

Cite as Det. No. 18-0040, 38 WTD 71 (2019)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0040
)	
. . . )	Registration No. . . .
)	

**RULE 111: ADVANCES AND REIMBURSEMENTS – TAXPAYER AS EMPLOYER OF RECORD – PRESUMPTION AS EMPLOYER.** When a taxpayer is the employer of record, it is presumed to be the employer with liability for employer obligations. This presumption can be rebutted by showing the taxpayer has no control over the employees and by providing a writing enforceable by the employees showing that the client is the employer liable for all employer obligations.

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.

Sattelberg, T.R.O. – A payroll processing services provider (“Taxpayer”) protests the Department of Revenue’s (“Department”) assessment of service and other activities business and occupation (“B&O”) tax. Taxpayer argues that all of its receipts are excluded from the measure of B&O tax. We deny the petition.<sup>1</sup>

**ISSUE**

Whether Taxpayer has shown that amounts received from affiliates to pay payroll expenses may be excluded from gross income under WAC 458-20-111 (“Rule 111”).

**FINDINGS OF FACT**

Taxpayer is one of several affiliated entities and is based [out-of-state]. Taxpayer provides payroll and personnel services to its affiliated entities. As part of these services, Taxpayer filed quarterly wage reporting information to Washington for its affiliate’s Washington-based employees. Taxpayer registered with the Department as of January 1, 2011, but did not report any income to Washington through June 30, 2016.

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

In 2016, the Department’s Audit Division (“Audit”) began auditing Taxpayer for the time period January 1, 2012, through June 30, 2016. Taxpayer provided Audit its quarterly wage reports for the audit period. Based on amount of payroll reported in Washington on the wage reports, Audit determined that Taxpayer had substantial nexus with Washington. As it had found that Taxpayer had substantial nexus, Audit found Taxpayer’s income during the audit period taxable under the service and other activities B&O tax classification. Audit calculated Taxpayer’s income as the amount of wages it reported to Washington, considering the money Taxpayer received from affiliates as Taxpayer’s income.

Audit next looked to see if any deductions, exemptions, or exclusions applied to Taxpayer. Audit found that Taxpayer was eligible for the B&O tax deduction for paymaster services found in RCW 82.04.43393. As this deduction became effective only after October 1, 2013, Audit applied it only to that portion of the audit period. This left the remainder of the income, income received prior to October 1, 2013, not eligible for any deduction, and thus taxable. On April 19, 2017, Audit issued Taxpayer an assessment totaling \$ . . . .<sup>2</sup>

Taxpayer timely petitioned for review of the assessment, arguing that it did not provide a service to its affiliates, that it merely passed through the amounts it received from them, and thus should not be taxed on these amounts. Taxpayer did not provide any documents in support of its petition.

### ANALYSIS

Washington imposes B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. “[T]he legislative purpose behind the B&O tax scheme is to tax virtually all business activity in the state.” *Impecoven v. Dep’t of Revenue*, 120 Wn.2d 357, 841 P.2d 752 (1992). The tax is measured by applying particular rates against the value of products, gross proceeds of sale, or gross income of the business, as the case may be. RCW 82.04.220.

Gross income from providing payroll and benefits services, administrative services, and accounting services is generally taxable under the service and other activities B&O tax classification, measured by the “gross income of the business.” RCW 82.04.290(2). “Gross income of the business” means the value proceeding or accruing by reason of the transaction of the business engaged in, without any deduction on account of any expense whatsoever paid or accrued. RCW 82.04.080. As RCW 82.04.43393 is not retroactive, we will apply Rule 111 to amounts Taxpayer received prior to October 1, 2013. *See* Det. No. 14-0237R, 34 WTD 515 (2015).

The Department recognizes that certain payments are mere reimbursements for expenses advanced for a client and excludes such receipts from the gross income of the business. Rule 111 is the Department’s administrative rule setting forth the criteria for excludable advances and reimbursements. Rule 111 states, “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.”

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<sup>2</sup> The assessment consists of \$ . . . in service & other activities B&O tax, \$ . . . in delinquent penalties, a \$ . . . substantial underpayment penalty, and \$ . . . in interest.

Rule 111 defines the terms “advance” and “reimbursement” and limits the application of these terms to “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.” See *Washington Imaging Services, LLC v. Dep’t of Revenue*, 171 Wn.2d 548, 560, 252 P.3d 885 (2011) (“The concept is that ‘amounts that merely ‘pass through’ a business in its capacity as an agent cannot be attributed to the business activities of the agent’ and therefore ‘such amounts are not taxable.’”); *Rho Co. v. Dep’t of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989); *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002). [Rule 111 excludes from taxation only those amounts where the taxpayer assumes solely agent liability. *Washington Imaging*, 171 Wn.2d at 561; *Wm. Rogers*, 148 Wn.2d at 176.]

[. . .] The Department issued Excise Tax Advisory 3181.2013 (“ETA 3181”) clarifying when paymasters qualify to exclude amounts received to pay employer obligations from gross income under Rule 111.<sup>3</sup> ETA 3181 states, in pertinent part:

When the taxpayer is the employer of record, *the taxpayer is presumed to be the employer with liability for the employer obligations*. To satisfy this element, the taxpayer must provide the Department with evidence to establish that the client is the employer with liability for the employer obligations.

- For example, the following evidence will collectively establish that the client is the employer with liability for the employer obligations:
  - The client has all control over the employees (such as determining and supervising activities, setting compensation, hiring and firing authority, etc.);
  - The taxpayer has no such control; and
  - The client agrees in a writing enforceable by the employees that it is the employer liable for all employer obligations (e.g. through an employment contract or employee handbook).<sup>4</sup>

(Emphasis added.) Taxpayer has provided no documents regarding who has control over employees or whether the affiliates agreed in a writing enforceable by the employees that it was the employer liable for all employer obligations. Without this documentation, Taxpayer has not overcome the presumption in ETA 3181 that it is the employer with liability for the employer obligations. As such, Taxpayer does not qualify to exclude its receipts under ETA 3181 and Rule 111. Thus, we deny Taxpayer’s petition.<sup>5</sup>

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<sup>3</sup> ETA 3181 is an interpretive statement that is advisory only under RCW 34.05.230. As such, ETA 3181 applies retroactively, and does not create any new requirements for Rule 111 treatment for paymasters. Det. No. 14-0237R, 34 WTD 515 (2015).

<sup>4</sup> [We note that ETA 3181 defines employer of record as “the person who reports employees under its own UBI or EIN for state or federal tax, employment security, or insurance purposes.”]

<sup>5</sup> [We note that even if Taxpayer could establish that this requirement was met, Taxpayer would need to meet the other requirements of ETA 3181 to prevail.]

DECISION AND DISPOSITION

We deny Taxpayer's petition.

Dated this 7th day of February 2018.