattanooga, all in Tennessee; Spartanburg and Greenville in South Carolina; Cleveland and Columbus in Ohio; Birmingham, Alabama; Fort Lauderdale and Jacksonville, Florida (both closed in 1968); 3 branch offices located in Atlanta and one in Dalton, all in Georgia; Boston, Massachusetts; Columbus, Gulfport, Jackson and Meridian, all in Miss.; Greensboro, North Carolina and New York City, New York. The petitioner was engaged in business as a broker and dealer of securities.

3. The petitioner during the years in issue was and still is a member of the New York Stock Exchange, the American Stock Exchange and other security and commodity exchanges. One of the petitioner's general partners spends all of his time executing the firm's New York Stock Exchange orders. The petitioner does not have a floor partner on the American Exchange but retains another firm to execute its orders on that exchange.

4. The petitioner's business includes the purchase and sale, as agent for its customers, of securities listed on the various exchanges including the New York Stock Exchange and the American Stock Exchange. In addition, the petitioner acts as agent or principal in connection with the purchase and sale by its customers of "over-the-counter" or unlisted securities, mutual funds, municipal bonds, industrial revenue bonds and commodities.

5. During the years in issue J. C. Bradford & Co. participated and still participates in public underwritings of corporate stocks and bonds, municipal bonds and industrial revenue bonds. The partnership also originates and manages its own underwritings and syndicates the issues to other underwriters and selling group participants.

6. Many corporate underwritings are managed by an underwriter or underwriters located in New York City. To keep abreast of developments with respect to underwriting, one of the petitioner's partners is attached to the New York office. His duties are to attend price meetings, to sign underwriting agreements and to keep the firm's principal office informed of any developments related to the underwriting.

7. The petitioner also participated in underwritings outside the State of New York. In those instances where the petitioner was the managing underwriter, the syndication would be handled by the Nashville office and the New York branch office was not involved.

8. During the years in issue, the petitioner was a member of underwriting syndicates where the manager was located within the State of New York. The underwriting agreements entered into by such members of the syndicate are retained by the underwriting managers. The settlement and distribution of profits arising from the distribution of securities is usually made in the manager's office but may be made in another place determined by such managing underwriters. Such underwriting agreements were approved by the principal office and signed by a partner assigned to the New York branch office for that purpose, or some other partner in the principal office, and then returned to the managing underwriter or underwriters in New York.

9. The underwriting agreements were entered into for the purpose of facilitating the sale to the public of securities issued by an issuing corporation. These agreements were subject to the regulations of the Securities and Exchange Commission. The difference in price between that at which the shares are issued, that at which they are purchased from the issuing corporations and the price at which they are to be offered to the public is called the spread. A certain portion of the spread is to be returned to the managing underwriter or underwriters as their underwriting fee. Another portion is retained by the underwriter as his underwriting profits, as compensation for being part of the underwriting syndicate. The balance of the spread, namely the secondary profits, are retained by the sellers of the stock to the public, whether they are sold to the public by the underwriters through their branch offices or a selling group of which the underwriter may or may not be a part, or by any dealers invited by the managing underwriter who have sold the shares of stock. The underwriting agreement provides for a commitment by each underwriter to purchase a certain amount of the issued securities. The underwriting agreement may provide that a certain portion of the securities to which the underwriting member has committed himself may be reserved by the management to be sold to members of a selling group who are not parties to the underwriting agreement and would be entitled only to their "dealer's concession", the secondary profits.

These members may be invited by the underwriting manager or they may request the manager to be allowed to participate. Each dealer who has been invited or has requested an invitation from a member of such a group may enter into a legal commitment to purchase issued shares. In certain instances, the underwriter may request to become a member of the selling group whenever a member underwriter finds itself in a position to be able to sell more than the shares allotted to it. In that event, with respect to the shares sold only as a member of the selling group, only the dealer's concession is allowed. The advantage of being an underwriter rather than a member of the selling group lies in the fact that the underwriter, by selling directly to the public, will be able to receive not only the secondary profits which are made by a dealer but the underwriting profits as well.

10. The petitioner maintained its books and records at its principal office in Nashville, Tennessee. The partnership's income producing departments include the Principal Office Sales, Branch Office sales, Institutional, the Trading Departments, the Corporate Underwriting Department and the Municipal Department. Trading Departments are maintained in Nashville and Memphis, Tennessee and Atlanta, Georgia. Until 1968 there was a Trading Department maintained at the New York City branch office. The Administration and Service Departments, located in the principal office, include the Accounting Department, the Compliance Department, the Research Department and the Operations Department.

The Operations Department is made up of the following departments: Personnel and Office Services Department, Internal Auditor Dividend Department, Margin Department, Broker/Dealer's Cashier's Department, Institutional Department, System and Communications Department and New York Operations Department. The Systems and Communications Department, located in the principal office includes the Mail and Duplication Department, the Wire and Order Department, the Purchase and Sale Department and the Data Processing Department. The Wire and Order Department is connected by teletype to each of the firm's branch offices and to the floors of the New York and American Stock Exchanges.

11. The New York Operations Department located in the New York City branch office is responsible for verifying the partnership's transactions on the New York and American Stock Exchanges. In addition, it maintains records of floor brokerage commissions due to or from other brokers, and receives and delivers securities due to or from other brokers.

12. The petitioner's branch office in New York City is under the management of a resident partner. Its registered representatives buy and sell securities for customers of the firm. The New York office as well as the other branch offices maintain a "blotter" record of the transactions within that particular branch office. Reports of the execution are simultaneously sent to Nashville through the Wire and Order Department. It would then be entered into the computers maintained in Chicago, Illinois. Orders to buy and sell over-the-counter securities originating in the New York office would be credited to that office.

13. The petitioner reported no New York income from either the underwriting of securities or the distribution of underwritten securities. The petitioner allocated its income on the basis of the three factor formula as provided for in section 707 subsection (c) of the Tax Law. The petitioner also allocated the salary of the floor partner on the New York Stock Exchange to the principal office in Nashville, Tennessee.

14. The petitioner estimated that the primary underwriting profits attributable to New York sources (where the managing underwriter was located in New York and Distribution of underwritten securities takes place in New York) represented 27% of its corporate trading income. Such a percentage was based on the figures of the petitioner by dividing gross corporate income by the primary profit less the primary profit already included in New York sales. The auditor accepted such estimates in computing primary underwriting profit attributable to New York sources. The primary profit on underwritings where the manager was located outside New York was not considered income attributable to New York sources.

15. The petitioner did not allocate to New York sources the over-the-counter trades consummated or executed in New York. It estimated such trades to be 20% of its total commissions from unlisted securities. The auditor erroneously allocated 100% of such commissions instead of 50% thereof, or 10% of the total commission of over-the-counter trades.

16. Assessments of additional income for the years in issue included income originating in the petitioner's New York office under the headings "Trading-Other". For the year 1966 the auditor erroneously included under the aforementioned heading a profit in the amount of \$119,382.00, instead of a loss in that amount.

17. The figures on the schedules of the auditor which are attached to the Statement of Audit Changes were based on the figures as reflected on the books and records of the petitioner.

18. In 20 NYCRR 207.5(c)(1) and (2) it is provided:

c. Special rule for security and commodity brokers.

In any method of allocation permitted or required in the case of security and commodity brokers doing business within and without New York State, the commissions derived from the execution of purchase or sales orders for the account of customers shall be allocated on the following basis:

1. If the order received at the New York State place of business for execution on a New York State exchange originates at a bona fide established office of the broker located outside the State, 40 percent of the commission in the case of stocks and 50 percent of the commission in the case of bonds and commodities

shall be allocated to the State of New York and included in gross income attributable to New York State.

2. If the order originates at the New York State place of business and is transmitted to a bona fide established office of the broker for execution on an exchange located in another State, 60 percent of the commission in the case of stocks and 50 percent of the commission in the case of bonds and commodities shall be allocated to the State of New York and included in gross income attributable to New York State.

19. The "Schedule B" attached to the Statement of Audit Changes included direct and indirect expenses attributable to New York sources. The direct expenses included all of the actual expenses incurred by the New York office including salaries, rent, taxes, depreciation, wires, tickets, floor brokerage, other brokerage, clearance charges and maintenance charges. All of these expenses were reflected on the books of the partnership.

The indirect expenses were allocated on the basis of a percentage of total New York income divided by the total income of the partnership. The percentage of such indirect expenses amounted to 28.597% for 1964; 27.802% for 1965; 30.169% for 1966; 29.639% for 1967; 29.482% for 1968; 28.613% for 1969 and 30.033% for 1970.

CONCLUSIONS OF LAW

A. That the Income Tax Bureau is directed to recompute the taxes due on the basis of the errors on audit as set forth in Findings (15) and (16), supra.

B. That although the total profits made from the underwriting, distribution and sale of securities include both underwriting profits and secondary profits, the underwriting profits are separate and distinct from the secondary profits. Each of the profits is required to be allocated to the source of such profits. The source of the primary and underwriting profits was the principal office of the managing underwriter of the underwriting syndicate and not the principal office of the taxpayer or any offices of the taxpayer where the shares were sold.

C. That the Income Tax Bureau properly allocated to New York all underwriting or primary profits received by the taxpayer as a member of an underwriting syndicate managed by a New York underwriting manager.

D. That the net business income of the petitioner allocable to New York State was properly determined pursuant to the provisions of subsection (b) section 707 of the Tax Law and 20 NYCRR 207.3 (Piper Jaffray and Hopwood v. State Tax Commission, 42 AD 2d 381, 348 NYS 2d 242).

E. That the allocation of commission income on listed securities executed on the exchanges located in New York pursuant to 20NYCRR 207.5(c)(1) and (2) was proper and not discriminatory or arbitrary.

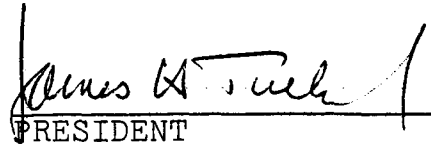
F. That the allocation of commissions on over-the-counter (unlisted) securities consummated within the State of New York was properly allocated 50% to New York and 50% to the principal office in Nashville, Tennessee.

G. That the allocation of expenses attributable to New York sources was proper.

H. That the petition of J. C. Bradford & Co. is granted to the extent indicated in Conclusion (A) supra and is in all other respects denied.

DATED: Albany, New York
February 1, 1977

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