

Cite as Det. No. 05-0206E, 25 WTD 72 (2006)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	
Assessment and Refund of)	<u>FINAL</u>
)	<u>EXECUTIVE LEVEL</u>
)	<u>DETERMINATION</u>
)	
)	No. 05-0206E
)	
...)	Registration No. . . .
)	. . ./Audit No. . . .
)	Docket No. . . .

[1] RULE 111: ADVANCES – PASS-THROUGH – ENTITLEMENT. An advance received by a taxpayer from its client for payment to a third party is not entitled to the Rule 111 “pass through” unless the taxpayer can first demonstrate that its role was that of an agent. If so, the second query will be “whether the taxpayer’s liability to pay the advance ‘constituted solely agent liability.’” Common law, and not how the parties described themselves in their contract documents, control in determining whether an agency relationship existed.

[2] RULE 111: ADVANCES – PASS-THROUGH – AGENCY – ESSENTIAL ELEMENTS. The essential elements of an agency relationship are mutual consent between a principal and agent, and control of the agent by the principal. Agency must be proven and cannot be presumed, and the burden of establishing an agency relationship is on the party asserting its existence. When a purported principal does not acknowledge that another entity is its agent, an agency relationship will not be found.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION

Director’s Designee: Mary C. Barrett, Assistant Director, Appeals Division

Bauer, A.L.J. – An employer of record desires “pass through” treatment under WAC 458-20-111 (Rule 111) for wages it received and paid to agricultural workers. We hold that Taxpayer has not carried its burden of proof that it was an agent of its claimed principal.¹

ISSUE

Has an employer of record, in claiming entitlement to Rule 111’s “pass through” treatment of amounts it received from a client to pay workers, satisfied its burden of proof that it is an agent?

FINDINGS OF FACT

Three entities – . . . (Taxpayer), [Entity 1]² and [Entity 2] -- were involved in the operation and management of various Washington orchards. The orchards were owned by [Investment Group] which was a fiduciary for its client investors.³ For each of the various orchards involved, Taxpayer entered into at least two standard written contracts,⁴ as follows:

Under Taxpayer’s standard contract with [Entity 1] -- the “[Entity 1] Agreement”⁵ -- [Entity 1] hired Taxpayer to be responsible for the overall “care and supervision” (*i.e.*, management) of an orchard. The [Entity 1] Agreement specifically provided that Taxpayer would “furnish all labor and supervision” in fulfilling its operation of the identified orchard,⁶ and that Taxpayer was to provide its services to [Entity 1] as an independent contractor, and not as an agent.⁷

Under its standard contract with [Entity 2] -- the “[Entity 2] Agreement”⁸ -- Taxpayer retained [Entity 2] to provide actual on-site management of the identified orchard. Although the [Entity 2] Agreement provided that [Entity 2] would “supervise” the orchard workers, this agreement did

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

² . . .

³ Although Taxpayer’s representative at the hearing stated that the orchards were owned by [Entity 1] as a holding company for [another] company, we believe the information on the [Investment Group] website to be more credible.

⁴ Taxpayer has not provided us with [a] representative contract between [Investment Group] and [Entity 1].

⁵ Taxpayer entered one contract dated [during the audit period at issue] into evidence, stating that it was a standard contract used for all of the orchard properties it manages for [Investment Group].

⁶ [The contract] provided: “[Taxpayer] will arrange for and supervise the care and cultivation of all cropland . . . [Taxpayer] shall furnish all labor and supervision . . .” [The contract] provided: “Agricultural services on [the orchard] shall be performed exclusively by [Taxpayer] through its employees, or as [otherwise] provided in [the contract].” [The contract] provided that Taxpayer might contract with others to furnish portions of these services, but any proposed contract would have to be in writing, and Taxpayer would remain liable to [Entity 1] for the adequacy of such services.

