

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 287

April 23, 1965

ALLOCATION: STOCK BROKER PARTNERSHIP INCOME

Syllabus:

Two partnerships are investment brokerage firms. The major part of their revenue comes from commissions received for buying or selling securities or commodities for their clients. However, they also incidentally engage in other activities such as underwriting securities and trading in securities for their own account. Both partnerships have branch offices located in cities throughout the nation.

The main office of each partnership is in New York. Orders solicited at branch offices are transmitted to the main office and are executed there, generally by trading on the floor of the exchange concerned. The main office also maintains records of all transactions, services all accounts, conducts research and provides an advisory service for the clients of the business.

Should the income of a stock broker be allocated entirely to the point of solicitation or to the areas where the services are performed?

In the case of corporations engaged in a service business it is our practice to allocate sales to the situs where the service is performed. This method of allocation has been called the "simplest and most accurate method of giving recognition to a taxpayer's income producing activities with respect to the sales factor," when dealing with service corporations. (Final Report of the Committee on Tax Situs and Allocation, 1951 Proceedings of the National Tax Association p. 465.)

In the case of partnerships our practice is to follow the same rules for allocation as we do for corporations. Personal Income Tax Reg. 17951 -- 17954(d)(4)(c) provides that charges for personal services be allocated to the place where the services are performed. Thus the rule for personal service organizations is the same regardless of whether it is a partnership or a corporation, i.e., the income for the services is apportioned on the basis of where the services are performed.

In the instant case there seems to be no question but that a stock broker is rendering a service only to his clients. Part of that service involves researching the market in order to advise the clients properly and in addition agreeing to buy or sell the necessary securities wanted by the client. Securities listed on a certain exchange must be purchased at the city where the

exchange is located. Obviously some of the services are performed at the exchange if the broker has a seat on such exchange and employees engaged in exchange activities.

In evaluating the extent of such services we have been directed to the New York Unincorporated Business Tax which allocates 40% of the commission on stock transactions and 50% of bond and commodity commissions to New York on orders received in New York from outside the state to be consummated on the New York Exchange. This apportionment of the fee compares with the information given by a local broker which, although a member of the New York Exchange, pays an independent broker in New York 40% of its commission to handle its purchase and sales on that exchange.

Under the circumstances, it was recommended that the notices be adjusted to reflect a sales factor of only 60% of the New York and American Exchange commissions received, and include in the factor 40% of the commissions received on orders consummated on the Pacific Exchange from clients of these taxpayers residing outside the State of California.