

Cite as Det. No. 99-119, 19 WTD 249 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 99-119
)	
...)	Registration No. ...
)	FY ... /Audit No. ...
)	
)	

[1] RULE 105 AND RCW 82.04.360: EMPLOYEES AND INDEPENDENT CONTRACTORS DISTINGUISHED – CRITERIA. The Department of Revenue does not find a person to be either an employee or an independent contractor on the existence of any one criterion in Rule 105. Instead, the Department of Revenue considers all the criteria and the facts in each case.

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:

The taxpayer appeals a tax assessment for business and occupation (B&O) tax, penalties and interest assessed on commissions earned but not reported. The taxpayer claims he was an employee and was not subject to B&O tax.¹

FACTS:

Gray, A.L.J. -- The Department of Revenue (Department) Audit Division issued a partial assessment for unreported business income the taxpayer received for the period January 1, 1995 through December 31, 1996. The taxpayer was discovered by the Department during a routine review of another, affiliated business' records covering the period January 1993 through December 1996. The taxpayer was the president of this other business, a corporation.

Upon the Department's request for records, the taxpayer submitted a "1099" for 1995 and for 1996, as proof of income for those years. The taxpayer received the 1099s² from an unrelated

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

company, which began doing business in April 1995 and, for which, according to the taxpayer, he was an employee.³ Prior to this period, the taxpayer had engaged in business in Washington, operating under two corporations and one sole proprietorship, all of which were closed in December 1994.

At the hearing, the taxpayer stated that he was an employee of the mortgage company, which issued the 1099s. The taxpayer explained, however, that the mortgage company did not withhold social security or federal income tax from his pay, and did not pay employment security or industrial insurance taxes to the Employment Security Department or Department of Labor & Industries, respectively. The mortgage company did not give the taxpayer an IRS W-2. The mortgage company provided the office equipment for his use. The mortgage company did not set office hours for him, although he customarily was at the office between 8:00 AM and 6:00 PM. The mortgage company provided loan packages that he, in turn, presented to customers. The mortgage company reviewed his work and corrected any errors that he made. His customers were obligated to pay the mortgage company, not the taxpayer, for the services rendered.

The taxpayer supplied a sample of a “commission paysheet” which the taxpayer received with his paychecks. The sample identifies the taxpayer as the “loan officer,” the amount of the loan fees and total commission, the amount of B&O tax withheld from the total commission, and the net commission (gross commission less the B&O tax). The taxpayer states that because the B&O tax was withheld from the commissions the company paid him, the Department erred in assessing B&O tax based on the 1099s he received from the company. The taxpayer did not provide any evidence of the mortgage company’s B&O payment on his behalf. Further, the taxpayer did not provide the Audit Division with any documentation supporting his contention that he was employee and not engaged in the business of doing appraisals as an independent contractor.

The Department’s records reveal that the taxpayer was engaged in business beginning in the first quarter of 1993 through the 3rd quarter of 1994, as a sole proprietor. The taxpayer states his business was unsuccessful and in 1995, he became an employee of the mortgage company. The taxpayer states he had a contract with the mortgage company but it did not contain a non-competition clause.

According to notations in the Department’s records, the [department] requested, on April 5, 1995, that his account be closed. However, earlier notations indicate that the taxpayer’s sole proprietor account was closed effective December 31, 1994. Two other accounts, cross-referenced to taxpayer, were also closed effective December 31, 1994. These two accounts were corporations of which the taxpayer was a principal. In 1997, the Department initiated an audit of one of the closed corporations of which the taxpayer was president. When asked for records for

²Generally, a “form 1099” is an annual federal tax form that records miscellaneous income which a business has paid an individual (other than an employee) or a sole proprietorship or partnership for goods or services. In contrast, a “W2” is an annual IRS form an employer gives an employee reporting salary (income) paid.

³But see, the taxpayer’s petition received by the Appeals Division on November 24, 1997, in which he wrote that he was an independent contractor and that the company paid the B&O tax on his commissions.

1993 through 1996, the taxpayer provided the Department the 1099s, referenced above. The Department reactivated the taxpayer's sole proprietorship account and assessed B&O tax, penalties and interest because the taxpayer had not reported this income for 1995 and 1996. Subsequent notes, however, indicate the Department reactivated the account when it decided taxpayer had been engaged in business during 1995 and 1996. Finally, the notes say the account should not have been closed.

The auditor's notes disclose that the taxpayer did not provide any records to show that he was not actively engaged in business as a sole proprietor in 1995 and 1996, and to refute the Department's position that the income [reflected on the] 1099 was for services rendered as an independent contractor, not an employee. The auditor also noted that the taxpayer had reported his 1993 and 1994 income under the financial business classification. The audit presumes the accuracy of these returns absent any evidence to the contrary. Because the taxpayer did not produce any other information to the Department, the assessment is limited to the 1995 – 1996 period, subject to future adjustment. Taxpayer also requested a possible small business credit. This request was denied by the Audit Division because the taxpayer did not provide any documents from which the Department could determine whether the taxpayer was entitled to receive a credit

ISSUE:

Whether the taxpayer is engaged in business an independent contractor whose gross income would be subject to service . . . B&O tax or as an employee whose income would not be subject to B&O tax.

DISCUSSION:

The B&O tax is imposed on every person⁴ who engages in business⁵ in Washington. RCW 82.04.220. Employees are specifically exempted from the B&O tax, but independent contractors are specifically included as subject to the B&O tax. RCW 82.04.360. There is no definition of "employee" or "independent contractor" in Title 82 RCW for excise tax purposes.⁶ The Department promulgated WAC 458-20-105 (Rule 105) to provide guidance to the public and to Department employees in the administration of RCW 82.04.360 and the B&O tax generally. Rule 105 contains criteria to be used to determine "employee" or "independent contractor" status, but Rule 105(2) cautions:

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

⁴ RCW 82.04.030.

⁵ RCW 82.04.140; .150.

⁶ The Revised Code of Washington contains several definitions of "employee," "employer," and "employment" for various purposes. For example, RCW 49.17.020(5) (WISHA); 50.04.100 ("employment" for unemployment compensation); 51.08.185 (industrial insurance).

details and means by which the work is accomplished. In cases of doubt about employee status all the pertinent facts should be submitted to the department of revenue for a specific ruling.

The Department looks to the employer's right, or the absence of the right, to control the employee as the most significant factor in determining whether a person is an employee or an independent contractor.

Rule 105(3) sets forth criteria to be used to determine whether a person is an independent contractor:

(3) **Persons engaging in business.** The term "engaging in business" means the act of transferring, selling or otherwise dealing in real or personal property, or the rendition of services, for consideration except as an employee. The following conditions will serve to indicate that a person is engaging in business.

If a person is:

- (a) Holding oneself out to the public as engaging in business with respect to dealings in real or personal property, or in respect to the rendition of services;
- (b) Entitled to receive the gross income of the business or any part thereof;
- (c) Liable for business losses or the expense of conducting a business, even though such expenses may ultimately be reimbursed by a principal;
- (d) Controlling and supervising others, and being personally liable for their payroll, as a part of engaging in business;
- (e) Employing others to carry out duties and responsibilities related to the engaging in business and being personally liable for their pay;
- (f) Filing a statement of business income and expenses (Schedule C) for federal income tax purposes;
- (g) A party to a written contract, the intent of which establishes the person to be an independent contractor;
- (h) Paid a gross amount for the work without deductions for employment taxes (such as Federal Insurance Contributions Act, Federal Unemployment Tax Act, and similar state taxes).

Rule 105(4) contains the criteria for determining whether a person is an employee:

(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 taxpayer asserts that he does not owe B&O tax because he was an employee for 1995 and 1996. Rule 105 lists the criteria that should be considered and weighed in determining whether a person is an employee or an independent contractor.

Considering the evidence that was presented, we find the taxpayer was an independent contractor. The burden of proof to show entitlement to a deduction or an exclusion from tax is on the taxpayer. Det. No. 93-191, 13 WTD 344 (1994). The taxpayer has not submitted any evidence to support his position. The taxpayer apparently had a written contract, but no copy was provided to the Department. The taxpayer's only evidence of income are the 1099s. The taxpayer did not provide tax returns, including any schedule Cs, filed with the Internal Revenue Service. The Audit Division found, and the taxpayer does not contest, that the mortgage company reported the taxpayer's annual pay on form 1099s, which is indicative of an independent contractor relationship. The mortgage company did not treat the taxpayer as an employee with regard to the IRS, the Employment Security Department, or the Department of Labor & Industries. There is no hard evidence as to whether the mortgage company controlled the taxpayer by instructing him how to transact business on its behalf. The taxpayer said the mortgage company did not control his hours, but provided his office equipment and the business forms they wanted him to use. This assertion is insufficient to refute the fact that the mortgage company did not treat the taxpayer as an employee and in fact treated the taxpayer as an independent contractor.

After reviewing the criteria of Rule 105 and applying them to the facts presented by the taxpayer and by the Audit Division, we conclude that the Audit Division correctly assessed B&O tax against the taxpayer as an independent contractor based on the limited evidence available to it. Further we note that RCW 82.32.070 bars a taxpayer from challenging an assessment in the absence of maintaining adequate records from which the Department can determine most accurately a taxpayer's tax liability. The taxpayer failed to maintain and provide such records.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 30th day of April, 1999.