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January 13, 1961

Honorable Earl W. Fase
Director of Taxation
State of Hawaii
Honolulu, Hawaii

Attention: Mr. John A. Bell
Deputy Director of Taxation

Dear Sir:

This is in response to your request for our advice with regard to the application of the Hawaii General Excise Tax to the following two factual situations:

The first situation involves X, a mutual fund dealer who is a registered security dealer in the State of Hawaii. X has agreements with mainland security dealers to sell those securities handled by the mainland dealers in the State of Hawaii for a stated commission. The agreement provides that X is deemed to be a principal at all times except for the sale of certain securities in which instance X acts as the agent of the mainland dealers. X's selling activity is not controlled by the mainland dealers except that X's representation with regard to any security must be in accordance with the official prospectus. In carrying out his selling activity, X entered into an agreement with an associate who agreed to sell securities for X for a percentage of the commission which X receives from the mainland dealers. The associate is free to exercise his judgment in the solicitation of business.

The second situation concerns Y, another mutual fund dealer who is also a registered security dealer in the State of Hawaii. Y has an agreement with Z Co., a mainland security dealer, which states that Y shall devote his full time and attention to the sale and promotion of securities handled by Z Co. The agreement further states that Y shall employ, instruct and train local associates for carrying out the selling of securities. The agreement also states that Y is not to be construed a partner, employee, or agent of Z Co. Under the agreement, Y is entitled to a specific amount of commission from Z Co. for sales made by Y personally and an overriding commission of 5% for sales consummated by the associate. There is a second agreement between Y, Z Co. and an associate which provides for the amount of commission to be paid to the associate from Z Co. based on the

associate's sales. The tri-party agreement provides that the associate shall not be deemed to be an employee of Z Co. and that as between Y and the associate, the associate is free to exercise his own judgment in the solicitation of business.

Under Section 117-14, R.L.H. 1955, as amended, one who sells securities is taxable on the gross income from his selling activity unless such an individual is considered an employee section 117-21(f), R.L.H. 1955, as amended. Although no question has been raised with regard to the relationship between the dealers and their associates, we are satisfied that in both situations, there is no existence of an employer-employee relationship. The controlling factor in the employer-employee relationship is the retention by the person employing the services of another of the right or power to exercise control over the employed on details and method of performing the desired result. Byrne v. Pennsylvania R. CO., 262 F.2d 906, 912 (3rd Cir. 1959); 35 Am. Jur., Master and servants, Sec. 3; 2 C.J.S., Agency, p. 1027-1028. Cimorolli v. New York Cent. R. Co., 148 F.2d 575, 578 (6th Cir. 1945): Restatement, Agency 2d, Sec. 220, Illus. 7. When the retention of control by the employer is only with respect to the result, the employed is an independent contractor. Sutton v. Industrial Commission, 344 P.2d 538; Kippen v. Jewkes, 258 F.2d 869; Christean v. Industrial Commission, 196 P.2d 502. In both fact situations, the associate is free to use his own judgment in the solicitation of business. The control retained by-the dealers is over the desired result and net as to the method of solicitation of business by the associate. Consequently, the associates are independent contractors. This means that the dealer and the associate in both fact situations are subject to the General Excise Tax under Sec. 117-14, R.L.H. 1955, as amended.

With regard to the specific question of what is the gross income of the dealers, it is the opinion of this office that the dealers in both fact situations are subject to the General Excise Tax to the extent of compensation which they can rightfully claim against the mainland dealer or dealers. Under the first situation, X is entitled to all of the commission paid by the mainland dealer. In fact X is the only one who has the right to demand the total commission from the mainland dealers under the contractual obligation between them. The commission which X pays to his associate, which is measured in terms of a percentage of the commission which X receives from the mainland dealers, is a division of X's commission. Such a division of commission is not allowed under our General Excise Tax Law, Chapter 117, R.L.H. 1955, as amended, except for those instances set forth under Section 117-16(e) which reads as follows:

> Sec. 117-16(e). Where insurance agents, including general agents, subagents or solicitors, who are not employees and are licensed pursuant to chapter 181, or real estate brokers who are not employees and are licensed pursuant to chapter 170, produce commissions which are divided between such general agents, subagents or solicitors or between such real estate brokers, as the case may be, the tax levied under subsection (f) of section 117-14, or under section 117-14.6, shall apply to each such person with respect to his portion of the commissions, and no more.

Inasmuch as a security dealer such as X does not fall within the scope of Section 117-16(e), X is taxable for all the commission which he has a right to claim from the mainland dealers which includes the commission which X pays to his associate.

Turning to the second fact situation, Y is also subject to the General Excise Tax for all the commission he has a right to claim against Z Co., the mainland dealer. The total compensation that Y can claim against the mainland dealer is the commission on his personal sales and the overriding commission of 5% on the sales by the associate. The commission paid to Y's associate directly by Z Co., the mainland dealer, is not part to Y's compensation at all. In fact Z Co. is obligated to pay the associate's commission directly to the associate. The tri-party agreement signed by Y, Z Co. and the associate sets forth the compensation payable to Y and the associate by Z Co. Consequently, there is no division of commission.

The situation presented in the instant case is similar to the General Excise Tax liability of an insurance general agent which existed prior to the enactment of Section 117-16(e). See opinion of the Attorney General dated June 2, 1943, 45 O.L.C. 2232. In the absence of legislation authorizing the division of commission for security dealers such as X in the first situation, X is subject to the General Excise Tax for the total commission he is entitled to receive from the mainland dealers and X's associate is also subject to a tax on the amount of his own commission.

Respectfully,

/s/ Shuichi Miyasaki

SHUICHI MIYASAKI
Deputy Attorney General

APPROVED:

\s\ Shiro Kashiwa
SHIRO KASHIWA
Attorney General

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