

STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition

of

JOHN C. LEGG & COMPANY

AFFIDAVIT OF MAILING

For a Redetermination of a Deficiency or :  
a Revision of a Determination or a Refund :  
of Unincorporated Business :  
Taxes under Article ~~(8)~~ 23 of the :  
Tax Law for the Year(s) ~~or Period(s)~~ :  
1960, 1961 and 1962.

State of New York  
County of Albany

Catherine Steele, being duly sworn, deposes and says that  
she is an employee of the Department of Taxation and Finance, over 18 years of  
age, and that on the 1st day of October, 1976, she served the within  
Notice of Decision by (certified) mail upon John C. Legg & Company

~~(representative of)~~ the petitioner in the within proceeding,  
by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed  
as follows: John C. Legg & Company  
22 Light Street  
Baltimore, Maryland

and by depositing same enclosed in a postpaid properly addressed wrapper in a  
(post office or official depository) under the exclusive care and custody of  
the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the ~~(representative of the)~~  
~~of the~~ petitioner herein and that the address set forth on said wrapper is the  
last known address of the ~~(representative of the)~~ petitioner.

Sworn to before me this

1st day of October, 1976

Catherine Steele

ant Mack

STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition

of

JOHN C. LEGG & COMPANY

AFFIDAVIT OF MAILING

For a Redetermination of a Deficiency or  
a Revision of a Determination or a Refund  
of Unincorporated Business  
Taxes under Article (s) 23 of the  
Tax Law for the Year(s) ~~or Period(s)~~  
1960, 1961 and 1962.

State of New York  
County of Albany

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she is an employee of the Department of Taxation and Finance, over 18 years of  
age, and that on the 1st day of October, 1976, she served the within  
Notice of Decision by (certified) mail upon Howard O. Colgan, Jr., Esq.  
Robert Franklin, Esq.  
Horace Newman, Esq.  
(representative of) the petitioner in the within proceeding,

by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed  
Howard O. Colgan, Jr., Robert Franklin & Horace Newman, Esqs.  
as follows: Milbank, Tweed, Hadley & McCloy  
1 Chase Manhattan Plaza  
New York, New York 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a  
(post office or official depository) under the exclusive care and custody of  
the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the (representative  
of the) petitioner herein and that the address set forth on said wrapper is the  
last known address of the (representative of the) petitioner.

Sworn to before me this

1st day of October, 1976

Catherine Steele

Janet Mack



STATE OF NEW YORK  
DEPARTMENT OF TAXATION AND FINANCE

STATE TAX COMMISSION

TAX APPEALS BUREAU  
STATE CAMPUS  
ALBANY, N.Y. 12227

ADDRESS YOUR REPLY TO

October 1, 1976

TELEPHONE: (518) **457-3850**

**John C. Legg & Company**  
**22 Light Street**  
**Baltimore, Maryland**

**Gentlemen:**

Please take notice of the **DECISION**  
of the State Tax Commission enclosed herewith.

Please take further notice that pursuant to  
Section ~~(xx)~~ **722** of the Tax Law, any  
proceeding in court to review an adverse deci-  
sion must be commenced within **4 months**  
from the date of this notice.

Inquiries concerning the computation of tax  
due or refund allowed in accordance with this  
decision or concerning any other matter relative  
hereto may be addressed to the undersigned. They  
will be referred to the proper party for reply.

Very truly yours,

**Paul B. Coburn**  
**Supervising Tax**  
**Hearing Officer**

Enc.

cc: Petitioner's Representative:

Taxing Bureau's Representative:

STATE OF NEW YORK

STATE TAX COMMISSION

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|  |   |          |
|--|---|----------|
| In the Matter of the Petition            | : |          |
| of                                       | : |          |
| JOHN C. LEGG & COMPANY                   | : | DECISION |
| for a Redetermination of a Deficiency or | : |          |
| for Refund of Unincorporated Business    | : |          |
| Taxes under Article 23 of the Tax Law    | : |          |
| for the Years 1960, 1961 and 1962.       | : |          |

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John C. Legg & Company filed a petition for the re-determination of a deficiency issued under date of April 13, 1965 in unincorporated business taxes (under a previously filed consent) for the years 1960, 1961 and 1962 in the amount of \$7,154.57, plus a penalty under section 685(a) of the Tax Law for the year 1960 in the amount of \$791.72, plus interest of \$1,379.48, for a total of \$9,325.77.

A hearing was duly held on May 19, 1970, at the offices of the State Tax Commission, 80 Centre Street, New York City before Lawrence Newman, Hearing Officer. Howard O. Colgan, Jr., Esq., Robert Franklin, Esq., and Horace Howman, Esq., all of Milbank, Tweed, Hadley & McCloy represented the petitioner. Edward H. Best, Esq., appearing by Solomon Sies, Esq., represented the Income Tax Bureau.

The record of said hearing has been duly examined and considered.

ISSUE

The issue in this case is the proper method of allocating primary or underwriting profits by petitioner, an underwriter and dealer in securities, 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.

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.

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 Maryland where its principal office is located.

