Cite as Det. No. 01-121, 21 WTD 90 (2002)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Refund of	)	D E T E R M I N A T I O N
	)	No. 01-121
. . .	)	Registration No. . . .
	)	Docket No. . . .

RULE 111: B&O TAX – GROSS INCOME – ADVANCE & REIMBURSEMENT – CONSULTANTS -- INDEPENDENT THIRD-PARTY CONTRACTORS -- PAYMASTER. A Rule 111 pass-through was not allowed where a consultant was hired by clients to provide business consulting services, actually performed some of those consulting services himself, and billed clients in his own name for all consulting services provided.

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 business consultant petitions for a refund of overpaid business and occupation (B&O) on consulting fees earned from services performed by its associates.[1]

FACTS:

Okimoto, A.L.J. -- . . . (Taxpayer) is a business consultant who conducts seminars and provides executive consulting services throughout the United States . . . . Taxpayer operated his business as a sole proprietorship out of his home in Washington during the refund period. Taxpayer subsequently moved his home and business to Oregon in 1997.

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

Taxpayer originally filed amended returns covering the period 10/1/93 through 3/31/97 on July 16, 1997. Taxpayer sought a deduction for consulting services performed outside the state of Washington in accordance with WAC 458-20-194 (Rule 194). After considerable correspondence with the Department's Taxpayer Account Administration Division (TAA), TAA denied Taxpayer's refund by letter dated September 7, 2000. Taxpayer timely appealed the denial to the Department's Appeals Division (Appeals). Taxpayer later modified his request, to seek a ruling that amounts received by Taxpayer for services performed by independent consultants were exempt advance and reimbursements under WAC 458-20-111 (Rule 111).

Taxpayer explained during the hearing that he did not have a formal partnership agreement with Mr. . . . or any of the other co-consultants, but only worked on an informal basis. If a client wanted consulting services, the client would normally contact Taxpayer, because he was more involved in the marketing side of the business. Taxpayer would then contact Mr. . . . or other associates to work out the details. Taxpayer states that some clients would contact Mr. . . . initially, in which case, Mr. . . . would contact Taxpayer to work out the details of the seminar.

Taxpayer describes his business activities in his petition as follows:

> Taxpayer did not have employees. When more than one consultant was needed by the client because of multiple locations of the client or otherwise, taxpayer would enlist the services of other independent contractors to do much of the consulting/training, most of whom did not reside in Washington State. Taxpayer's clients authorized taxpayer, as their agent, to engage these independent contractors on behalf of the respective client. As a matter of administrative convenience for the client companies which engaged the services, taxpayer allowed those companies to pay him, not only for his services, but as a nominee of these other independent contractors. Taxpayer did not charge anything for the services of these independent associates and retained none of the funds which he received as a mere nominee for their benefit. In other words, taxpayer did not even retain anything to cover his overhead in this regard, but was merely a nominee or paymaster for the convenience of these client companies.

Taxpayer has also submitted signed statements from two co-consultants stating that it was their understanding that the relationship between the co-consultant and Taxpayer was one of two separate independent consultants working with clients together, and not as Taxpayer's employee or subcontractor.

Taxpayer also submitted a copy of a sample invoice. For seminars, Taxpayer would bill the client on a single invoice listing charges for each consultant as follows:

Service:	. . . Training…	
Dates:	April 20-24, 1997; . . .	
	April 15, 1997; . . .	
Fee:	[Mr. B]	. . .
	[Mr. W]	. . .

[Mr. C]	. . .
[Mr. L]	. . .
Expenses: (Travel, room, board, etc.)	. . .
Total	$ . . .

The invoice was billed to each client with instructions to remit payment to: [Taxpayer]. During the refund period, Taxpayer reported all income received, including those amounts received for services performed by independent contractor consultants.

TAXPAYER'S CONTENTIONS AND ARGUMENTS:

Taxpayer makes the following arguments in its petition.

