

Cite as 11 WTD 181 (1991).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment)	
of)	No. 91-143
)	
. . .)	Registration No. . . .
)	. . ./Audit No. . . .
)	

[1] RCW 82.32.360. EMPLOYEE EXEMPTION. A full time life insurance agent who is classified as a "statutory employee" for Social Security and Federal fringe benefits purposes is not an employee for the B&O tax exemption.

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.

DATE OF HEARING: March 21, 1991

NATURE OF ACTION:

The taxpayer petitions for the correction of assessment of business and occupation taxes and use tax for the period from January 1, 1986 through December 31, 1989. The total due and assessed was \$. . . and remains unpaid.

FACTS AND ISSUES:

Pree, A.L.J. -- The taxpayer is an insurance agent During the audit period, the taxpayer considered himself an employee and did not pay business and occupation taxes to the state. The auditor considered the taxpayer to be engaging in business subject to the business and occupation tax rather than exempt as an employee. In addition to assessing business and occupation tax, use tax was initially assessed on the taxpayer's computers. The use tax assessment has since been revised and the parties are now in agreement regarding the use taxes.

The taxpayer has been an agent of [the insurance company] since 1973. He is a participant in their qualified retirement plans (including a 401(k) plan), group life, and group medical. He contends that to be eligible for these benefits, he is required to be an employee under the Internal Revenue Code.

Under the terms of the contract, [the insurance company] provides the agent a handbook which includes limitations and rules that the agent agrees to follow.¹ For instance, it limits the taxpayer's advertisements to specific formats written by the home office, all displaying "[the insurance company]" prominently. This includes phone book, newspaper, and radio advertisements.

[The insurance company] controls what he may put on his business card prohibiting him from using his professional designation of He may not use the office [the insurance company] provides him except to sell for [the insurance company].

He does not have a business checking account. He must follow [the insurance company's] procedures regarding how to get [the insurance company] to issue checks or receive applications.

He states that the [insurance company's] General Manager controls and supervises him. The General Manager does all the hiring and runs the office for the company. However, the taxpayer has, and other agents do, hire clerical employees who work directly for them (rather than as [the insurance company's] employees).

The General Manager conducts interviews of the representatives checking among other things, the following:

I.A. Whether the agent uses only preapproved sales promotion materials;

I.B. Whether advertising has been approved by [the insurance company] in advance;

¹ We should note that section (6) of the contract goes on to state, ". . . but no rule hereafter adopted shall be construed so as to restrict the Agent's right to direct and control the Agent's work in performance of this contract."

I.C. Whether all mail uses the return address of the [insurance company's] General office;

I.D. Whether the agent's letterhead and business cards conform to [the insurance company's] standards;

I.E. Whether the agent understands that all customer payments are by checks to [the insurance company] with an application and are promptly remitted to [the insurance company];

I.F. Whether the agent understands that he may not make projections of future investment performance and may only recommend purchases to clients suitable in light of their financial objectives;

I.G. Whether the agent understands that he must refer all complaints to the General Manager;

I.H. Whether the agent understands that he may not sell securities for other companies without the approval of [the insurance company]; and

I.I. Whether the agent has sold or distributed securities for any other private company.

After the hearing, the taxpayer submitted copy of a letter requiring the taxpayer to resign from all general agent contracts with other companies. The letter also required the taxpayer to meet his "full-time" requirement with [the insurance company], placing most of his production with that company. Both these requirements were conditions which the taxpayer had to meet to continue under the [insurance company] contract.

In addition, the [insurance company] directs and controls agents with a series of incentives and disincentives based on its determination of whether or not the agent is "Pro-active". The determination is made based on quantified goals depending on the experience and sales of the agent. If the agent is "Pro-active", he receives various memberships, discounts, leads, and advertising privileges.

Either the agent or [the insurance company] may terminate their relationship with or without cause. As an agent, his commission is set by the company and may not be negotiated or rebated. [The insurance company] requires 30 hours per year

of continuing education compared to the 12 hours the taxpayer indicates is required by law.

The point the taxpayer is trying to make is that [the insurance company] exerts direct and indirect control over many of the details of his business activities. In his petition, he cites Packard v. Commissioner, 63 T.C. 621, 628 (1975) as standing for the proposition that whether an individual is an employee or independent contractor is determined by the application of common law. The key to the test he points out is "whether the employee[r?] has the right to exercise direction or control over the work a worker works, both as to the final results & as to the details of when, where, and how the work is to be performed. The employer need not, in fact have exercised this control; it is sufficient that the employer has the right to do so."

The taxpayer also cites a second case, Alsco Storm Windows, Inc. v. United States, 311 F.2d 341 (9th Cir. 1962) which states that the status of the worker is determined by considering the factual situation. He indicates that the majority of cases which discuss the distinction between employee and employer enumerate seven factors:

1. The degree of control exercised by the principal over the details of the work;
2. Which party invests in the facilities used in the work;
3. The opportunity of the individual for profit and loss;
4. Whether or not the principal has the right to discharge the individual;
5. Whether the work is part of the principal's regular business;
6. The permanency of the relationship; and
7. The relationship the parties believe they are creating.

The auditors focused on the contract the taxpayer had with [the insurance company], which provides in part 5:

5. Neither the term "Agent" (used in this contract solely for convenience in designating one

of the parties) nor anything contained in this contract or in any of the rules or regulations of the Company shall be construed as creating the relationship of employer and employee between the Company and the Agent. Subject to the provisions of this contract and within the scope of the authority granted by this contract, the Agent as an independent contractor, shall be free to exercise the Agent's own discretion and judgement with respect to the persons from whom the Agent will solicit applications, and with respect to the time, place, method and manner of solicitation and performance under this contract. But the Agent agrees that the Agent will not engage in conduct which will affect adversely the good standing or reputation of the Company.

Based on the taxpayer's income tax records, the auditors noted that for Federal income tax withholding purposes, [the insurance company] does not consider the taxpayer an employee. The IRS applies the common law definition of employee in making such determinations for the purposes of withholding income tax. We note however, that the taxpayer is a "statutory employee" for the purposes of FICA.²

In addition, the taxpayer did in fact sell insurance for another company. Those commissions were reported on a 1099, indicating that company did not consider the taxpayer an employee for any purposes.

The auditor found that the taxpayer was an independent contractor and assessed business and occupation tax on the amounts reported to the IRS. The taxpayer disputes the finding that he was an independent contractor, contending that under common law he should have been considered an employee exempt from business and occupation tax. The issue is, was the taxpayer working as an employee exempt from tax, or an independent contractor subject to business and occupation tax.

DISCUSSION:

² See IRC 3121(d)(2) & (3)(B) which distinguish between the usual common law rules in determining whether an individual is an employee used for income taxes in (2) and a special category for a noncommon law employee full-time life insurance salesman in (3)(B).

RCW 82.04.220 imposes business and occupation tax on the privilege of engaging in business activities. RCW 82.04.360 exempts from tax earnings made in the capacity of an employee or servant as distinguished from that of an independent contractor stating:

Exemptions--Employees. This chapter shall not apply to any person in respect to his employment in the capacity of an employee or servant as distinguished from that of an independent contractor.

We must determine whether the taxpayer was working as an employee exempt from tax, or an independent contractor subject to business and occupation tax. The Department adopted WAC 458-20-105 to address this distinction which provides in parts (2) & (4):

(2) While no one factor definitely determines employee status, the most important consideration is the employer's right to control the employee. The right to control is not limited to controlling the result of the work to be accomplished, but includes controlling the details and means by which the work is accomplished.

(4) EMPLOYEES. The following conditions indicate that a person is an employee.

If the person:

(a) Receives compensation, which is fixed at a certain rate per day, week, month or year, or at a certain percentage of business obtained, payable in all events;

(b) Is employed to perform services in the affairs of another, subject to the other's control or right to control;

(c) Has no liability for the expenses of maintaining an office or other place of business, or any other overhead expenses or for compensation of employees;

(d) Has no liability for losses or indebtedness incurred in the conduct of the business;

(e) Is generally entitled to fringe benefits normally associated with an employer-employee relationship, e.g., paid vacation, sick leave, insurance, and pension benefits;

(f) Is treated as an employee for federal tax purposes;

(g) Is paid a net amount after deductions for employment taxes, such as those identified in subsection (3)(h) of this section.

The Department has adopted an Excise Tax Bulletin (ETB) that deals specifically with the employment status of insurance agents for business and occupation tax purposes. ETB 546.04.164 issued April 24, 1990 provides in part:

The Washington Courts, in determining whether an individual is an employee, have held that controlling or having the right to control the performance of the duties including the details and means of accomplishing the work product is the most important element. That determination shall be made based on the facts and circumstances surrounding the relationship between the agent and insurance company.

Life insurance agents are considered employees only if they meet the following criteria:

1. They have no direct interest in the profits or losses of the insurance business including no liability for maintaining a place of business and overhead; and
2. Meet one of the following:
 - A. They are subject to the control or right of control of the insurance company in the performance of the details of the work; or
 - B. They are treated as employees for Federal income tax purposes as evidenced by the filing of a W-4 form, and the withholding of income tax, when necessary.

The taxpayer does not meet the second requirement of this test. Regarding requirement A, [the insurance company] does direct some of the taxpayer's business activities, in some instances, in great detail. However, it does not have the right to control the primary task the taxpayer performs: When and from whom he solicits insurance. Those rights are specifically reserved by the agent in part 5 of the contract. To repeat:

. . . the Agent as an independent contractor, shall be free to exercise the Agent's own discretion and judgement with respect to the persons from whom the Agent will solicit applications, and with respect to the time, place, method and manner of solicitation and performance under this contract.

Regarding requirement B, the person must be a "regular" employee which is an employee under the "common law" tests. "Statutory employees" are independent contractors who were treated as employees only for the purposes of Social Security and in recent years for the purposes of qualifying for fringe benefits. This is covered in Section 3121 (d)(3) of the Internal Revenue Code. The I.R.S. recently confirmed this interpretation in Rev. Rul. 90-93 in which they held:

A full-time life insurance salesman described in section 3121 (d)(3) of the Code is not an employee for purposes of section 62 and 67.

The I.R.S. stated in that ruling that life insurance salesmen could file Schedule C of Form 1040 and not be subject to the limitations as employees for miscellaneous itemized deductions.

As a full time life insurance agent with [the insurance company], the taxpayer signed a contract with them that provided that he was an independent contractor and not an employee. Under Federal law, he became subject to Social Security taxes and was issued a W-2 form as a "statutory employee".

The Department of Revenue accepts the independent contractor status specified under the contract signed by both parties and the Federal law designation as a statutory employee rather than a common law employee unless it can be shown that [the insurance company] greatly exceeded its powers under the contract and controlled the details and means of accomplishing the person's work. The courts³ have considered the details of work to include whether the agent is directed as to the hours of work, persons from whom they shall solicit insurance, and the way the agent reports to the insurance company.

³ See generally, BNA Tax Management Portfolio #391, *Employee Defined*, pp. A - 71-74

We find that the taxpayer was an independent contractor and not an employee for business and occupation tax purposes. While [the insurance company] exerted a high level of control over this agent regarding training, qualifications, advertising, and selling policies of competitors; it does not control the hours of work and perhaps most important, it does not control from whom the agents solicit insurance,⁴ which directly affects the taxpayer's compensation. The contract with [the insurance company] specifically reserved those rights for the agent.

The taxpayer believes that recent legislative action affects his situation. Effective July 1, 1991, the Washington legislature has expanded the definition of employee in RCW 82.04.360 to include the class of "statutory employees" defined in Section 3121 D(d)(3)(B). These are full time life insurance agents. By changing the existing law prospectively only, the legislature demonstrated that it did not intend to exempt "statutory employees" from B&O tax under the law in effect for the years covered in the assessment notice that is in controversy.

The taxpayer expressed discontent that the Department had changed positions often in the last couple of years regarding this issue, but did not specify his objections to this particular Excise Tax Bulletin at the hearing. After the hearing, the taxpayer refers to other insurance agents whose tax status was different. We cannot reveal their specific circumstances.⁵ Relief has been granted to particular taxpayers when the department has incorrectly advised the particular taxpayer. That is not the case here. The circumstances relevant in those situations were different than the circumstances found in this case. The department made no

⁴ In Reserve National Insurance Co. v. U.S., 74-1 USTC ¶ 9486 (W.D. Okla. 1974) at 84,306, the court considered nearly identical contract language:

Within the territory above described soliciting agent shall be free to exercise his own judgement as to the persons from whom he will solicit insurance and the time and place of solicitation

The court found the agent to be an independent contractor, not an employee.

⁵ RCW 82.32.330 prohibits the Department from revealing facts or tax information of other taxpayers.

direct representation to the taxpayer that he was exempt from tax. We cannot grant similar relief to the taxpayer.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 30th day of May 1991.