⁷ [The contract] provided, “The manner and means by which the agricultural services are accomplished shall be agreed upon by [Entity 1] and [Taxpayer] and implemented by [Taxpayer] as an independent contractor.” [The contract] provides: “It is understood and agreed that the relationship between the parties hereunder shall consist solely of [Entity 1] and [Taxpayer] as an independent contractor and in no event and under no circumstances shall such relationship be construed as any agency, partnership, joint venture, or any similar such relationship.” (Emphasis added.)

⁸ The contract submitted with Taxpayer’s petition was executed in 1986.

not provide that [Entity 2] would procure or pay them. A review of the Department's records reveals that [Entity 2] is not registered to do business in the State of Washington.

In 1999, Taxpayer asked the Department's Taxpayer Information and Education Section (TI&E) to confirm its understanding that amounts it paid to third-party subcontractors for on-site management, and for employee procurement, were not taxable. On June 25, 1999, TI&E advised by letter that Taxpayer could not lawfully exclude such amounts:

Thank you for your Internet Inquiry of June 23, 1999, asking about the application of the business and occupation tax to your farm property management business.

You charge clients a monthly per acre fee. On certain jobs, you subcontract the on-site work to another company while you perform the administrative work. You collect the entire fee from the property owner and pay the other company for the work it performed.

You also employ orchard workers through a third party charged to the orchard owner for the cost of the workers.

It is your understanding that the amount paid to the company for on-site work performed and the amount paid to the third party employee provider are not subject to the business and occupation (B&O) tax. You would like confirmation that this is correct.

Based on the facts presented, your understanding is not correct. The gross income of the farm property management business is subject to the service and other activities classification of the B&O tax without any deduction for amounts paid to third parties or any other expenses whatsoever paid or accrued. RCW 82.04.220, RCW 82.04.080. The B&O tax is intended to be pyramiding in nature. Thus, amounts paid to subcontractors are fully taxable. Similarly, amounts paid to employment agencies or directly to temporary employees cannot be deducted. In addition, any person hired as a subcontractor must also pay B&O tax on the gross income.

(Emphasis added.) Thus, when it solicited TI&E's advice, Taxpayer's description of its activities was in accord with the [Entity 1] and [Entity 2] agreements. Taxpayer did not contend that the orchard workers were not its own employees, but represented that they were employed through a third party (presumably [Entity 2]). Taxpayer did not contend that it was merely a payroll agent for another employer. Another Entity (presumably [Entity 2]) was subcontracted to perform only the necessary on-site management.

Based on TI&E's advice in its letter, Taxpayer stopped deducting these amounts in calendar year 2000, but did not amend prior periods.

The Audit Division (Audit) of the Department of Revenue (Department) audited Taxpayer's business records for the period January 1, 1999 through December 31, 2002 (audit period). As a result of this audit, the above-referenced tax assessment was issued in the total amount of \$. . .

(mostly attributable to the year 1999). This amount included \$. . . of interest and the 5% assessment penalty in the amount of \$. . . .

Taxpayer paid the assessment in full and, on December 31, 2003, requested a refund of \$. . . . This amount included the \$. . . paid in satisfaction of the assessment and those amounts it paid after the audit period through January 14, 2005, the date of Taxpayer's petition to the Appeals Division.

Taxpayer provided Audit with copies of the [Entity 1] and the [Entity 2] agreements.⁹ According to the Field Audit Manager's letter to Taxpayer dated June 2, 2003,¹⁰ Taxpayer was then claiming to be [Entity 2's] payrolling agent:

You have given further explanation of activities including:

- You are really a payrolling agent for a related Entity, [Entity 2]. While you contract with the financial institutions to manage properties, [Entity 2] puts together the work crews to do the "hands on" work on the farms and ranches.
- [Entity 2] is paid directly for their services by the financial institutions although [Taxpayer] will coordinate their activities and treat the work crews directed by them as employees of [Taxpayer].
- All aspects of farm labor are handled by [Entity 2] and the administration and payment of laborers is done by [Taxpayer].
- The past couple of years [Taxpayer] has only had two employees on staff and currently just one to run its operations. It is contended that this is more of a payrolling function than anything else and should not warrant payment of [B&O] tax on gross income.

(Emphasis added.) Thus, for audit purposes, Taxpayer represented that the orchard workers were employed by [Entity 2], and that it was [Entity 2's] payrolling agent. This differed substantially from the information given in soliciting the TI&E advice. Despite this assertion, Audit concluded that the orchard workers supervised by [Entity 2] were, in fact, Taxpayer's own employees, and that Taxpayer was not an [Entity 2] "payrolling agent."

Based on the evidence and arguments submitted in the course of this appeal, we find that the orchard workers' payroll function was mechanically handled in the following manner:

⁹ The agreements in the Department's audit jacket were identical to the agreements submitted with Taxpayer's petition.

¹⁰ [The letter was sent f]ollowing the supervisor's conference provided for by WAC 458-20-100 (Rule 100) held on May 21, 2003. Rule 100 provides: "A taxpayer is encouraged to request a conference with a supervisor of the department where disagreement exists over a proposed action of the department. The request for the conference should be made to the division of the department that is proposing to issue an assessment or is taking some other action in dispute. Such conferences provide an opportunity to resolve any issue without a review as provided in this section."

[Entity 2] prepared the orchard workers' IRS Forms W-4, on which Taxpayer was listed as the "employer." Taxpayer's hiring of the orchard workers was in accordance with the [Entity 1] agreement. In turn, [Entity 2] provided Taxpayer with ongoing payroll information for these workers. Then, except for L&I¹¹ claims (which were handled by [Entity 2] because they were "on the ground" where accidents occurred), Taxpayer performed all payroll functions, consistent with its contractual obligation under the [Entity 1] contract, including issuing paychecks based on submitted time records, withholding and depositing income taxes based on employees' IRS W-4 forms, paying FICA, FUTA, SUTA, Worker's Compensation and Liability Insurance, providing W-2 forms, and completing other payroll reports required by state and federal law. Other than the information it received on payroll cards completed by [Entity 2], Taxpayer had no contact with the workers.

Taxpayer sent the payroll information directly to [Entity 1] who after review authorized payment. If [Entity 1] had questions about the accuracy of any report, it worked with [Entity 2] and Taxpayer to resolve any issues. [Entity 1] then wired the amount of funds required, without markup, into a "dedicated" account maintained by Taxpayer. This dedicated account was not formally a trust account, although Taxpayer asserts it "could be construed to be a trust." Although Taxpayer states that it was proscribed from using any monies in this account for anything but worker payroll, Taxpayer has provided no written agreement to this effect. We therefore decline to find that it was legally a restricted account or a trust account. The account had two signatories. Both were from Taxpayer.

In exchange for its services to [Entity 1],¹² Taxpayer earned a fee which was deposited into its own administrative account. It was a set fee – and not a percentage of payroll costs -- which was negotiated with [Entity 1] on an orchard-to-orchard basis. Taxpayer claims it had only one active employee – [an office manager].¹³ [Taxpayer's office manager] alleges that he has no skills related to managing orchards, and that he did the payroll function only.

ANALYSIS

In the course of this appeal, Taxpayer, claims to be the payrolling agent for [Entity 1], which it now characterizes as the orchard workers' actual employer. Taxpayer therefore seeks to exclude from its B&O tax base as nontaxable "pass throughs" under Rule 111 those amounts it received from [Entity 1] [and used] for payment of the orchard workers.

¹¹ L&I is the acronym for the State of Washington's Department of Labor and Industries.

¹² Unrelated to the payroll function, Taxpayer also received invoices from third party vendors. Taxpayer's mailing address was used for the bills of third party vendors. Taxpayer conferred with [Entity 2] to determine that the billings were accurate, and then forwarded them to [Entity 1] for payment. These payments are not subject to this appeal.

¹³ Taxpayer's website at . . . lists [numerous] staff members. [Taxpayer's president]; [Taxpayer's office manager]; and [several] horticulturalists. When queried, Taxpayer advised that the . . . horticulturalists were really employed by [Entity 2], but were listed on taxpayer's website in order to let prospective clients know that horticultural services were available through Taxpayer. The nature of the employment status of these workers is not part of this audit and therefore not addressed here.

The B&O tax applies to virtually all business activities conducted in this state. *Simpson Inv. Co. v. Department of Rev.*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000); *Impecoven v. Department of Rev.*, 120 Wn.2d 357, 363, 841 P.2d 752 (1992). The measure of the B&O tax is “gross income” or gross receipts.” RCW 82.04.220. The definition of “gross income of the business” is:

the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.080 (emphasis added). Under this broad definition, a service provider may not deduct from its gross income any of its own costs of doing business, including its labor costs. *Rho Co. v. Department of Rev.*, 113 Wn.2d 561, 566-67, 782 P.2d 986 (1989); *Pilcher v. Department of Rev.*, 112 Wash. App. 428, 436, 49 P.3d 947 (2002).

Taxpayer, relying on the principles of *Rho*, contends the Department cannot rely solely on its [Entity 1] and [Entity 2] Agreements, as written, to determine that Taxpayer worked as an independent contractor and employed the orchard workers itself to fulfill its management contract with [Entity 1]. Taxpayer argues that the provisions of the [Entity 1] and [Entity 2] Agreements have been significantly amended by the parties in their course of dealing with one another over the years, and that the written contracts are in many respects no longer relevant. Taxpayer claims that everyone – including the orchard workers – knew that the orchard workers were actually employed by [Entity 1], and not by Taxpayer.

No evidence, other than the statements of Taxpayer and [Entity 2] were offered. The statement offered by Taxpayer from [Entity 1] was limited in scope and specifically failed to assert who was the employer. Taxpayer further argues that there were no factors present that support a finding of an employer-employee relationship between Taxpayer and the orchard workers.

Taxpayer argues that two separate strings of unwritten contractual relationships have evolved in spite of the language in the standard agreements: First, [Entity 2] (instead of Taxpayer) now provides overall management of the orchards, including obtaining and supervising orchard workers. Second, Taxpayer no longer provides overall management of the orchards, but merely serves as [Entity 1’s] payroll agent. Taxpayer asserts its status as “employer” for all paperwork purposes is in name only (*i.e.*, employer of record).

Taxpayer claims that during the audit period: (1) Taxpayer had no contractual privity with the orchard workers; (2) Taxpayer exercised no control over them; (3) [Entity 1] was the orchard worker’s and [Entity 2’s] management staff employer for tax purposes, and (4) Taxpayer paid

them solely as [Entity 1's] agent. Based on these assertions, Taxpayer argues that it should be accorded Rule 111 pass through treatment on payroll amounts it received from [Entity 1].

Rule 111 provides, in pertinent part:

The word “advance” as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client. . . .

The words “advance” and “reimbursement” apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefore [sic], either primarily or secondarily, other than as agent for the customer or client.

There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.

The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

(Emphasis added.) Excise Tax Advisory No. 2016.04.111 (First Revision, issued on January 4, 2005¹⁴) (ETA 2016) also provides:

In order to exclude these [pass through] payments from the measure of tax, the Washington State Supreme Court has ruled that two conditions must be met. The taxpayer must first establish that it received the funds as the agent of the customer or client. If this first condition is satisfied, the taxpayer must also establish that its use of the funds to pay a third party is solely as an agent of the customer or client. *City of Tacoma v. William Rogers Co.*, 149 [sic] Wn.2d 169, 60 P.3d 79 (2002). . . .¹⁵

The existence of an agency relationship is not controlled by the labels the parties use to describe themselves in their contract documents. Rather, standard common law agency principles are used in analyzing whether an agency relationship exists. The essential

¹⁴ The Department promulgated this revision after the issuance of *Tacoma v. The William Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002).

¹⁵ The correct Washington Supreme Court Reporter citation is “148 Wn.2d 169.”

elements of common law agency are mutual consent to the relationship between a principal and an agent, and the right of control over the agent by the principal. If these elements are not satisfied, there is no agency relationship.

If a staffing company assumes any liability to third parties in connection with the receipt of payment, including any liability to the workers, beyond that of an agent of the client, the payments it receives and uses to pay the third parties are not excludable “pass through” payments. These payments must be included in the measure of tax, notwithstanding that the staffing company or its client may designate these payments for paying workers’ wages and benefits. For example, the Washington State Supreme Court held that when a staffing company is the employer of temporary workers, the staffing company is liable for paying the workers as a principal, not solely as an agent. *City of Tacoma v. William Rogers Co.*, 149 [sic] Wn.2d 169, 60 P.3d 79 (2002).

[1] (Emphasis and footnotes added.) *Tacoma v. The William Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002), the case referenced in ETA 2016, is the Washington Supreme Court’s most recent pronouncement on the Rule 111 “pass throughs.” *Rogers* clarified that court’s earlier *Rho* decision¹⁶ by holding that an advance received by a taxpayer from its client for payment to a third party is not entitled to the Rule 111 “pass through” unless the taxpayer can first demonstrate that its role is that of an agent.¹⁷ If so, the second query will be “whether the taxpayer’s liability to pay the advance ‘constituted solely agent liability.’”¹⁸ Common law, and not how the parties describe themselves in their contract documents, control in determining whether an agency relationship existed.¹⁹ Finally, the amount of control a taxpayer exercised over the employees was not (as it may have appeared in *Rho*) the exclusive factor to consider when determining whether advances were made “solely” as the agent of a principal.²⁰

Rogers considered a number of control factors -- e.g., who is the employer of record, who controls hiring and firing, who controls workers’ assignments, etc.²¹ – to determine that *Rogers* was the actual employer instead of the agent of its clients.

In accordance with Rule 111, *Rogers*, and ETA 2016, the initial element to be proven in order for an “advance” to qualify as a true “pass through” is that the advance of funds must have been made “pursuant to an agency relationship.”²² We agree with Taxpayer that the “[d]etermination

¹⁶ [*Rogers*], *supra* at 177.

¹⁷ *Rogers*, *supra*, at 178.

¹⁸ *Rogers*, *supra* at 178, citing *Rho*, 113 Wn.2d at 573.

¹⁹ *Rogers*, *supra* at 177-78.

²⁰ *Rogers*, *supra* at 179.

²¹ Factors examined in *Rogers* included: who is the employer of record and is such labeling part of the service provided, who does the employee handbook identify as the employer, who withholds income and other employee taxes and complies with industrial insurance laws, who does safety inspections, who responds to on-the-job injuries, who is solely responsible for wages, who grants holidays and vacations, control over hiring, firing, etc.

²² *Rogers*, *supra* at 177, 178.

of an agency relationship is not necessarily controlled by the manner in which the parties contractually describe their relationship.”²³

[2] The essential elements of an agency relationship are mutual consent between a principal and agent, and control of the agent by the principal. *See, e.g., Nordstrom Credit, Inc. v. Department of Rev.*, 120 Wn.2d 935, 941, 845 P.2d 1331 (1993); *Rho*, 113 Wn.2d at 561. Agency must be proven; it cannot be presumed. *Stockdale v. Horlacher*; 189 Wash. 264, 267, 64 P.2d 1015 (1937); *Blodgett v. Olympic Sav. & Loan Ass’n.*, 32 Wash. App. 116, 128, 646 P.2d 139 (1982). The burden of establishing an agency relationship is on the party asserting its existence. *Hewson Constr., Inc. v. Reintree Corp.*, 101 Wn.2d 819, 823, 685 P.2d 1062 (1984); *Bergin v. Thomas*, 30 Wash. App. 967, 970, 638 P.2d 621 (1981).

Taxpayer submitted the following statements of others²⁴ in support of its assertion that [Entity 1] was the orchard workers’ actual employer, and that Taxpayer was [Entity 1]’s agent:

[Taxpayer’s president] stated:²⁵

Taxpayer’s duties . . . included paymaster services . . . to its principal, [Entity 1]. . . . Taxpayer paid the [payroll] expenses from the funds provided by [Entity 1]. . . . [Taxpayer] was the nominal employer for purposes of issuing payroll checks on behalf of [Entity 1] with duties limited to issuing payroll checks, and paying associated taxes and labor and industries charges. . . . Taxpayer had no liability to the payees or labor other than that of an agent that in each case was not indemnified fully by [Entity 1] as principal to Taxpayer as agent. . . . [Taxpayer] did not have the authority to hire, direct, or terminate workers on the [Entity 1] orchards. This authority was exercised exclusively by [Entity 2] for the benefit of [Entity 1].

(Emphasis added.) [One of the . . . horticulturists],²⁶ (A principal of [Entity 2]), stated:

The various workers . . . know they are working on . . . Orchards that that are managed, not owned or leased by [Entity 2],²⁷ and the owner of the Orchards is [Entity 1].

[Taxpayer’s office manager],²⁸ (Taxpayer’s full-time employee), stated:

²³ *Rogers, supra* at 177 (citing *Rho*, 113 Wn.2d at 570).

²⁴ Taxpayer submitted the following sworn declarations: for Taxpayer, [the Taxpayer’s president] (1/14/05 and 3/18/05); [one of the horticulturists] for [Entity 2] (2/28/05); and [Taxpayer’s office manager] for Taxpayer (2/28/05).

²⁵ Excerpts from paragraphs 3, 4, and 5 are from his sworn declaration dated January 14, 2005. The excerpt from paragraph (7) is from [Taxpayer’s president’s] sworn declaration dated 3/18/05.

²⁶ Sworn declaration dated February 28, 2005.

²⁷ The original declaration said “[Entity 1].” This was later corrected both orally by Taxpayer’s representative in the hearing conducted on 3/11/05, and in paragraph (5) of [Taxpayer’s president’s] sworn declaration dated 3/18/05.

²⁸ Sworn declaration dated 2/28/05.

[Taxpayer] provided . . . the payroll function for workers in orchards . . . owned by [Entity 1] in Washington. . . . I made all payroll and associated tax payments from the Payroll Account. As sole employee of [Taxpayer], I made no payments of payroll or associated taxes or judicially required payments from the Payroll Account for the workers on the Orchards that were not both approved and funded in advance of payment by [Entity 1]. . . . [Taxpayer] acted and continues to act as an agent with limited authority to perform payroll functions of [Entity 1] for workers on the Orchards

(Emphasis added). The above statements were submitted to [the Appeals] division before the second teleconference. We expressed the following concerns about Taxpayer’s evidence in the course of our second teleconference:

First, the [Entity 1] Agreement required Taxpayer to provide its services as an independent contractor, and not an agent, to [Entity 1] using its own employees. This contract language was directly contrary to Taxpayer’s assertion that [Entity 1] was the orchard workers’ actual employer, and Taxpayer only its payroll agent. Although under *Rho* and *Rogers* we may look beyond the form of the agreements to determine that Taxpayer was not an agent, we were nonetheless concerned that the parties to these contracts had decided not to amend them to accurately reflect what they assert to be their current agreements.

Second, [Entity 1] – the claimed principal – had not provided any statement to the effect that the orchard workers were its actual employees. Neither had there been any non-testamentary evidence introduced that would support a finding that the employees were controlled – and therefore actually employed by [Entity 1] or any Entity other than Taxpayer.

These concerns made it reasonable to ask for more evidence in support of Taxpayer’s agency claim. Accordingly, in this case, we asked Taxpayer to obtain a sworn statement from [Entity 1], as Taxpayer’s claimed principal, declaring that it was the orchard workers’ actual employer, and that Taxpayer was acting solely as its agent for payroll purposes.