First, Taxpayer argues that the monies Taxpayer received from clients for remittance to independent third-party consultants were exempt advances under WAC 458-20-111 (Rule 111) and therefore excludable from Taxpayer's income.

Second, Taxpayer argues that it acted only as a paymaster in respect to fees received from clients for services performed by independent third-party consultants. Taxpayer states that he only received the money as a convenience for the clients and the independent third-party consultants. In addition, Taxpayer contends that he satisfies the 10 elements of being a paymaster outlined in Revenue Policy Memorandum 90-1 (RPM 90-1).[2]

Finally, Taxpayer argues that he is entitled to apportion his income to other states pursuant to WAC 458-20-194 (Rule 194).

ISSUES:

1) Should monies received by Taxpayer for payment of services performed by independent consultants be included in Taxpayer's gross income?

2) If the receipts must be included in Taxpayer's gross income, may they be apportioned to other states?

[2] Reissued July 1, 1998 as Excise Tax Advisory (ETA) 90-001.

DISCUSSION:

RCW 82.04.290(1) imposes a B&O tax under the selective business services tax classification:[3]

> Upon every person engaging within this state in the business of providing selected business services other than or in addition to those enumerated in RCW 82.04.250 or 82.04.270; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 2.5 percent.

RCW 82.04.055(1)(h) defines "selected business services" as including "Business consulting services." In this case, Taxpayer is engaged in providing business consulting services and therefore taxed under the selected business services tax classification on its gross income of the business.

RCW 82.04.080 defines "gross income of the business" as:

> . . . 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 tangible property sold, 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.

The Department recently addressed whether receipts paid to one consultant for services performed by a co-consultant should be included in the gross income of the first consultant's business. In Det. No. 99-126, 19 WTD 94 (2000) an employee-placement consultant matched qualified professionals with job openings offered by law firms and other professional businesses. The consultant usually matched and placed the employee on his own and reported 100% of that income. In some situations, however, the consultant would work with another independent consultant to fill the positions and if the placement was successfully completed, the first consultant would receive the entire payment and pay the joint consultant his/her share. The first consultant reported all of his receipts and then took a deduction for the amounts paid to the other independent consultant. The consultants had some written agreements memorializing their fee splitting arrangements.

That determination relied on the Washington Board of Tax Appeals' discussion of the "pyramiding" nature of Washington's B&O tax and the application of Rule 111 contained in *Mills & Uchida Court Reporting, Inc. v. Department of Rev*, Docket No. 46110 (BTA 1996). Mills & Uchida (The Corporation) was a corporation whose two principals and its employees

[3] The selected business services tax classification expired on July 1, 1998 and is no longer in effect. It was in effect during the entire refund period, however. The above quoted version of the statute was in effect from 1993 through 1995.

provided court-reporting services and also entered into arrangements with independent court reporters to provide services for clients. The Corporation reported 100% of fees earned by its employees and independent contractors, but then deducted from its gross income the portion of the fee paid to the independent contractors (65%). In effect, the Corporation paid tax on only the 35% of the fee retained as its share, which is similar to Taxpayer's argument. The Corporation also argued that it acted solely as an agent in procuring court reporter services for attorneys. The Board applied the three-part Rule 111 test established by courts in *Christensen, O'Connor, Garrison, & Havelka v. Department of Rev*., 97 Wn. 2d 764, 649 P.2d 839 (1982), and *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Department of Rev*., 103 Wn.2d 183, 691 P.2d 559 (1984), for determining whether receipts were exempt "pass-throughs." This test requires that in order to be exempt advances and reimbursements, the payments must satisfy the following requirements: (1) repayments must be customary reimbursements for advances made to procure a service for the client; (2) repayments must involve services that the taxpayer did not or could not render; and (3) the taxpayer must not be liable for the initial payments.