FINDINGS OF FACT

1. Petitioner is a partnership engaged in the general investment banking and brokerage business. It is a member firm of the New York Stock Exchange. Its main office was at 22 Light Street, Baltimore, Maryland, where its principal books and records were kept. It had branch offices in Picksville, Maryland, and in New York City. Petitioner's national income, as reflected in its tax returns, consists of trading profits which were about two-thirds of its total profits, commissions which were about one-quarter of total profits, and income from syndicates which was between five and ten per centum of total profits and certain miscellaneous income.

2. Petitioner had at its New York office, one partner, Mr. Cyril Murphy, three employed "traders" and clerical help. The partner's function was to head the trading operation. The income of the New York office, as reflected in petitioner's tax returns, consisted of trading commissions, trading profits, joint account profits and profits and commission from certain insurance stock transactions.

3. During the years in issue, the petitioner was a member of underwriting syndicates. 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. The petitioner signed the agreements in its principal office and then returned the agreements to the managing underwriters.

4. The underwriting agreements were entered into for the purpose of facilitating the sale to the public of securities issued by an issuing corporation and was subject to the regulations of the Securities and Exchange Commission. The difference in price between that at which the shares are issued and purchased from the issuing corporations and the price at which they are to be offered to the public is called the spread. Of the spread, a certain portion 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, that is 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 to a member of such 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.

5. Petitioner would in most instances, sell less stock than it had underwritten, but on some occasions in each of the years involved it sold more shares than it had underwritten.

6. Petitioner engaged in underwriting syndications where the managing underwriter was outside of New York and also when the managing underwriter was in New York. The total number and the total profit from all syndications for each year was as follows:



|             | 1960      | 1961      | 1962      |
|-------------|-----------|-----------|-----------|
| U.S. number | 25        | 39        | 26        |
| U.S. gross  | \$421,360 | \$181,027 | \$123,489 |

The total number of New York managed syndicates and their gross profits for each year were as follows:

|             | 1960     | 1961      | 1962     |
|-------------|----------|-----------|----------|
| N.Y. number | 19       | 33        | 22       |
| N.Y. gross  | \$56,054 | \$128,537 | \$84,993 |

The gross profits from New York managed syndicates were found, upon audit, to be attributable to both the underwriting of securities and the distribution of those securities and in the following amounts for each year:

|              | 1960            | 1961            | 1962            |
|--------------|-----------------|-----------------|-----------------|
| Distribution | \$31,797        | \$89,937        | \$64,142        |
| Underwriting | <u>\$24,257</u> | <u>\$38,600</u> | <u>\$20,851</u> |
|              | \$56,054        | \$128,537       | \$84,993        |

7. Petitioner filed New York Unincorporated Business Tax Returns for 1960, 1961 and 1962. Petitioner reported as New York income only certain income from its trading and insurance stock activities. It reported no New York income from either the underwriting of securities or the distribution of underwritten securities.

8. The deficiency notice here in issue adds to New York income the "primary" or underwriting profit derived from underwritten securities less a certain amount for expenses. For 1961, an additional amount of \$10,000 was added to income, but this is not contested. These amounts for each year are:

|                | 1960         | 1961          | 1962         |
|----------------|--------------|---------------|--------------|
| Primary Profit | \$24,257     | \$38,600      | \$20,851     |
| Expenses       | <u>6,064</u> | <u>9,650</u>  | <u>5,213</u> |
| Added Income   | \$18,193     | \$28,950      | \$15,638     |
| Other Income   |              | <u>10,000</u> |              |
|                |              | \$38,950      |              |

9. The primary profit as assessed was computed by subtracting the selling or distribution profit from the gross profit as shown on petitioner's books. This gross profit is presumably the gross income less the direct expenses of the underwriting as incurred in the first instance by the managing underwriter and reimbursed to him by petitioner. The selling profit was computed by multiplying the dealer's concession by the number of petitioner's allotment of underwritten shares which petitioner has sold directly plus the number of excess shares which petitioner has received from the managing underwriter as a signatory of a selected dealer's agreement.

10. Petitioner incurred no losses in the taxable years in question either in its total profit from syndications or in its primary or secondary profits as separately computed.

11. The expenses reflected specifically in the assessment are to reflect certain indirect expenses attributable to the underwritings which were incurred at petitioners' Baltimore office and which therefore would not be otherwise deductible against New York income. These expenses were estimated and computed to be twenty-five per cent of the primary profits. Petitioner has not come forward with evidence of more exact figures.

12. The 1960 tax return showed no entries on the schedules relating to unincorporated business tax despite the fact that New York income was shown for purposes of the schedules applicable to the partnership portion of said return. The penalty under review was imposed for failing to file a proper return. No explanation has been made for said failure.

#### CONCLUSIONS OF LAW

(A) 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.

(B) Each of the profits is required to be allocated to the source of such profits.

(C) 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.

(D) 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.

(E) The addition to 1961 income of the \$10,000 which is not contested is proper.

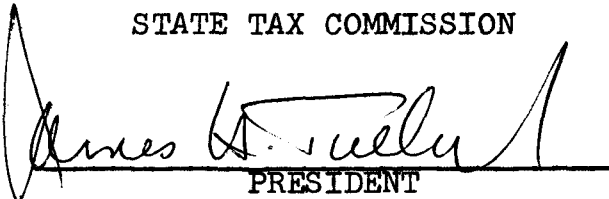
(F) A penalty with respect to the 1960 returns is proper.

(G) The deficiency is hereby affirmed and the petition accordingly denied.

Dated: October 1, 1976

Albany, New York

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER