BEFORE THE FAIR POLITICAL PRACTICES COMMISSION

In the Matter of:	
Opinion requested by: Scott T. Carey, Councilmember, City of Palo Alto	No. 76-087 Nov. 3, 1977

BY THE COMMISSION: We have been asked the following questions by Scott T. Carey, a member of the Palo Alto City Council:

Scott T. Carey, a member of the Palo Alto City Council, owns 10 percent of the outstanding stock of Cornish and Carey, a real estate brokerage firm with several offices located in the peninsula area south of San Francisco. Mr. Carey also is a director and an officer of the firm and is entitled to 24 percent of the firm's annual profits as compensation for services rendered.

Cornisn and Carey derives its income from commissions earned in connection with real estate sales brokered by the firm's salespersons. Most of the firm's transactions involve residential real estate, but it also has salespersons who work with commercial and industrial properties.

The firm has approximately 300 salespersons associated with it. Most of them are independent contractors but a small number, primarily those involved in commercial and industrial real estate, are employees of the firm. Although some of the firm's salespersons are independent contractors and others are employees, all of the salespersons are compensated in essentially the same manner. They are entitled to a fixed percentage of the total earned on each sale. The fixed percentage generally amounts to between 60 and 70 percent of the total commission, the precise percentage being determined on the basis of the type of real estate involved and any contractual bonus clauses that may be in effect. Cornish and Carey retains the remaining 30 to 40 percent of each commission and from that amount pays overhead, salaries of the firm's principals and other expenses.

Because Mr. Carey is a member of a city council and has a 10 percent ownership interest in a business entity that provides brokerage services, he must disclose the name of every person who pays fees to the entity of which his pro rata share is $1,000 or more. Government Code Section 87207(b)(2). Mr. Carey has asked the following questions with respect to this obligation:

(1) To determine his pro rata share of a commission, may he first deduct the percentage that must be paid to the salesperson who produced the commission?

(2) To determine his pro rata share of a commission, may he deduct overhead expenses incurred by the firm?

(3) To measure his pro rata share of a commission, should he use his 10 percent ownership interest or his 24 percent profit share?

(4) Even if his pro rata share of a commission is $1,000 or more, must he disclose the identity of the person who paid the commission if that person does not reside in Palo Alto?

CONCLUSION

(1) To determine his pro rata share of a commission, Mr. Carey may first deduct the amount that must be paid to the salesperson who produced the commission.

(2) To determine his pro rata share of a commission, Mr. Carey may not deduct overhead expenses incurred by the firm.

(3) To measure his pro rata share of a commission, Mr. Carey should use his 10 percent ownership interest.

(4) Income includes income "from any source," but income, other than income in the form of a gift, "does not include income received from any source outside the jurisdiction and not doing business within the jurisdiction, not planning to do business within the jurisdiction, or not having done business within the jurisdiction during the two years prior to the time any statement" must be filed. Government Code Section 82030(a). Pursuant to this definition, Mr. Carey may have to disclose the identity of a source of income regardless of whether that source resides in Palo Alto.

ANALYSIS

(1) Government Code Section 87207(b)[1/] provides, in pertinent part, that:

> When income of a business entity, including income of a sole proprietorship, is required to be reported under this article, the statement shall contain:
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> ...
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> (2) In the case of a business entity which provides legal or brokerage services, the name of every person who paid fees to the business entity if the filer's pro rata share of fees from such person was equal to or greater than one thousand dollars ($1,000);...

Income of a business entity must be reported when the individual filing the statement, or his spouse, "owns, directly, indirectly or beneficially, a 10-percent interest or greater" in the entity. Section 82030(a).

Mr. Carey owns 10 percent of the outstanding stock of the brokerage firm of Cornish and Carey and, hence, must disclose the identity of every person who paid the firm fees of which his pro rata share is $1,000 or more. His first question requires that we decide whether the "fee" against which he must measure his pro rata share is the entire commission earned on a sale or only that portion retained by his firm after paying the salesperson his contractual percentage.

We conclude that the "fee" paid to the business entity under the circumstances before us herein is only that portion of the total commission retained by the firm. We think that the proper characterization of the transaction in question is that there are, in effect, two separate payments subsumed in the one negotiable instrument used by the buyer to pay the real estate commission, one payment to the firm of Cornish and Carey and another to the salesperson who brokered the sale.

Although the firm of Cornish and Carey may be the payee designated on the instrument used by the purchaser to

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1/ All references are to the Government Code unless otherwise noted.

pay the commission, this is only done to facilitate payment and avoid the necessity of having the purchaser write two checks. The firm, in fact, has no rights in the salesperson's portion of the commission and, pursuant to the form contracts used by the firm, is obligated to pay the salesperson his share "immediately upon collection or as soon thereafter as practicable." (Form 1-14, para. 7; Form ABS 14, para. 6). Thus, it would exalt form over substance to conclude that the "fee" paid to the firm is the entire commission.

We note, moreover, that the payment to the salesperson is inseparable from the transaction that produces it. In other words, the payment is made with funds derived from the particular sale that creates the salesperson's right to the payment. This is in contrast to payments for ordinary operating expenses which, as we discuss infra, are not deductible for purposes of determining Mr. Carey's pro rata share of a fee. General operating expenses, such as rent, salaries or utility bills, are not paid with funds derived from transactions that are directly related to a particular expense incurred. Rather, they are paid with funds received from all of the firm's various business transactions, which are commingled and then used to pay the various operating expenses as they become due.

Accordingly, we conclude that Mr. Carey may deduct the amount paid to a salesperson as his contractual percentage of a commission in order to determine the "fee" against which he must measure his pro rata share. Moreover, we think that this conclusion is applicable regardless of whether the salesperson is an employee or an independent contractor. Although various business consequences depend on the status of the salesperson, it is our understanding that the compensation arrangements with each group are the same and, consequently, our analysis will be applicable in either case.

(2) Mr. Carey's second question is whether he can deduct the firm's overhead expenses to determine the fee against which he must measure his pro rata share. We conclude that he cannot.

Section 87207(b)(2) refers to "fees" paid to the business entity and requires disclosure on the basis of the filer's pro rata share of the "fees." We think that the plain meaning of the term "fees" is the total amount paid to the firm for whatever service is rendered, and that the drafters of the Political Reform Act, by choosing this term, evidenced an intention not to have the filer deduct overhead

expenses from the total amount received prior to determining whether the $1,000 threshold is satisfied. If they had wanted to allow for a deduction, a term such as "profits" or "net profits" undoubtedly would have been used.

Moreover, Section 87207(b)(3), the parallel disclosure provision to Section 87207(b)(2) for business entities other than those which provide legal or brokerage services, bases disclosure on "gross receipts" and, thus, clearly does not contemplate a prior deduction for overhead expenses. Since the two provisions address the same disclosure question, differing only with respect to the type of business entity covered and the dollar disclosure threshold, it would be anomalous to allow a deduction for overhead expenses in one context but not in the other. Accordingly, Mr. Carey should determine whether he has a disclosure obligation on the basis of his pro rata share of the total portion of the commission retained by his firm.

(3) Mr. Carey owns 10 percent of the outstanding stock of Cornish and Carey but receives 24 percent of the firm's annual profits as compensation for the services he renders. He asks whether he should use the 10 percent figure or the 24 percent figure in determining his pro rata share of the firm's fees. We think that the 10 percent ownership figure is appropriate.

The Political Reform Act initially ties the duty to disclose certain information concerning income earned by a business entity to an individual's ownership interest in the entity. See Section 82030(a). In other words, Mr. Carey will incur a disclosure obligation under Section 87207(b)(2) only if he has a 10 percent or greater ownership interest in the firm of Cornish and Carey. However, once the requisite ownership percentage is present, the Act refers to the filer's "pro rata share" of the fees, or gross receipts, in specifying when the duty to disclose the identity of the provider of the fees or gross receipts will be activated. See Section 87207(b)(2) and (b)(3).

Although the Act does not declare whether the reference to "pro rata share" means the actual amount of the fee to which the filer is entitled or the portion of the fee in which he has an interest by reason of his status as an owner, we think that the latter approach necessarily must have been intended. Otherwise, a variety of anomalous situations will result. For example, a person could have a 5 percent ownership interest in a brokerage firm and, like

Mr. Carey, be entitled to 24 percent of the firm's profits as compensation. He would, however, incur no disclosure obligation with respect to clients of the firm because his ownership interest did not amount to the requisite 10 percent. Conversely, a person could have a 10 percent ownership interest in a brokerage firm but not be entitled to any of the profits derived from the firm's operation. If "pro rata share" referred to the portion of the fees to which he were entitled, again there would be no client identity disclosure.[2/]

These contradictions are avoided, and the purposes of the Act best served, by concluding that "pro rata share" refers to the individual's ownership share of the fees or gross receipts, not the share he receives as compensation. Accordingly, Mr. Carey should use his 10 percent ownership interest to determine whether his pro rata share of a fee is $1,000 or more.

(4) Mr. Carey's final question is whether he must disclose the identity of a person who pays a fee, of which Mr. Carey's pro rata share is $1,000 or more, if the person does not reside in Palo Alto. The Act's definition of income was amended, effective January 1, 1977 (Stats. 1976, Ch. 1161), and now provides, in pertinent part, that:

> ... "Income," other than a gift, does not include income received from any source outside the jurisdiction and not doing business within the jurisdiction, not planning to do business within the jurisdiction, or not having done business within the jurisdiction during the two years prior to the time any statement or other action is required under this title.
>
> Section 82030(a)

[2/] This situation could occur, for example, if an individual provided "venture capital" to a firm in exchange for an ownership interest and a degree of voting control but agreed not to receive a share of the firm's profits derived from operations, either by way of compensation or dividends. Rather, the investor would rely on the potential increase in the value of his stock to profit from his investment. The potential for bias in favor of persons paying substantial fees to the firm, and the consequent need for disclosure in this context, are readily apparent.

Thus, to the extent that a person satisfies all of the foregoing criteria, a payment from him to Mr. Carey's firm will not be "income" to Mr. Carey within the meaning of the Act.[3/] Mr. Carey, therefore, will not have to reveal the identity of that individual even if his pro rata share of the fee paid is $1,000 or more.

We note, however, that a person who owns property in Palo Alto but does not reside there is not "outside the jurisdiction" within the meaning of Section 82030(a). Accordingly, Mr. Carey would have to disclose the identity of such a person if the firm received a fee from him of which Mr. Carey's pro rata share was $1,000 or more.

Adopted by the Commission on November 3, 1977. Concurring: Lowenstein, McAndrews and Remcho. Commissioner Lapan dissented. Commissioner Quinn concurred in questions 1, 3 and 4 but dissented in question 2.

Daniel H. Lowenstein
Chairman

QUINN, COMMISSIONER, DISSENTING IN PART: I dissent from that portion of this opinion which holds that Mr. Carey may not deduct the firm's overhead expenses to determine the fee against which he must measure his pro rata share of the fees.

The Act speaks to this matter by requiring disclosure of the name of every person who paid fees to the business entity if the filer's pro rata share of fees from such person was equal to or greater than $1,000 (Government Code Section 87207(b)(2)). It is clear that the intent is to concentrate on the portion of the fee going to the filer, not the filer's portion plus the firm's overhead. It should be remembered that it is the individual filer who must make the public disclosure, not the firm. It seems perfectly reasonable to allow deduction of the firm's costs prior to determining whether the filer has an obligation to disclose the name of a person paying fees to the firm.

3/ Mr. Carey's jurisdiction with respect to a source of income is the City of Palo Alto. See Section 82035.

It is possible that many filers are including the firm's overhead in their calculations, inasmuch as the mathematics are less burdensome if the firm overhead is included. However, the Act should not be read to require inclusion of the firm's costs. The requirement that names of clients of firms providing legal and brokerage services be disclosed imposes a heavy burden on many filers. In a case such as this, where the plain English can be interpreted to allow exclusion of all funds except the filer's own pro rata share of the fees paid the firm, such a reading should be allowed. A liberal interpretation of Government Code Section 87207(b)(2) is to be preferred.

I also find fault with the majority's insistence that the word "salesperson" be used, rather than "salesman" and "saleswoman." These fine old Anglo-Saxon words have served the English language well for several centuries. "Salesman" is an accepted generic term referring to an individual of either gender, and finds furtner descriptive usage in words such as "salesmanship." The fashionable foolishness of degenderizing the English language is an undertaking which our opinions could do without.

T. Anthony Quinn
Commissioner