Cite as Det. No. 03-0148, 23 WTD 90 (2004)

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. 03-0148
. . .	)	
	)	Registration No. . . .
	)	. . . /Audit No. . . .
	)	Docket No. . . .

[1] RULE 111: B&O TAX -- GROSS INCOME -- ADVANCE & REIMBURSEMENT -- SHARED EMPLOYEES. A corporation that reported all administrative workers as its employees for purposes of unemployment insurance, federal payroll taxes and workers' compensation claims, was not allowed to exclude reimbursed payroll costs received from its affiliates for services the workers performed for the affiliates. The employing corporation was found to be the sole contractual employer of the shared employees.

[2] RULE 111: B&O TAX -- GROSS INCOME -- ADVANCE & REIMBURSEMENT -- ALLOCATED OVERHEAD EXPENSES. A taxpayer that paid for overhead expenses may only exclude amounts billed to and received from affiliates as advance and reimbursements under Rule 111 if the taxpayer contracted for the goods and services solely as agent of the affiliate. In this case the taxpayer contracted for the goods and services solely in its own name and was not allowed the exclusion.

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.

Okimoto, A.L.J. – A corporation engaged in the business of hauling interstate freight protests the assessment of business and occupation taxes (B&O) on amounts allocated and billed to affiliated corporations for payroll costs and overhead charges. We sustain the assessment.[1]

ISSUES

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

1) May the principal corporation exclude from its gross income amounts billed to affiliated corporations for their share of payroll costs?

2) May the principal corporation exclude from its gross income amounts billed to affiliated corporations for their share of overhead costs?

FINDINGS OF FACT

. . . (Trucking) is an interstate trucking company based in . . . , Washington. It operates throughout the lower 48 states. Trucking's books and records were examined by the Audit Division (Audit) of the Department of Revenue (DOR) for the period January 1, 1997 through December 31, 2000. As a result of that examination, additional taxes and interest were found owing in the amount of $ . . . , and Doc. No. . . . was issued in that amount on October 2, 2001. Trucking made partial payment of the unprotested portion of the assessment, and the balance remains due.

Trucking, . . . and [two affiliates] are all separately incorporated entities licensed to do business within this state. All are corporations whose primary business purpose is the movement of freight in interstate commerce for hire. All share a common building, a common office space, and a common telephone system. Trucking is the principal business entity and initially incurs all administrative and payroll expenses. These include payroll costs, office and information system expenses, and facility expenses. Trucking reported all administrative and workers as its employees to the Department of Labor and Industries (L&I), Department of Employment Securities (ES), and the Internal Revenue Service (IRS). In addition, all vendors invoice Trucking directly for rent and other administrative and overhead expenses. Affiliates are billed in the following manner. On January 9, 2001, Trucking sent an invoice/worksheet to . . . and charged it a pro-rated amount designated as ". . . Admin For Dec. 2000." The pro-rated administration charge was based on the affiliate's gross sales during the previous month. Trucking did not bill out all administrative expenses, however, but only those that the affiliate actually utilized.

The protested portion of the audit involved Schedule 2 and Schedule 3:

Schedule 2 – Selected Business Services Tax[2] on Administrative Charges to [affiliates]

In this adjustment, Audit assessed selected business services B&O taxes measured by amounts Trucking billed its affiliate for salaries and related costs, which it paid to accounting personnel and workers when they performed services for the affiliates.

[2] The selected business services tax classification expired on July 1, 1998. After that date, Audit assessed B&O taxes under the service and other activities Tax classification in Schedule 3.

Schedule 3 – Service and Other Activities Tax on Overhead Expenses Charged to Affiliates and Post July 1, 1998 Administrative Charges

In this adjustment, Audit assessed service and other activities B&O taxes measured by amounts Trucking billed the affiliates for salaries and related costs paid to accounting personnel and workers for periods after the expiration of the selected business services tax classification. In addition, Audit assessed service and other activities B&O taxes measured by amounts charged to affiliates for expenses incurred by Trucking at the single building occupied and shared by all three entities. These overhead expenses included rent, telephone, utilities, building repairs, laundry, office supplies, and automobile expenses. Trucking billed only those shared expenses that were actually utilized by each affiliate. Expenses were allocated and billed to each affiliate pro rata, based on the previous month's sales of each affiliate.

ANALYSIS

The B&O tax is imposed for the privilege of engaging in business and is measured by the gross income of a business.[3] RCW 82.04.220. Normally, any value proceeding or accruing to a business must be included in the measure of the business's B&O tax. RCW 82.04.080. Affiliated corporations are each a "person" within the meaning of Washington's Revenue Act, and, in general, transactions between them are fully subject to the B&O tax. RCW 82.04.030 and WAC 458-20-203 (Rule 203). In this case, Taxpayer allocated some of its own administrative and payroll expenses to its affiliated corporations and charged them for these expenses. These charges fall within the broad definition of gross income of the business[4] and must be included in the measure of the B&O tax unless exempted by statute or rule.

While RCW 82.04.080 does not allow a business to deduct its expenses from the measure of the tax, DOR has recognized that some funds that pass through a taxpayer's hands fall outside the definition of "gross income of the business," and may be excluded from the measure of the tax. DOR adopted WAC 458-20-111 (Rule 111), which allows a taxpayer under limited circumstances, to exclude amounts received from a client solely for the payment of the client's obligation to a third party.

Rule 111 provides in part:

> 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 therefor, either primarily or secondarily, other than as agent for the customer or client.

[3] Depending on the particular activity, the B&O tax may be measured by value of products or gross proceeds of sales.

[4] RCW 82.04.080 defines the term "Gross income of the business" to mean: "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, . . . 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."

> 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. (Underlining added.)

Allocation of Shared Employee Costs to Affiliates

DOR has interpreted Rule 111 in a number of decisions involving employers who shared employees. Some involved affiliated companies. Under Rule 111, the amounts Trucking allocated to its affiliates for their shares of the common employees' compensation may be excluded as "reimbursements" only if Trucking had no personal liability for the payment, either primarily or secondarily, other than as agent for the affiliates. Furthermore, DOR has consistently held that Rule 111 is inapplicable when the taxpayer is the sole contractual employer and is rendering services to the affiliates by providing loaned servants for the conduct of the affiliates' businesses. *See* Det. No. 91-211, 11 WTD 395 (1992), Det. Nos. 85-308A and 86-20A, 1 WTD 415 (1986), Det. No. 87-340, 4 WTD 221 (1987), and Excise Tax Advisory No. 90.04.203 (ETA 90). If the taxpayer is the sole contractual employer, it is taxable on portions of the employee compensation that it allocates to affiliates even if each employee knows that he or she is working for the affiliate, each employee was hired through a joint effort of the affiliated companies, and supervision is performed by the affiliate's personnel when the employee is performing tasks for that affiliate. Det. No. 91-339, 11 WTD 535 (1991); s*ee also, City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 60 P.3rd 79 (2002).

In this case, based upon a preponderance of evidence, we conclude that Trucking was the sole contractual employer. Trucking was listed as the employer of record for other governmental agencies, including; the IRS for social security and federal withholding taxes, ES for state unemployment insurance, and L&I for work[ers'] compensation insurance. Normally, if the payer of the workers is also listed as the employer of record for other taxes, DOR will presume that the payer is the employer for state B&O taxes as well. Det. No. 98-008, 17 WTD 296 (1998). In this case, Taxpayer allocated payroll expenses based on each affiliate's gross receipts during the previous month and not based on the actual amount of time each employee spent on an affiliate's business. We conclude that Trucking was merely recovering the part of its own payroll costs that it incurred when its employees performed services for the affiliates. It was not a joint payroll arrangement. Consequently, we conclude that Trucking was the sole contractual employer and the amounts received from [the affiliates] were properly subjected to the B&O taxes. Det. No. 91-339, *supra*.; Det. No. 91-211, *supra; William Rogers Co., supra*.

Allocation of Overhead Expenses

A taxpayer may only exclude amounts billed to and received from affiliates as advance and reimbursements under Rule 111 if the taxpayer contracted for the goods and services used by the subsidiary or affiliate solely as agent of the subsidiary or affiliate. *William Rogers Co. supra.*

In Trucking's case, the goods and services were contracted only in Trucking's name. The sharing was merely an arrangement between Trucking and the affiliates. We find no evidence that the vendors understood and agreed that anyone other than Trucking was liable for any portion of the expenses. Therefore, we conclude that Trucking was solely and primarily liable for all overhead costs, including rent, telephone, utilities, building repairs, laundry, office supplies, and automobile expenses. Because Trucking was primarily liable for these expenses, amounts received by Trucking from its affiliates do not qualify for exclusion from gross income as an advance and reimbursement under Rule 111. *Id.* Trucking's petition is denied on this issue.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of April 2003