In applying the test, the Board rejected the corporation's claim and distinguished the case from the *Christensen*, and *Walthew* cases because the attorneys in those cases were uniquely required by their Code of Professional Responsibility, to only procure the additional third-party services solely as agent of the client. The Board then went on to point out that this was not true with the Corporation because it was in the business of providing the same court reporter services that it subcontracted out to independent third-party court reporters. Nor, was the Corporation required by rules of professional conduct to procure the services solely as agent.

In rejecting the Corporation's arguments, the Board stated:

> The service that Mills & Uchida provides is that of procuring and scheduling reporters for attorneys. Mills and Uchida's income is dependent upon the services of the reporters. The payments did not involve services that Mills & Uchida did not or could not render as was the case in Walthew and Christensen . . . . Clearly, Mills & Uchida's business is offering court reporting services . . . .
>
> Mills & Uchida's version of the exemption would characterize revenue generated by subcontractor work as "pass-throughs." We decline to make that leap. Mills & Uchida is not prevented from hiring reporters as employees to provide court reporter services. The fact that Mill & Uchida chooses to subcontract some of its work to independent reporters does not change Mills & Uchida's customer relationship with attorneys. Such a conclusion would mean that any business who uses subcontractors could qualify subcontractor work as a "pass-through" if it had an agreement that it was not liable when the customer failed to pay.

We similarly find the Board's analysis in *Mills* to be persuasive. First, the payments from the clients to Taxpayer were not customary reimbursements for advances made to procure a service for the clients. The clients contracted with Taxpayer for consulting services and paid Taxpayer all fees for those consulting services. Second, the payments from clients involved services that

Taxpayer did and could render. Like *Mills*, Taxpayer is in the business of offering consulting services and did provide large portions of those services. Finally, Taxpayer is not liable to pay the other consultants as a mere paymaster. We find that Taxpayer collected fees in his own name for services he contracted to and did render to clients. In part, Taxpayer rendered those services by contracting with independent consultants. As the Board stated in *Mills*, using independent contractors rather than employees does not change Taxpayer's relationship to his clients.

We further find Taxpayer's reliance on RPM 90-1 to be misplaced. The ten control factors contemplated by that memorandum are to be utilized to determine whether certain workers are employees of an employee placement company or employees of the client. Taxpayer is not an employee placement company. He is a consulting company, and his clients contract with Taxpayer to provide consulting services. Whether Taxpayer provides those services through employees or independent contractors is irrelevant. Since, we find that Taxpayer was responsible for providing the consulting services and did so, all income received must be included in Taxpayer's gross income.

Out-of-state Apportionment:

Washington is able to tax gross receipts from those activities which occur wholly within its borders. *Department of Rev. v. Association of Washington Stevedoring Co*., 435 U.S. 734 (1978). The corollary is that Washington may not tax gross receipts from activities that occur outside its borders. *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1938). Thus, in those cases where an entity engages in business both within and without the state, Washington must apportion gross receipts. RCW 82.04.460 states:

> (1) Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of his total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

WAC 458-20-194 (Rule 194) is the lawfully promulgated rule implementing the above statute. It states in part:

> Persons engaged in a business taxable under the service and other business activities classification and who maintain places of business both inside and outside this state which contribute to the performance of a service, shall apportion to this state that portion of gross income derived from services rendered by them in this state. Where it is not practical to determine such apportionment by separate accounting methods, the taxpayer shall apportion to this state that proportion of total income which the cost of doing business within this state bears to the total cost of doing business both within and without this state.

The Department recently issued Det. No. 01-006, 20 WTD 124 (2001), explaining its position on apportionment, and TAA has not had an opportunity to consider Taxpayer's arguments in light of those explanations. Accordingly, we remand Taxpayer's petition to TAA for a recomputation, if any, of the apportionment factors pursuant to the guidelines set forth in 20 WTD 124 (2001).

DECISION AND DISPOSITION:

Taxpayer's petition is denied on the paymaster/inclusion issue and the file shall be remanded to TAA for consideration of the apportionment issue.

Dated this 29th day of August, 2001.