After the second hearing, Taxpayer provided us with a Statement²⁹ from . . . , an officer of [Entity 1],³⁰ which provided as follows:

(4) I confirm that during the refund period, [Taxpayer] provided the following services to [Entity 1] for its Washington orchards: (a) in [Taxpayer’s] name, paying payroll and governmental impositions associated therewith; (b) in [Taxpayer’s] name, filing required returns and reports with governmental agencies associated with such payroll. . . .

(7) During the refund period and currently, [Entity 1] deals with [Taxpayer] and [Entity 2] separately. They perform different functions for [Entity 1]. [Taxpayer] acts as [Entity 1]’s paymaster as to payroll and related tax charges. [Entity 2] acts as [Entity 1]’s

²⁹ The statement was dated March 18, 2005.
³⁰ This sworn declaration was executed on March 18, 2005.

onsite orchard manager. . . . All costs incurred for [Entity 1] . . . paid . . . indirectly through [Taxpayer] as payroll and associated taxes are paid strictly on a cost basis. All savings, whether discounts or otherwise inure only to [Entity 1's] benefit. [Taxpayer] receives funds to pay approved payroll costs exclusively through a dedicated account established in the name of [Taxpayer] to pay such costs. . . . [Taxpayer] never receives funding for approved payroll costs other than by wire through its dedicated agricultural payroll account. The only unrestricted funds from [Entity 1] available to [Taxpayer] are [its] respective fees.

(8) [Entity 1] realizes that the existing agreements do not reflect the actual arrangements and relationship of [Entity 1] and [Taxpayer] and of [Entity 1] and [Entity 2]. The arrangement of the parties from the standpoint of [Entity 1] is described herein. I have taken this opportunity to describe the relationships separately to avoid confirming factual statements contained in the existing declarations of which I do not have direct knowledge.

(Emphasis added.) [An officer of Entity 1's] declaration avoided answering the question necessary under *Rogers*. Is there an agency relationship? If yes, is its scope limited to payroll agent? Here we know taxpayer performed payroll functions, but the purported principal will not acknowledge an agency relationship. Its failure to do so leaves these employees with no employer for the purposes of this appeal except Taxpayer. [An officer of Entity 1] did not characterize Taxpayer's role to be that of [Entity 1's] "agent." Further, [an officer of Entity 1] states that [Entity 1] does not confirm any other factual assertions beyond those contained in his declaration. Thus, even the statements of [Taxpayer's president] and [Taxpayer's office manager] as to their understanding that Taxpayer operated as [Entity 1's] agent must be disregarded.

[Entity 1's] current reluctance to agree with Taxpayer's characterization of itself as [Entity 1's] agent has left an ambiguity concerning the nature of Taxpayer's paymaster activity. In reviewing this ambiguity under the common law, we are presented with a business venture in which there are three players: Both Taxpayer and [Entity 2] claim that they are not the orchard workers' actual employers, but merely agents of [Entity 1], the orchard workers' actual employer. [Entity 1], the reported principal, is noncommittal as to these points.

Further, Taxpayer and [Entity 2] are parties to contracts for management services as principal and agent respectively, yet these contracts do not appear to reflect current relationships. Testimony has not clarified what the relationships are, and Taxpayer has not rectified this situation by offering uncorroborated and contradictory information before the Department. While all three entities acknowledge a role for [Entity 2], it is not registered to do business in the State of Washington. Finally, websites concerning [Investment Group], [Entity 1], and Taxpayer contradict these entities' assertions as to the nature of the relationships they claim to have with each other.

