Cite as Det. No. 03-0128, 24 WTD 168 (2005)

BEFORE THE 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. 03-0128
	)	
	)	Registration No. . . .
	)	Petition for Refund
	)	Docket No. . . .

[1] RULE 111: B&O TAX -- TEMPORARY STAFFING BUSINESS – AGENCY -- BURDEN. To show that payments to the temporary workers it provides its customers are "pass through" payments excludable from gross income under Rule 111, a temporary staffing business must prove that it made the payments pursuant to an agency relationship with its customers, and its liability to pay the funds must have constituted solely agent liability.

[2] RULE 111: B&O TAX -- TEMPORARY STAFFING BUSINESS – WHEN TEMPORARY STAFFING BUSINESS IS THE EMPLOYER. A temporary staffing business that is the employer of the temporary workers it provides may not exclude from its gross income subject to B&O tax, under Rule 111, receipts representing the wages and other labor costs of the temporary workers. The labor costs are a nondeductible cost of doing business, and their payment is not a "pass-through."

[3] RULE 111: MISCELLANEOUS -- ERRONEOUS APPLICATION OF A RULE. A Department error in granting to one taxpayer the benefit of the Rule 111 exclusion need not be perpetuated by granting unrelated third parties the same erroneous application.

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.

Prusia, A.L.J. – A temporary staffing service that provides temporary office workers to other businesses requests a refund of business and occupation ("B&O") tax it paid on the portion of its revenues that it received from its customers for the labor of those temporary workers. Taxpayer

contends the amounts it paid the workers as compensation were deductible as "pass through" payments under WAC 458-20-111 (Rule 111). In the alternative, Taxpayer contends it . . . would be unfair for the Department of Revenue ("DOR") to deny its refund request, because DOR granted a refund to another taxpayer whose facts were the same as or less favorable than Taxpayer's. We conclude that Taxpayer is liable to pay B&O tax on the amounts it received from its customers for the labor of the temporary workers. We deny the petition for refund. [1]

ISSUES

[1] Were the amounts Taxpayer received from its customers for the labor of temporary workers Taxpayer provided to those customers excludable from the measure of Taxpayer's B&O tax under Rule 111? . . .

[2] If DOR granted a refund request to another temporary staffing service under nearly identical facts, does equity require that DOR also grant Taxpayer's refund request?

FINDINGS OF FACT

Taxpayer is a temporary staffing service that provides temporary personnel to businesses throughout the United States . . . . Taxpayer has one office in Washington, located in . . . , which provides temporary office staffing (hereinafter "temps"). The temps the [Washington] office provides include administrative assistant, customer service, receptionist and other support personnel.

Taxpayer recruits the temps through advertising and referrals. Prospective temps fill out Taxpayer's employment application.

After a potential temp submits the application, Taxpayer does skills testing to determine or verify what skills the temp has. If a potential temp passes the tests, Taxpayer has the temp fill out a W-4, and puts the temp into a database as available for assignment.

Temps who become members of Taxpayer's pool of workers receive an Employee Handbook. The handbook identifies the temps as Taxpayer's employees. It describes the employment relationship between Taxpayer and the temp as an "at-will employment relationship." It states that the temp's employment "with us begins on the first day of your first assignment." It states: "You are the employee of [Taxpayer] for the duration of your assignments." The handbook describes job opportunities, benefits and training programs that Taxpayer offers, how temps are assigned, appropriate workplace behavior, safety reminders, how pay rate is determined, and how the temp will get paid.

Placement of temps with customers is based on a skills match. The process for placing temps varies depending upon the customer and the nature of the assignment. Customers who have a

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

long-term relationship with their Taxpayer account representative often rely on the account representative to send the right people. For placements where the customer just needs bodies without special skills, Taxpayer selects the temps to send to the customer from Taxpayer's pool of available workers. For some placements, Taxpayer sends the customer resumes from its temp pool for the customer to choose among. For a few placements, Taxpayer recruits specifically for the placement, and sends the resumes to the customer for the customer to choose among.

The Employee Handbook describes how a temp's pay rate is determined . . . . [Factors include the temp's educational experience and complexity of the assignment. Sometimes Taxpayer has a contract with a client that establishes the pay rates for temps.]

Before placing a temp, Taxpayer and the customer agree upon an amount that the customer will pay Taxpayer for the placement. Taxpayer keeps, as its fee, 47% of that amount, and 53% of that amount is the temp's wage. After the amount is set, Taxpayer contacts the temp and tells the temp what the job is and how much the wage is. If the Temp doesn't want to work for that wage, the temp does not take the job. The temp has no role in negotiating the wage.

After placing a temp, Taxpayer is responsible for withholding and remitting all income and Social Security taxes from the temp's wages, and for paying workers' compensation insurance premiums, state and federal unemployment taxes, and the employer's share of Social Security taxes. Taxpayer is the employer of record of the temps, filing the employer's state and federal tax returns.

Taxpayer pays temps at the end of the assignment (if the assignment is only for a day or a few days), or at the end of the day [once a week]. At such times, Taxpayer pays the temp immediately if the temp brings his or her signed time sheet(s) to Taxpayer's branch office. Taxpayer bills the customer after the work is performed, weekly. The temp has no written obligation to return the pay to Taxpayer, should the customer not pay Taxpayer.

Temps are entitled to one week of paid vacation after working . . . hours for Taxpayer during any consecutive . . . week period, at a rate equal to the average of the hourly rates paid the temp during that period. Temps are entitled to paid holidays when they have accrued . . . total hours working for Taxpayer, and have worked 100% of the client's normal work week the week before the holiday and the week of the holiday. Taxpayer makes group health insurance available to temps and their eligible dependents, under the same plan that covers its own administrative staff. Premium payments are made through payroll deductions and can be continued during weeks when the temp is not working. The Employee Handbook directs temps to call Taxpayer if the temp is injured while performing work on an assignment, and directs temps to call Taxpayer if they are ill or are running late to their assignment, and Taxpayer will inform its customer.

The customer provides the necessary workspace, equipment, tools, and materials required by the temp to perform the job. The customer exercises exclusive guidance and supervision over the work performed. Both the customer and Taxpayer evaluate the worker's performance. The Employee Handbook contains a lengthy list of expected workplace behavior, and provides that

impermissible behavior or inappropriate or unsatisfactory workplace conduct may subject the worker to disciplinary action, up to and including termination.

Taxpayer guarantees satisfactory performance by the temps, even when the customer has pre-approved the temps who will be assigned. If a customer becomes dissatisfied with the performance of any temp, the customer may cancel the assignment by notifying Taxpayer that it is dissatisfied. If the customer does so within the first 40 hours of a temp's assignment, the customer will not have to pay Taxpayer for the time spent by the temp, and Taxpayer will attempt to supply the customer with a replacement. If a customer is dissatisfied with a temp and follows the above-described procedure, or if a customer fails to pay for work performed, Taxpayer remains liable for paying the temp.

Taxpayer does not describe itself as the agent of its customers.

Taxpayer enters into written contracts with customers for longer placements or recurring placements. At least some of those contracts have the following prohibition against soliciting one another's employees:

. . .

During the period January 1, 1996 through March 31, 2000, Taxpayer reported, and paid B&O tax on, the full amount it received from its customers.[2] In June 2000, Taxpayer filed amended returns for those periods, on which it claimed a deduction for amounts it paid temps during those periods. With the filing, Taxpayer requested a refund of B&O taxes paid during those periods, based on the claimed deduction. Taxpayer's request stated that "Taxpayer is amending its filings to seek a deduction of 'pass through' payments from gross income for purposes of business and occupation taxes pursuant to WAC 458-20-111, referred to as Rule 111." The request stated that Taxpayer believed it satisfied the three criteria for the pass-through established by the Washington Supreme Court in *Rho Co. v. Department of Rev.*, 113 Wn.2d 561, 782 P.2d 986 (1989).

By letter dated May 4, 2001, DOR's Taxpayer Account Administration (TAA) Division disallowed the deduction and denied the refund request. Taxpayer appeals the disallowance and denial.

ANALYSIS

1. May Taxpayer exclude payments to temps from measure of B&O tax under Rule 111?

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the state. RCW 82.04.220. The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. Taxpayer and DOR agree that the proper B&O tax classification of the revenues that are the subject of this request is service and other activities.

[2] Taxpayer reported the revenues under the Service and Other Activities classification. Taxpayer filed quarterly returns for 1996 and monthly returns thereafter.

The service and other activities B&O tax is measured by the gross income of the business. RCW 82.04.220 and RCW 82.04.290. No deduction is permitted for expenses involved in conducting a business. RCW 82.04.080. However, because amounts that merely "pass through" a business in its capacity as an agent cannot be attributed to the business activities of the agent, such "pass through" amounts do not come under the definition of gross income of the business, and are not taxable. *See Walthew, Warner, Keefe, Arron, Costello & Thompson v. Department of Rev.*, 103 Wn.2d 183, 188, 691 P.2d 559 (1984).

Rule 111 is a DOR administrative rule that explains when a taxpayer may exclude advances or reimbursements from gross income as "pass through" payments:

> The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.
>
> The word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.
>
> 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.
>
> 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.

Rule 111 provides several examples of how the exception is intended to work. For example, an attorney advancing filing fees on behalf of the attorney's client is not required to pay B&O tax on the reimbursed fees. On the other hand, a doctor who furnishes medicine or drugs as a part of the doctor's treatment is not merely acting as an agent of the patient in doing so, and may not exclude amounts received for the medicine or drugs.

The Washington Supreme Court has held that in the traditional "pass through" scenario recognized in Rule 111, the client has sole liability for an expense paid on its behalf and is responsible for advancing the cost to the taxpayer or reimbursing the taxpayer. *Christensen, O'Connor, Garrison & Havelka v. Department of Rev.*, 97 Wn.2d 764, 769, 649 P.2d 839

(1982); *Walthew*, 103 Wn.2d at 186.[3] The *Walthew* decision explained that if a taxpayer assumes any liability beyond that of an agent, the payments it receives are not "pass through" payments. *Walthew*, 103 Wn.2d at 189.

Rho Co. v. Department of Rev., 113 Wn.2d 561, 782 P.2d 986 (1989), involved a taxpayer that supplied manufacturers temporary workers with engineering skills. The *Rho* decision summarized the operation of Rule 111, as follows:

> [T]he rule allows an exclusion from income for a "pass-through" payment when the following three conditions are met: (1) the payments are "customary reimbursements for advances made to procure a service for the client"; (2) the payments "involve services that the taxpayer did not or could not render"; and (3) the taxpayer "is not liable for paying the associate firms except as the agent of the client." [citations to *Christensen* and *Walthew* omitted.]

[1] *Rho*, 113 Wn.2d at 567-68. We will focus on the third condition. On the third condition, the *Rho* decision explained that the taxpayer had to prove that the advance or reimbursement in question was made pursuant to an agency relationship. When a taxpayer meets its burden and establishes an agency relationship, a second question must be asked: whether the taxpayer's liability to pay the advance "constituted solely agent liability." *Rho*, 113 Wn.2d at 573. On the first prong of the third condition, the *Rho* decision stated that "If Rho is the employer, then Rho is liable in its own right for the payment, and Rule 111 does not apply." On the second prong, the *Rho* decision remanded and directed the Board of Tax Appeals to focus on supervision and control factors to determine whether the advances were made "solely" as the agent of a principal.

In *City of Tacoma v. The William Rogers Company, Inc.*, 148 Wn.2d 169, 60 P.3d 79 (2002), the court clarified that the factors enumerated in *Rho* were not the exclusive factors to consider when determining whether advances are made "solely" as an agent.[4]

[2] Taxpayer has not met its first burden, to demonstrate an agency relationship with its customers for the purpose of providing temporary workers. Rather, the evidence establishes that Taxpayer is the employer of the temps. Evidence supporting this finding includes the following. Taxpayer is the employer of record. Taxpayer's employment application refers to the applicant being "employed by" Taxpayer. . . . . Taxpayer gives the temps an Employee Handbook. The Employee Handbook describes Taxpayer's relationship with the temps as an "employment

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[3] *Christensen* concerned payments made by a law firm to attorneys in another city on behalf of the client, where the parties stipulated that the out of town attorneys understood they were working directly for the clients. *Walthew* held that filing fees paid be a lawyer on behalf of a client were deductible because the attorney disciplinary rules forbade the law firm from advancing fees to the client on a nonrefundable basis.

[4] The William Rogers Company, d.b.a. Evergreen Staffing Services, is a temporary staffing service. *William Rogers* addressed the application of the City of Tacoma's Rule 111 to Evergreen Staffing's receipts. The City of Tacoma's Rule 111 is identical to DOR's Rule 111 (see footnote 5 of the court's decision). The court analyzed the city's rule in the context of Washington court decisions that have interpreted DOR's Rule 111. The *William Rogers* analysis therefore applies to DOR's Rule 111

relationship," and repeatedly identifies the temps as employees of Taxpayer. The Employee Handbook directs temps to call Taxpayer if the temp is injured while performing work on an assignment. Taxpayer's representative customer contract does not describe Taxpayer as the agent of the customer. It also refers to the temps as Taxpayer's employees. It bars the customer from soliciting or hiring any of the temps Taxpayer supplies under the contract.

Because Taxpayer was the employer, Taxpayer was liable in its own right for paying the workers, and Rule 111 does not apply. *Rho*, 113 Wn.2d at 569; *William Rogers*, 148 Wn.2d at 178.

Even if Taxpayer had established agency, the employee compensation could be considered as a "pass though" expense only if Taxpayer acted solely as the agent of its customer for the purposes of paying that compensation. On this prong, the control factors in Taxpayer's case are almost identical to those that the *William Rogers* decision held established that Evergreen Staffing was not acting solely as an agent. Taxpayer is the employer of record for the temps. Taxpayer provides the temps with an employee handbook identifying them as employees of Taxpayer. As employer of record, Taxpayer withholds income and employment taxes and files all tax returns for the temps. It is also responsible for complying with Washington's workers compensation laws. It responds in the event of an on-the-job injury. Regardless of whether it receives reimbursement from its customers, Taxpayer is responsible for paying the workers. Taxpayer has sole liability to pay the workers. For example, when a customer is not satisfied with a temp's performance and invokes Taxpayer's satisfaction guaranty, only Taxpayer is liable for the payment. Also, where a client is for any reason unable or unwilling to pay the worker, Taxpayer is liable for making the payment. If Taxpayer had only agency liability, it would not be making payments that were unauthorized by the principal. Taxpayer grants its temps paid holidays and accrued vacation time. This compensation is not authorized by any particular customer, and is solely the obligation of Taxpayer.[5] Taxpayer negotiates a rate with its customer, and then offers the temp a placement at a dollar figure that is only a percentage of that rate. The temp does not know exactly how much the customer is paying Taxpayer for the temp's services, and the customer does not know exactly how much Taxpayer is paying the temp. The record demonstrates Taxpayer is not acting as a mere paymaster. Termination also is under the control of Taxpayer, because the decision whether to remove a temp a customer has found unsatisfactory from Taxpayer's pool of available workers is Taxpayer's decision.

As did the Supreme Court in *William Rogers* on nearly identical facts, we conclude Taxpayer was not acting solely as an agent in paying the temps.

To summarize, we conclude that Taxpayer has failed to establish that it paid its temps pursuant to an agency agreement. Even if Taxpayer had established agency, the employee compensation could not be considered as a "pass though" expense because Taxpayer was not acting solely as

[5] Taxpayer contends that it is immaterial that it offers these benefits, because most temps do not stay with Taxpayer long enough to become eligible for the benefits. We disagree. The fact that it is Taxpayer that is offers these benefits and is solely liable for paying them is material on the issues of who is the employer and whether taxpayer is liable solely as an agent in paying the benefits.

the agent of its customers for the purposes of paying that compensation. Accordingly, we hold that Taxpayer cannot exclude amounts it paid in temp wages and benefits from the measure of its B&O tax under Rule 111. . . .

2. Fairness issue

[3] Taxpayer argues that the *William Rogers* decision indicates DOR granted William Rogers Company (Evergreen Staffing) a refund on the same or less favorable facts than Taxpayer's, and it would be inequitable to treat Taxpayer differently. We find no merit in that argument. First, a taxpayer that is granted a refund by DOR is granted the refund based upon facts submitted to DOR. The *William Rogers* decision does not indicate on what facts DOR granted the refund request. Second, when DOR has erroneously applied the law to a particular taxpayer, as it did to William Rogers Company, it is not required to perpetuate the error by repeating it with respect to other taxpayers.[6] Taxpayers may not rely on the Department's erroneous interpretation of a rule issued to a third party. *Det. No 01-165R*, 22 WTD 11 (2003); . . . .

DECISION AND DISPOSITION

Taxpayer's petition for refund is denied.

Dated this 21st day of April 2003.

[6] DOR conceded its error at page 15 of its *Amicus Curiae* brief to the Supreme Court in the *William Rogers* case:

> The Department does not dispute that its Audit Division, after initially denying a refund request filed by Evergreen, later reversed that decision. But for the reasons set forth in this brief, as well as Tacoma's briefs, the Audit Division simply erred in allowing Evergreen to deduct the wages and benefits it paid temporary workers as "pass-through" payments under WAC 458-20-111.

(Emphasis and bracketed material added.)