

July 29, 1942

OPINION NO. 1823

TAXATION: GROSS INCOME TAX (ACT 141, L. 1935): APPORTIONMENT THEREOF.

In the case of a commission to a local broker for buying or selling securities on a mainland exchange the amount subject to tax is the amount derived from the business done in the Territory, after exclusion of the amount earned by the mainland broker for his services on mainland exchange.

Honorable William Borthwick  
Tax Commissioner  
Territory of Hawaii  
Honolulu, T.H.

Dear Sir:

We have for reply a question submitted by your letter of May 8, 1941, arising under Act 141, L. 1935, as amended.

Brokers who are members of the Honolulu Stock Exchange charge commissions in accordance with rates fixed by the Exchange. Where the transaction involves a purchase or sale of securities on a mainland exchange the Honolulu broker engages the services of a mainland broker. The relation between the Honolulu broker and the mainland broker is that of principal and agent. On the books of the Honolulu broker the commission of the mainland broker (fixed in accordance with the rules of his own exchange) appears, and the balance of the locally authorized commission appears as the Honolulu broker's share of the commission paid. The customer pays the commission in a lump sum and is not informed of the arrangements between the two brokers.

One mainland brokerage house has a branch on the exchange here. In this instance transactions are handled by the two branches of the firm.

So far as appears the relations between the two brokers in the first instance above described are the same

as the relations between the two real estate brokers considered in our opinion letter of December 7, 1939, No. 1727, so that the commission paid the mainland broker is an expense incurred by the local broker. However, the cases differ in that the undertaking of the local broker in the present instance is to buy or sell securities on a mainland exchange. It definitely is a contract for services to be performed both within and without the Territory.

The courts have ruled that no apportionment is required on account of merely incidental activities outside the taxing state. Department of the Treasury v. Ingram-Richardson Mfg. Co., 313 U.S. 252, 85 L.Ed. 1313; Dravo Contracting Co. v. James, 114 F. (2d) 242. Claims that gross income should be apportioned because derived from activities both within and without the Territory therefore should be carefully examined, and it would be well to refer such cases to this office. As an example of outside activities which are merely incidental we put the case of a contract to produce a show in Honolulu. Passage money paid to transport a troupe to Honolulu could not be deducted since the services contracted for are all to be furnished here. Or in the case of a contract to construct a building in Hawaii where the contractor fabricates part of the material on the mainland the mere fact of such prefabrication of materials would not require any apportionment or segregation of gross income. Dravo Contracting Co. v. James, supra. In the present instance the services which the customer has contracted for are to be performed on the mainland as well as in Honolulu since the thing to be ultimately accomplished must be done on the mainland, the mainland services are not incidental in character.

We do not agree with the attorneys for the Honolulu Stock Exchange that interstate commerce is involved, but whether it is or not is immaterial. The tax involved is a tax on account of business done in the Territory, measured by the gross income of that business. The act does not attempt to levy a tax on the gross income from mainland business. Whether or not a local resident could be taxed on gross income derived from mainland sources is immaterial. As a tax levied on local activities the tax must be (as it is) restricted to the gross income arising therefrom. James v. Dravo Contracting Co., 302 U.S. 134, 139, 82 L.Ed. 155.

Pursuant to subsection IV of Section 2 of the Act, added by Act 115, L. 1941, the apportionment must be made by separate accounting methods if it accurately can be. The portion of the commission derived from the business done in the Territory appears to be determined upon the books of Honolulu brokers. His share of the commission is the amount subject to the tax.

The same principles apply in the instance of the mainland firm having a local branch, that is, the taxable amount is the amount remaining after exclusion of the mainland commission determined according to the rules of the mainland exchange.

Respectfully,

/s/ Rhoda V. Lewis

Rhoda V. Lewis,  
Deputy Attorney General

APPROVED:

/s/ Ernest K. Kai

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Attorney General