Both principal and agent must agree for an agency relationship to exist. As we stated in Det. No. 98-004, 17 WTD 231 (1998):

Agency includes every relation in which one person acts for or represents another by latter's authority.³¹ An "agent" is "[a] person authorized by another to act for him, one entrusted with another's business."³²

(Emphasis added; footnotes original.) Det. No. 99-241, 19 WTD 295 (2000), additionally provides:

The Washington Supreme Court said: "Agency requires that both parties consent to the relationship and that the principal exercises control over the agent."³³

(Footnote original.) [Entity 1], as Taxpayer's claimed principal, has declined to overcome the existing proof problems enumerated above by affirmatively declaring itself to be the orchard workers' employer, or claim Taxpayer as its agent. Because of the ambiguities raised by the evidence, we conclude that Taxpayer has presented no legal authority under the common law which would compel the Department to accept that [Entity 1] was the orchard workers' actual employer, or that Taxpayer received payroll-related advances as [Entity 1's] agent. If [Entity 1] was not the orchard workers' actual employer, then Taxpayer cannot be [Entity 1's] agent in paying them. Taxpayer has not demonstrated a relationship that satisfies its burden of proof for Rule 111 "pass through" treatment.

Taxpayer asserts that [Entity 1's] failure to declare that it is the orchard workers' employer is extrinsic to the issue here involved. It argues that Rule 111 applies to undertakings to pay expenses unrelated to employment and that our ruling in this case therefore cannot be influenced by [Entity 1's] failure to claim an employer/employee relationship with the orchard workers.

We disagree with Taxpayer's assertion that Rule 111 "pass through" treatment is necessarily unrelated to the question of who the actual employer might be. To the contrary, the question of the actual employer was the critical element in both the *Rho* and *Rogers* cases:

The question that the parties have primarily addressed in this regard is: Who employed the contract personnel, Rho or Rho's corporate clients? If Rho is the employer, then Rho is liable in its own right for the payment, and Rule 111 does not apply. If, however, the clients are deemed to be employers, then Rho is more easily characterized as the clients' paymaster agent in paying the personnel.

Rho, *supra* at 569 (emphasis added).

³¹ Black's Law Dictionary, Fourth Edition, p. 84.

³² *Id.* at 85.

³³ *Nordstrom Credit, Inc. v. Department of Rev.*, 120 Wn.2d 935, 941, 845 P.2d 1331 (1993).

Evergreen fails to meet even its first burden, to demonstrate an agency relationship with its clients for the purpose of providing employees. . . . Evergreen stipulates to being the employer of the workers. As Mr. Rogers testified:

It is absolutely my understanding that the temp employees, when they are assigned to work as an Evergreen Staffing employee, they are the employees of my company, the William Rogers Company. No doubt in the world about that.

. . . We conclude that Evergreen has failed to establish that it paid its temporary workers pursuant to an agency relationship.

Rogers, supra at 178 (emphasis added). In this case Taxpayer claims that amounts equal to the employees' payroll should be exempt because it had no duty as an employer to pay the orchard workers because they were actually employed by [Entity 1], and that it paid them only as [Entity 1's] agent. But [Entity 1] has not admitted that the orchard workers are its employees. Absent this, Taxpayer has not successfully documented that the orchard workers' payroll is not its own expense as an employer. Therefore, it has not proven that it is paying the orchard workers as an agent.

We conclude that Taxpayer has not carried its burden of proof under the first element of *Rogers* and ETA 2016 -- that [Entity 1], as principal, was the employer of the orchard workers, and that Taxpayer received advances for their payroll in its agency capacity.³⁴ Therefore, we determine that Taxpayer has not satisfied the first element for the Rule 111 pass-through exemption as articulated by *Rogers* and ETA 2016. Because Taxpayer has not carried its burden of proof as to the first necessary element under *Rogers*, we need not further consider the second element.

DECISION AND DISPOSITION

Taxpayer's petition for correction of assessment and refund is denied.

Dated this 21st day of September 2005.

³⁴ Although not raised as an issue in this case, we note that ETA 2016 (First Revision) requires Taxpayer's reporting tax classification to be determined based on the services performed by the orchard workers it pays. Under WAC 458-20-209(3) (Rule 209(3)), "[p]ersons performing horticultural services for farmers are generally subject to the service and other business activities B&O tax upon the gross proceeds." Taxpayer's correct tax classification would be as a "Farmer for Hire" under Rule 209(3)(b). Because the tax was assessed and paid under the Service classification of the B&O tax, no adjustment in this regard is warranted.