

STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition :

of

J. C. Bradford & Co. :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of  
Unincorporated Business Tax :  
under Article 23 of the Tax Law  
for the Years 1964 - 1970. :

State of New York

County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 16th day of May, 1980, he served the within notice of Decision by certified mail upon J. C. Bradford & Co., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

J. C. Bradford & Co.

170 Fourth Ave. N.

Nashville, TN 37219

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 petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
16th day of May, 1980.

Joanne Knapp

J. Vredenburg

STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition  
of

J. C. Bradford & Co.

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of  
Unincorporated Business Tax :  
under Article 23 of the Tax Law  
for the Years 1964 - 1970. :

State of New York  
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 16th day of May, 1980, he served the within notice of Decision by certified mail upon Eugene Chester & Peter K. Lathrop the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Sirs Eugene Chester & Peter K. Lathrop  
Everett, Johnson & Breckinridge  
200 Exchange Pl.  
New York, NY

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  
16th day of May, 1980.

Joanne Knapp

J. Vredenburg

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

May 16, 1980

J. C. Bradford & Co.  
170 Fourth Ave. N.  
Nashville, TN 37219

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 722 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Deputy Commissioner and Counsel  
Albany, New York 12227  
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Eugene Chester & Peter K. Lathrop  
Everett, Johnson & Breckinridge  
200 Exchange Pl.  
New York, NY  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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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. :

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J. C. Bradford & Co., 170 Fourth Avenue North, Nashville, Tennessee 37219, filed a petition 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 formal hearing was held before Nigel G. Wright, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on April 28, 1976 at 9:15 A.M. Petitioner appeared by Everett, Johnson & Breckinridge, Esqs., (Eugene Chester and Peter K. Lathrop, Esqs., of counsel). The Audit Division appeared by Peter Crotty, Esq. (Solomon Sies, Esq., of counsel).

A decision affirming the deficiency was issued by the State Tax Commission on February 1, 1977 but was annulled by the Supreme Court, Appellate Division, Third Department, which remitted the matter to the State Tax Commission for further proceedings not inconsistent with its opinion.

ISSUES

I. Whether petitioner, an underwriter and dealer in securities, properly allocated primary or underwriting profits, where petitioner, as a member of an underwriting syndicate, entered into a commitment for the purchase of securities of an issuing corporation or bonds of a municipality.

II. Whether petitioner can allocate the excess of its unincorporated business gross income over its unincorporated business deductions based on the three factor formula.

III. Whether petitioner properly allocated commissions earned from the execution of stock purchase or sale orders on the New York and American Stock Exchanges, where such orders originated in petitioner's offices outside New York.

IV. Whether direct expenses claimed were attributable to business carried on in New York State and whether indirect expenses were properly allocated to New York State.

#### FINDINGS OF FACT

1. Petitioner, J. C. Bradford & Co., filed New York State partnership returns and unincorporated business income tax returns for 1964 through 1970. Petitioner executed a "Consent Fixing Period of Limitation upon Assessment of Unincorporated Business Taxes" to October 31, 1972. On October 12, 1972, the Income Tax Bureau issued a Notice of Deficiency against petitioner for unincorporated business taxes for 1964 through 1970 in the amount of \$188,480.00, plus interest of \$38,986.42, for a total of \$227,466.42.

2. Petitioner was a limited partnership consisting of approximately fifteen 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, South Carolina; Cleveland and Columbus, Ohio; Birmingham, Alabama; Fort Lauderdale and Jacksonville, Florida (both closed in 1968); three branch offices located in Atlanta and one in Dalton, all in Georgia; Boston, Massachusetts; Columbus, Gulfport, Jackson and Meridian, all in Mississippi; Greensboro, North Carolina and New York City, New York. Petitioner was engaged in business as a stock broker, dealer and underwriter of securities.

3. 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 petitioner's general partners spends all of his time as a floor broker executing the firm's New York Stock Exchange orders. Petitioner does not have a floor partner on the American Stock Exchange but retains another firm to execute its orders on that exchange.

4. 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, 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 in public underwritings of corporate stocks and bonds, municipal bonds and industrial revenue bonds. The partnership also originated and managed its own underwritings and syndicated the issues to other underwriters and selling group participants.

6. Many corporate underwritings were managed by an underwriter or underwriters located in New York City. To keep abreast of developments with respect to underwriting, one of petitioner's partners was assigned to the New York office. His duties were 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. Petitioner also participated in underwritings outside the State of New York. In those instances where 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, 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 were retained by the underwriting managers. 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 were issued and the price at which they were to be offered to the public was called the spread. A certain portion of the spread was to be returned to the managing underwriter or underwriters as their underwriting fee. Another portion was retained by the underwriter as his underwriting profit, as compensation for being part of the underwriting syndicate. The balance of the spread, namely the secondary profits, were retained by the sellers of the stock to the public, whether they were sold to the public by underwriters through their branch offices or by a selling group of which the underwriter may or may not have been a part, or by any dealer invited by the managing underwriter who had sold the shares of stock. The underwriting agreement provided for a commitment by each underwriter to purchase a certain amount of the issued securities. The underwriting agreement also provided that a certain portion of the securities to which the underwriting member committed himself be reserved by management to be sold to members of a selling group who were not parties to the underwriting agreement. These members were invited by the underwriting manager to participate.

