Cite as Det. No. 98-008, 17 WTD 236 (1998)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 98-008
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 105: SERVICE B&O TAX -- JOINT VENTURE -- EXISTENCE OF -- FACTORS. The essential ingredients of a joint venture are (1) a contract, express or implied; (2) a common purpose; (3) a community of interest; and (4) an equal right to a voice accompanied by an equal right to control. In addition courts have also generally required a sharing of profits and losses.

[2] RULE 111: SERVICE B&O TAX -- MANAGEMENT CONTRACTS -- REIMBURSEMENTS -- RHO -- RPM 90-1. Where the paymaster company was the employer of record for state and federal agencies and exercised the majority of the control elements listed in RPM 90-1, the paymaster was found to be the employer of the workers and subject to tax on reimbursed payroll costs.

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:

A condominium rental company protests service and other business and occupation (B&O) taxes assessed on payroll expenses paid to on-site personnel. [1]

FACTS:

Okimoto, A.L.J. -- (Taxpayer) is a condominium rental company based in eastern Washington. Taxpayer's books and records were examined by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1992 through June 30, 1996. The audit

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

examination resulted in Taxpayer being assessed additional taxes and interest of $ . . . and Document. No. . . . was issued in that amount on November 1, 1996. Taxpayer protests the entire assessment and it remains due.

Schedule 2: Unreported Service Income.

In this schedule, Audit assessed additional service B&O taxes on income labeled as management fees on Taxpayer's books and records. Taxpayer acknowledges that it recorded this income as a management fee, but now argues that the fees were to reimburse Taxpayer for payroll costs attributable to employees of (HOA). Therefore, Taxpayer argues that it is merely a payrolling agent and the receipt of this income is a nontaxable advance and reimbursement. Taxpayer concedes, however, that for purposes of reporting federal withholding, state unemployment insurance, workman's compensation, and social security taxes, the workers are employees of Taxpayer. Taxpayer contends, however, that the employees are under supervision and control of the HOA resident manager and therefore are actually employees of HOA.

Taxpayer describes its business relationship with HOA in its petition as follows:

> [Taxpayer] serves as a reservation clearing center for condominium orders and cleaning services after temporary visitation. Rental periods range from daily to weekly.
>
> [Taxpayer] enters into agreements to provide services to several owner groups, [HOA] the single largest unit holder, has a check-in office and resident manager. At their request and under the resident manager's direction and supervision, [Taxpayer] is to staff the check-in desk.
>
> As compensation for this service, [Taxpayer], prepares annually, a projected cost of providing the services including labor and payroll taxes. [HOA] then negotiates the amount they are willing to pay based on the projected actual costs.
>
> The people are hired with the permission of [HOA]. The compensation rate and other costs are a function of the budget negotiation between [Taxpayer] and [HOA]. [HOA] determines the days and hours of work. [HOA] provides a manager and supervises the operation.

Taxpayer relies on WAC 458-20-111 (Rule 111) and Rho Company, Inc. V. Department of Rev., 113 Wn. 2d 561, 782 P. 2d 986 (1989) in support of its argument.

Taxpayer also contends that it is really a joint venture cost-sharing arrangement undertaken primarily for the convenience and protection of the HOA. We presume that Taxpayer further argues that the so-called management fees are actually nontaxable distributions from this joint venture.

ISSUES:

1) Should Taxpayer be taxed as a joint venture?

2) Are Taxpayer's payroll receipts management fees or exempt advances and reimbursements?

DISCUSSION:

[1] For discussion purposes, we will first address Taxpayer's joint venture argument. For Washington tax purposes, a joint venture is a separate "person" and each joint venture should be separately registered with the Department. RCW 82.04.030.

Black's Law Dictionary, Revised Fourth Edition, defines the term "joint venture" (synonymous with "joint adventure") to mean:

> A commercial or maritime enterprise undertaken by several persons jointly . . . An association of two or more persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill and knowledge. A special combination of two or more persons, where, in some specific adventure, a profit is jointly sought, without any actual partnership or corporate designation. It is ordinarily, but not necessarily, limited to a single transaction, which serves to distinguish it from a partnership . . .

(Citations omitted and emphasis added.)

The "common law" principles expressed by Washington's courts have identified the elements of a joint venture:

> The essential ingredients of a joint venture are (1) a contract, express or implied; (2) a common purpose; (3) a community of interest; and (4) an equal right to a voice accompanied by an equal right to control.

Gleason v. Metropolitan Mortgage, 15 Wn.App. 481, 493, 542 P. 2d 1260 (1976).

The courts have generally also included the requirement of sharing profits and losses.

> Additionally, there must be a sharing of profits and losses in order for there to be a joint venture. Knisely v. Burke Contract Accessories, Inc., 2 Wn. App. 533, 468 P.2d 717 (1970). However, the parties need not expressly agree to share the losses. Eagle Star Ins. Co. v. Bean, 134 F.2d 755 (9th Cir. 1943);

Refrigeration Eng'r Co. v. Mckay, 4 Wn.App. 963, 973, 486 P. 2d 304 (1971)

> And, where the parties engage in a joint enterprise and there is an agreement to share profits, the law will presume that they agreed to share losses also.

Skrivanich v. Davis, 29 Wn.2d 150, 186 P. 2d 364 (1947).

The Department has held joint venture tax status to be proper in limited circumstances.

> In summary, the tax consequences applicable to joint ventures are proper when: (1) the joint venture was specifically formed to perform the contract work, (2) the formation of the joint venture occurred before any of the work required by the contract had been undertaken, (3) the contract work was in fact performed by the joint venture, (4) the funds were handled as a joint venture rather than as separate funds of any party to the joint venture agreement, and (5) there is a contribution of money, property and/or labor so that any profit or loss incurred by the joint venture is proportionately shared by all joint ventures.

Det. No. 87-93, 2 WTD 411, 415 (1987).

Applying the above essential ingredients and circumstances to Taxpayer's case, we believe that Taxpayer has failed to establish the existence of a joint venture. We have examined the agreement . . . in effect during the audit period and conclude that the agreement does not show an intent by both parties to formulate a joint venture. On the contrary, the agreement seems to express HOA's intent to turn over the timeshare and rental management duties to [Taxpayer] for a 5% commission. This intent is evidenced in the agreement which states in part:

> B. The HOA desires to replace itself as operator of the on-site rental program, and to be relieved of certain other duties arising from the day-to-day operations of the condominium.
>
> C.[Taxpayer] desires to become the operator of the on-site rental program, and to be relieved of certain other duties arising from the day-to-day operations.

In addition paragraph 1 states:

> 1. Rental Program. To the extent it is within the control of the HOA and permitted by law, [Taxpayer] is hereby engaged as the exclusive operator of an on-site Rental Program for the Condominium units and time share interest in Condominium units ("units"). . . .

This conclusion is further supported by the contractual provisions delineating each parties obligations. Whereas HOA is only obligated to refer all rental inquiries to Taxpayer, Taxpayer is obligated, in essence, to managing the entire rental program. The agreement states in particular:

> 3. [Taxpayer] Program Obligations. [Taxpayer's] obligations under the Rental Program shall include the following:

(a) [Taxpayer] shall install and maintain a phone line at the sole expense of [Taxpayer]. . .

(b) [Taxpayer]. shall maintain accurate and complete books and records relative to the Rental Program . . .

(c) [Taxpayer] shall enter into written rental agreements with each unit owner whose unit is entered into the Rental Program:

(d) [Taxpayer] shall obtain written acknowledgments from each renter of a unit in the Rental Program under which that renter acknowledges and agrees that use of the unit is subject to the HOA Rules and Regulations for the Condominium.. . .

(e) [Taxpayer] shall provide an on-site rental agent at a minimum from (9:00 a.m. to 5:00 p.m. each day, . . .)

Accordingly, we find that the agreement evidences an intent to hire a company to manage the on-site rental program and does not create a joint venture.

Even assuming that there was intent to form a joint venture, its existence must still fail because it does not allow for a sharing of profits and losses. This fact is clear from the rental program agreement. Section 3(c) clearly and unequivocally states:

. . .The 5% required by HOA shall be paid by the 15th of the month following receipt. [Taxpayer] shall provide a monthly accounting to the HOA with said payment.

This 5% payment must be made regardless of whether the overall rental program is profitable or unprofitable. It is a fixed fee based on the amount of rent received. There is no provision for dividing profits or losses outside the 5% fee. We do not believe that splitting or allocating receipts between two parties can be considered a sharing of profits when there is no provision for allocating excess profits. Accordingly, we conclude that all profits and losses of the rental program are borne by Taxpayer, alone. Since there is no sharing of profits and losses, we find the agreement is not a joint venture. Therefore, Taxpayer's petition is denied on this issue.

[2] Nor do we believe Taxpayer is entitled to relief on the grounds that it is merely a payrolling agent. To determine whether payroll costs were the obligation of Taxpayer or HOA, we must first determine the actual employer of the employees involved. Normally, if the payer of the workers is also listed as the employer for federal withholding, social security, and other taxes, the Department will presume that the payer is the employer for state B&O taxes as well. However, a leading case in this area, Rho Company, Inc. v. Department of Revenue, 113 Wn.2d 561, 782 P.2d 986 (1989), provides that even if a payer is the employer of record for some state and federal taxes, it may be considered a mere payrolling agent for B&O tax purposes under certain limited situations. Whereas a true employer is subject to tax on all its receipts resulting from that worker's labor, a mere

payrolling agent may exclude employee salaries reimbursed to them by their clients and passed through to the workers pursuant to WAC 458-20-111(Rule 111).

To qualify for the exclusion, the payrolling agent must show that the client business exercised pervasive control over the employees. In RPM 90-1, issued after the Rho decision, the Department outlines the 10 factors of control that were considered in the Rho decision. If none of the factors of control exist in the paymaster, then the client (or in this case the homeowners association) will be considered the employer.

According to RPM 90-1, we must consider the following factors of control:

1. Ultimate decision as to hiring and firing the worker;
2. Ultimate decision as to duration of employment;
3. Setting the rate, amount, and other aspects of compensation;
4. Determining the worker's job assignments and instructions;
5. Exercising exclusive guidance and supervision over the work performed;
6. Evaluating the worker's performance;
7. Determining the days and hours of work performed;
8. Providing the office space or other controlled work premises;
9. Providing the tools and materials applied in the workplace;
10. Compensating workers for vacation time, sick leave, and insurance benefits.

After examining the sample contract submitted by Taxpayer and discussing these factors with Taxpayer's representative during the teleconference, we find that HOA does not exercise the necessary pervasive control over the employees as required by the Rho decision.

First, Taxpayer acknowledges that although the HOA resident manager may have some influence over front-desk employees, the initial hiring and firing decisions are performed solely by Taxpayer. Taxpayer also determines the duration of employment for specific employees. Taxpayer sets the rate, amount, and other aspects of compensation, though these rates will be indirectly affected by the annual fee structure negotiated with HOA. Job assignments and instructions are performed in a cooperative manner. HOA may determine some tasks that need to be done and will communicate those needs to Taxpayer, who in turn, assigns them to individual employees. Taxpayer states that guidance and supervision over the work performed by each employee is done by Taxpayer, although HOA has some indirect input. Taxpayer concedes that evaluations of the worker's performance is done solely by Taxpayer. Office space, tools and materials applied in the workplace are provided by HOA. Compensation for vacation time, sick leave, and insurance benefits are provided by Taxpayer.

Because control factors 1-7 and 10 are either exclusively or primarily exercised by Taxpayer, we find that the designation of Taxpayer as the employer of record for other state and federal taxes is also applicable for B&O tax purposes as well. We find that HOA does not exercise the required pervasive control necessary to overcome this designation. Accordingly, we find that Taxpayer is the employer of all front desk employees and other similar personnel. Receipts received by

Taxpayer for payroll expenses are properly taxed as income to Taxpayer. Taxpayer's petition is denied on this issue.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 30th day of January, 1998.