Cite as 5 WTD 67 (1988)

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

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	No. 88-28
. . .	)	Registration No. . . .
	)	Tax Assessment Nos. . . .

[1] **RULE 111:** ADVANCES/REIMBURSEMENTS -- COMMON PAYMASTER -- EMPLOYER/EMPLOYEE -- AFFILIATES. Where a taxpayer's affiliates are the actual employers and the taxpayer acts as common paymaster for the affiliates' employees, the taxpayer is a mere conduit for affiliates' payroll expenses. The amounts received by the taxpayer from the affiliates for that paymaster purpose constitute nontaxable reimbursements per Rule 111.

[2] **RULE 111:** SERVICE B&O TAX -- ADVANCES/REIMBURSEMENTS -- AFFILIATES -- LOANED SERVANTS -- CORPORATE OFFICERS IN AFFILIATED ENTITIES. Where a taxpayer is rendering services to affiliates by providing a loaned servant for the conduct of the affiliates' businesses, amounts received by the taxpayer in return from the affiliates is subject to Service B&O tax. Where taxpayer's two corporate officers who are its sole stockholders are also the principals in affiliated partnership and corporate entities, they are not deemed "loaned servants" when rendering services to the affiliated entities. The amounts received by the taxpayer for the benefit of and payment to the two principals are not subject to Service B&O tax.

[3] **RULE 111:** SERVICE B&O TAX -- ADVANCES/REIMBURSEMENTS -- LOANED SERVANT -- HIRED BY TAXPAYER -- SERVICES TO AFFILIATES. Where taxpayer hired a controller to do its accounting and controller also does the accounting work for taxpayer's affiliates, the amounts paid by the affiliates to the taxpayer for disbursement to the controller or on his behalf are deemed payment to the taxpayer for rendering services by providing a loaned servant to the affiliates for conduct of their

businesses. Such payments are subject to Service B&O tax.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF HEARING: April 23, 1987

NATURE OF ACTION:

Petition protesting assessment of Service B&O tax on amounts received by taxpayer-corporation from affiliated partnership entities and affiliated corporation under a cost sharing arrangement.

FACTS AND ISSUES:

Krebs, A.L.J. -- . . . (taxpayer) was engaged in the construction of and sales of condominiums. The taxpayer-corporation is owned by two stockholders, . . . , who are also officers. The taxpayer registered with the Department of Revenue in May 1976.

Because the taxpayer as a corporation experienced difficulty in borrowing from banks, the two stockholder-officers formed the following two partnerships in which they were the sole principals to carry out the business operations of the taxpayer. . . . was formed in January 1978 (Registration No. . . .) to build apartment houses. . . . was formed in January 1978 (Registration No. . . .) to build condominiums.

The taxpayer's principals also formed the . . . in January 1980 (Registration No. . . .) to do real estate brokerage and management services only for their partnerships, ...

The Department of Revenue examined the taxpayer's business records for the period from January 1, 1981 through June 30, 1985. As a result of this audit, the Department issued Tax Assessment Nos. . . . on January 20, 1987 (. . .) asserting excise tax liability in the combined amount of $ . . . and interest due in the amount of $ . . . for a total combined sum of $ . . . which has been paid in full.

The taxpayer seeks a refund of amounts paid for Service B&O tax assessed on an item recorded in the taxpayer's general ledger account number 7,000.98 as "allocated overhead" which represented amounts received by the taxpayer from its affiliates (. . .) to pay the salaries of the two principals, . . . , and costs of each

affiliate pursuant to a Cost Sharing Agreement dated August 5, 1980 by and between the taxpayer and its affiliates.

The Cost Sharing Agreement arranged for the following to occur:

> 1. A "splitting of the cost for operating" the affiliates "under the same roof."
>
> 2. The taxpayer is to be a "conduit for the purpose of cost sharing and volume purchases."
>
> 3. The taxpayer will not render any management or administrative services for the affiliates.
>
> 4. Each affiliate will pay for its own management and administrative services by allocating all funds expended by the taxpayer back to the other affiliates using the following formula: gross receipts of each affiliate divided by the combined gross receipts of all affiliates equals the percentage of funds expended by the taxpayer allocated to each affiliate.
>
> 5. The allocation of cost sharing is to be accomplished annually.
>
> 6. Even though the taxpayer may pay the bill from a third party, the ultimate responsibility for payment to third parties of any direct expense shall be that of the affiliate that incurred the expense (i.e.,insurance expense).
>
> 7. Any indirect expense shall be the responsibility of all the affiliates based on the above formula.
>
> 8. The accounting of all advances will be done monthly.
>
> 9. . . . , the real estate brokerage affiliate, will only act on behalf of real estate owned, constructed or acquired by the affiliates, ...
>
> 10. . . . will not conduct brokerage for third parties.
>
> 11. In order to share costs and simplify procedures, . . . may cause persons to perform landscaping, maintenance and repair activity at the request of the affiliates. The payment for this work is the sole responsibility of the affiliate requesting the work.

Annually, the Cost Sharing Agreement is formalized by an agreement. The taxpayer submitted a representative agreement dated December 31, 1984 and executed by the taxpayer and its affiliates (. . .) . The annual agreement indicates additionally the following:

1. The affiliates are obligated to provide the taxpayer with sufficient funds to pay for their respective payrolls and to reimburse the taxpayer for any funds advanced by the taxpayer for salaries and other compensation due the officers, employees and/or partners of the affiliates for services rendered by them to the related affiliates.

2. The taxpayer is not liable for the salaries and compensation due the persons mentioned in number 1 above. The affiliates are solely liable.

3. The taxpayer has the right to be reimbursed for any advances made on behalf of the affiliates.

4. The taxpayer will not receive any benefit or value for services rendered to the affiliates.

5. The taxpayer acts as agent for the affiliates in making payments with the expectation of being reimbursed.

6. From time to time, the taxpayer may issue payroll checks to the principals, . . . , for services which are the obligation of the related affiliates. The sums will be allocated among the related affiliates based upon the Cost Sharing Agreement.

The taxpayer asserts that in effect it served as a clearing house and common paymaster for payment of the obligations incurred by the various affiliates.

The taxpayer protests the assessment of Service B&O tax on the amounts received by the taxpayer and designated by it as "allocated overhead" for the following reasons:

1. The taxpayer does not fall within the definition of "business" as defined in RCW 82.04.140. No management fee was charged by the taxpayer. No benefit or advantage was realized by the taxpayer in paying the allocated expenses.

2. The allocated costs paid by the affiliates were not income to the taxpayer. The taxpayer served as a conduit for payment of the expenses of the affiliates. The allocated charges to the affiliates were advances and reimbursements as defined in WAC 458-20-111 (Rule 111).

The issue is whether the taxpayer's receipt of money under the foregoing cost sharing arrangement is B&O taxable.

DISCUSSION:

Where amounts included in the "allocated overhead" account were reimbursements by the affiliates to the taxpayer for advances made by the taxpayer as payments to third parties on charges for which the taxpayer had no liability to pay, the auditor excluded the reimbursement amounts from being subject to the B&O tax. Thus, the auditor recognized such amounts as being within Rule 111's "advance and reimbursement" situation and not subject to B&O tax.

However, salaries and other payroll expenses of the affiliates were not recognized by the auditor as being amounts received by the taxpayer under a nontaxable "advance and reimbursement" situation.

The taxpayer has two principals, . . . , who actively engaged in the business operations of the affiliates (. . .) owned by them. The taxpayer as a corporate entity did not provide any goods or services to the affiliates other than performing as a "clearing house" under the Cost Sharing Agreement dated August 5, 1980 (See Facts and Issues part of this Determination) and as a common paymaster in disbursing payroll and other compensation benefits to the officers and employees of the affiliates for services rendered by them to their respective affiliate-employers. The taxpayer performed the "clearing-house" functions and common paymaster services in its name but the costs (bookkeeping, mailing, checkwriting, etc.) were borne by the affiliates under the Cost Sharing Agreement.

The corporate taxpayer and its affiliates shared the same office. Each affiliate hired and fired its own employees as needed. The bookkeeper employed by . . . , the real estate brokerage affiliate, did the bookkeeping and clerical work required by the "clearing house" operation and common paymaster services done in the name of the taxpayer. The cost of the bookkeeper's services was shared by the affiliates under the Cost Sharing Agreement.

The corporate taxpayer hired a controller in 1984 who did accounting work for the taxpayer and its affiliates. A typewritten statement of the controller, . . . , submitted by the taxpayer reads as follows:

> During 1984 through 1987 I worked as the controller for . . . [taxpayer], . . . , [and the affiliates].
>
> I was always aware that payments received by me as salary were the liability of the appropriate entity even though payment was secured through . . . [taxpayer].
>
> . . . was merely a conduit for accomplishing that goal. (Bracketed words supplied.)

[1] and [2]. The taxpayer has referred to Determination No. 86-234 (1 WTD 103) as ruling on a similar situation, that is, with respect

to "amounts received" from a taxpayer's "affiliate as reimbursement for payroll expenses." We adopt the rationale of that Determination. The Determination in pertinent part stated:

> To determine whether the tax is due, it is necessary to decide who in fact is the employer of the employees in question. If the taxpayer is the employer, then the taxpayer is rendering services to the affiliate by providing loaned servants for the conduct of the affiliate's business. Amounts received from the affiliate in return would be subject to Service and Other Activities B&O tax. Valley Cement Construction, Inc. v. Department of Revenue, Docket No. 71-70 (1973).
>
> On the other hand, if the affiliate is the employer and the taxpayer's sole function is to act as a paymaster, then the taxpayer is merely a conduit for payment of the affiliate's own payroll expenses and amounts received for that purpose are nontaxable reimbursements (see WAC 458-20-111).
>
> . . .
>
> A key consideration in determining who was the actual employer rests with an analysis of who controlled or had the right to control the activities of the employees. The element of control includes the right to hire, fire and supervise the physical performance of the individual employees.

In this case, the taxpayer's president, . . ., testified that the corporate taxpayer hired the controller but all other employees (bookkeepers, supervisors, real estate salespersons, and real estate managers) were hired as needed by the affiliates. The taxpayer's two principals, . . ., are the partners in the . . . partnerships. They are also the corporate officers and sole stockholders of . . . corporation. As partners in . . ., they cannot be deemed employees but rather as employers. Thus, they cannot be considered as the taxpayer's loaned servants to the partnerships for conduct of the affiliates' business. Similarly, when they conduct the taxpayer's corporate business and the business of the affiliate corporation, . . ., we do not believe that the taxpayer should be considered to have loaned its servants to the affiliate corporation. Rather, we view the situation as one where . . . individually exercised his prerogative by his status in each corporation to serve one corporation or the other. Because the principals and the affiliates' employees were not taxpayer's loaned servants to the affiliates, amounts received by the taxpayer as common paymaster on their behalf from the affiliates are not subject to Service B&O tax.

[3] However, with respect to the controller, . . ., who was hired by the taxpayer, we find that he is an employee of the taxpayer who is loaned to the affiliates to do their accounting work. He also did the accounting work for the taxpayer. We view the controller's work for the taxpayer to be primarily intended to coordinate and report the financial activities of the affiliates for the benefit of the taxpayer in filing its tax returns, maintaining a Pension & Profit Sharing Program, and in establishing a medical and dental program. We also believe that since the taxpayer hired the controller, the taxpayer had the right to fire the controller and supervise him. It is not conceivable that any of the affiliates could fire the controller and that he would remain employed by the taxpayer or be used by the other affiliates. Therefore, any amounts received by the taxpayer from the affiliates for the services of the controller are properly subject to the Service B&O tax.

DECISION AND DISPOSITION:

The taxpayer's petition is substantially granted and denied in part. All amounts received by the taxpayer from its affiliates and designated as "allocated overhead" are exempt from Service B&O tax except the portion received by the taxpayer as compensation for its loaned servant, the controller. The file is being referred to the Department's Audit Section for computation of the amount of the refund, including statutory refund interest, in line with the holding of this Determination and authorization of the issuance of the appropriate refund to the taxpayer.

DATED this 12th day of February 1988.