Each member of the underwriting syndicate entered into a legal commitment to purchase issued shares. In certain instances, the underwriter also requested to become a member of the selling group whenever a member underwriter found 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, the dealer's concession was allowed. The advantage of being an underwriter rather than a member of the selling group lies in the fact that an underwriter, by selling directly to the public, received not only the secondary profits which were made by the dealer but the primary underwriting profits as well.

10. Petitioner maintained its books and records at its principal office in Nashville, Tennessee. The partnership's income producing departments included the Principal Office Sales, Branch Office Sales, Institutional, the Trading Departments, the Corporate Underwriting Department and the Municipal Department. Trading Departments were 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 consisted 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, included 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 was 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 was responsible for verifying the partnership's transactions on the New York and American Stock Exchanges. In addition, it maintained records of floor brokerage commissions due to or from other brokers, and received and delivered securities due to or from other brokers.

12. Petitioner's branch office in New York City was under the management of a resident partner. Its registered representatives bought and sold securities for customers of the firm. The New York office, as well as the other branch offices, maintained a "blotter" record of the transactions within that particular branch office. Reports of execution were simultaneously sent to Nashville through the Wire and Order Department. The transaction 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 were credited to that office.

13. Petitioner allocated its total income from business on the basis of the three factor formula as provided for in section 707(c) of the Tax Law.

14. Petitioner estimated that 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 percent of its corporate trading income. Said percentage was based on figures submitted by petitioner and was determined 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 corporate primary underwriting profits 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. Petitioner did not allocate to New York sources over-the-counter trades consummated or executed in New York. It estimated such trades to be 20 percent of its total commissions from unlisted securities. The auditor erroneously allocated 100 percent of such commissions instead of 50 percent thereof, or 10 percent of the total commissions on 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 heading "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. Petitioner, on its partnership returns for the years in issue, allocated commissions in a manner consistent with 20 NYCRR 207.5(c) (1) and (2). Said regulation, substantially the same as 20 NYCRR 287.1 Question 82-a (section 287.1 had been promulgated under Article 16A of the Tax Law), was not in effect during the years at issue. However, both regulations provided as follows:

- "a. 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.
- b. 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."

Petitioner, subsequent to the decision of the Appellate Division, submitted evidence as to the commission rates which were charged for the years in issue and also submitted a worksheet showing the revised amounts for commission income. Said rates were applicable to both listed and unlisted (over-the-counter) securities.

18. The "Schedule B" attached to the Notice of Deficiency included direct and indirect expenses attributable to the New York office. 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 total income of the partnership. The percentage of such indirect expenses amounted to 18.562 percent for 1964; 15.775 percent for 1965; 12.727 percent for 1966; 17.155 percent for 1967; 18.329 percent for 1968; 17.029 percent for 1969 and 18.483 percent for 1970.

19. The worksheet submitted by petitioner (Finding of Fact "17", supra) also showed that net operating losses were incurred for 1965, 1966 and 1969 as a result of adjusting the amount of New York commission income. Petitioner, in another schedule, showed a carryover of the 1965 and 1966 losses to 1967 and 1968, respectively. Said losses were not allowed to be carried back since the partners during such years did not have a proportionate interest or interests, amounting to at least 80 percent of all such interests, in the unincorporated business gross income and unincorporated business deductions of J. C. Bradford & Co. (section 706(2)(b) of the Tax Law). The net operating loss incurred for 1969 was carried back to 1968 and was fully absorbed.

CONCLUSIONS OF LAW

A. That the Audit Division is directed to recompute the unincorporated business tax due for 1966 because of the audit error set forth in Finding of Fact "16".

B. That the allocation of primary underwriting profits based on the location of the managing underwriter and the location at which the underwriting activity is managed is erroneous (Matter of J. C. Bradford & Co. v. State Tax Commission, 62 AD2d 69, 403 NYS2d 813). The Audit Division is hereby directed to compute the primary underwriting profits and the secondary profits using the method set forth in the current regulations [20 NYCRR 207.8(d) (1) (2) (3) and 20 NYCRR 207.8(e) (1) (2) (3)].

C. That the use of the "direct accounting" method in determining the excess of unincorporated business gross income over unincorporated business deductions is proper and is the preferred method (Piper, Jaffray and Hopwood v. State Tax Commission, 42 AD2d 381, 348 NYS2d 242); that the use of the three factor formula, as provided for in section 707(c) of the Tax Law, to allocate net business income or loss of petitioner, is unwarranted when the portion allocable to this State can be determined from the books and records of the business.

D. That although the use of the percentage allocation of commissions to New York is expressly authorized by the State Tax Commission in its regulations [20 NYCRR 207.5(c) (1) and (2) and 20 NYCRR 287.1], said regulations are erroneous (Matter of J. C. Bradford & Co. v. State Tax Commission, 62 AD2d 69, 403 NYS2d 813). Petitioner has submitted evidence which showed that percentages were significantly less for the years in issue. The Audit Division is hereby directed to review petitioner's worksheet with respect to commission income from listed and unlisted (over-the-counter) securities.

E. That direct expenses incurred and paid in the operation of the New York office were properly deducted since said expenses were attributable to business carried on solely in this State; that indirect expenses incurred by petitioner, which benefited all offices, including New York, were properly allocated on the basis of total New York income divided by total income of the partnership.

F. That the petition of J. C. Bradford & Co. is granted to the extent indicated in Conclusions of Law "A", "B" and "D", supra; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

MAY 16 1980

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER