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BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0184
. . .	)	Registration No. . . .

RCW 82.04.43393: FUNCTIONAL EMPLOYMENT RELATIONSHIP. A taxpayer has a functional employment relationship with an employee where the employer has control over whether the employee receives health care benefits. Additionally, a taxpayer is a qualified employer of record where the taxpayer has a contractual liability with a qualified employee where the taxpayer is contractually liable for the employee costs.

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.

Fisher, T.R.O. – An employer of record disputes taxes assessed on amounts received from affiliates to compensate for the employer of record's payment of the affiliates' employee expenses. The employer asserts it met the requirements of RCW 82.04.43393, and alternatively that it was entitled to rely on written instructions from the Department. The petition is denied. [1]

ISSUES

1. Whether an employer of record may deduct amounts received from affiliates to compensate for the employer of record's payment of the affiliates' employee expenses under RCW 82.04.43393.

2. Whether an employer of record had the right to rely on e-mails sent from a Department employee in reporting its tax liability under RCW 82.32A.020(2).

FINDINGS OF FACT

. . . ("Taxpayer") processes payroll for three . . . restaurants: [Restaurant 1], [Restaurant 2], and [Restaurant 3] (collectively, "[Restaurant] Entities"). [Owner 1] and [Owner 2] are the majority owners of Taxpayer and the [Restaurant] [E]ntities. According to Taxpayer, each [Restaurant] entity individually owns and operates one restaurant. *See* Petition, Attachment 2, at 1.

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

Taxpayer explains that, in 2014, [Owner 1] and [Owner 2] decided to restructure their business to centralize payroll and tax reporting for the [Restaurant] Entities. [Owner 1] e-mailed a Washington Department of Revenue ("Department") Excise Tax Examiner ("employee") to discuss the potential tax implications of centralizing payroll and tax reporting. On August 22, 2014, the employee discussed the business and occupation ("B&O") tax deduction for paymasters in general terms. The employee specifically stated "[a]lso, once you think you have a workable plan, I would get a written ruling from [the Department] before I made any final decisions and/or changes." Petition, Attachment 2, Exhibit A, at 2.

[Owner 1] sent additional e-mails asking more questions. On September 9, 2014, the employee wrote back stating that legislation had been passed to allow payroll reporting under a paymaster entity "as long as [Taxpayer] met the requirements." *Id.* at 5. The September 9, 2014, e-mail referenced and attached copies of RCW 82.04.43393 and the Special Notice regarding the paymaster deduction, and further stated "[t]here is more information on our website if you want to dig deeper." Petition, Attachment 2, Exhibit A, at 5. The employee gave more general information about the deduction, and concluded the e-mail by stating "I hope this answers your questions, and I still encourage you to seek a binding ruling from [the Department] once you have a defined plan of action." *Id.*

[Owner 1] sent another e-mail on September 17, 2014, that stated in part, "[o]nce we are done and have everything figured out, I am planning on sending our results to [the Department] using the format for the 'Legally Binding' advice." *Id.* at 6. The employee responded on September 30, 2014, again giving general advice regarding the paymaster deduction. *Id.* at 7. Taxpayer never requested a binding ruling from the Department.

The Department reviewed Taxpayer's books, records, and excise tax returns from July 1, 2014, through September 30, 2016 ("the Audit Period"). During the [A]udit [P]eriod, Taxpayer reported its income for payroll related and other various business services[2] under the Service and Other B&O Tax classification, and deducted the amounts it paid out in employee wages, employment insurance, and employment taxes (collectively, "Employee Costs") as "Paymaster Services from Affiliated Businesses." The Department disallowed the deductions for the Employee Costs, determining that Taxpayer did not meet the requirements of WAC 458-20-111. The Department assessed Taxpayer $ . . . in service and other activities B&O tax, $ . . . in interest, and a substantial underpayment penalty of $ . . . .

Taxpayer timely sought administrative review. In its petition, Taxpayer asserted that the money it received for payroll purposes was deductible from the amount used to calculate Taxpayer's B&O liability under RCW 82.04.43393; Taxpayer did not argue that it met the requirements of WAC 458-20-111. Taxpayer further argued that, if it reported its taxes incorrectly, that it was entitled to rely on the Department's statements in the e-mails exchanged between a Department employee and Taxpayer.

At the hearing, Taxpayer conceded it did not have any agreements between Taxpayer and any of the individual [Restaurant] Entities regarding who was responsible for what payments because of

[2] Taxpayer charged the [Restaurant] Entities fees for management, marketing, and printing of menus; reported these amounts under the Service & Other B&O Tax classification; and paid the tax.

the common ownership between Taxpayer and [Restaurant] Entities. Taxpayer further advised that there are no documents or agreements between Taxpayer and the employees of [Restaurant] Entities. Taxpayer stated all of the employees of the [Restaurant] Entities received the same employee handbook.

Following the hearing, Taxpayer provided a copy of the 2015 and 2016 handbooks given to [Restaurant] Entities' employees ("the Handbook"). Both the 2015 and the 2016 Handbooks state that the [H]andbook does not constitute a contract of employment, and that no representative of . . . has authority to enter any agreement for employment for a specified period of time or to make any representations or agreements contrary to an at-will employment. 2015 Handbook at 2; 2016 Handbook at 2. It is unclear whether . . . in the Handbook means one of the [Restaurant] Entities or Taxpayer.

Both the 2015 and the 2016 Handbooks state that the [Restaurant] Entities' Employees schedule "will be prepared by your manager." 2015 Handbook at 8; 2016 Handbook at 9. The Handbooks also state requests for specific days off "must be in writing and emailed to . . . ." 2015 Handbook at 8-9; 2016 Handbook at 9.

The 2015 Handbook is completely silent as to the role of Taxpayer. The 2016 Handbook states that as of January 1, 2016, Taxpayer offers health insurance to all full-time employees, and that Taxpayer "will contribute 50% of the 'base' health insurance plan offered for the employee only." 2016 Handbook at 10. The 2016 Handbook makes clear Taxpayer chose the measurement periods for determining whether an employee is full time. *Id.* at 11.

ANALYSIS

Washington imposes the 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, 363, 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.

RCW 82.04.080 defines "gross income of the business" for the purposes of calculating B&O tax under RCW 82.04.220. WAC 458-20-111 excludes certain amounts from being included in the gross income of the business calculation under RCW 82.04.220. WAC 458-20-111 ("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.") (emphasis added). Here, Taxpayer does not dispute the Department's conclusion that Taxpayer does not meet the requirements of WAC 458-20-111.

Unlike WAC 458-20-111, which excludes certain "advances" and "reimbursements" from being considered as "gross income of the business" generally, there is a separate, specific deduction for amounts received by certain employers of record providing paymaster services covering certain employee costs: RCW 82.04.43393. Effective October 1, 2013, RCW 82.04.43393 provides:

> In computing tax there may be deducted from the measure of tax, amounts that a qualified employer of record engaged in providing paymaster services receives from an affiliated business to cover employee costs of a qualified employee. However, no exclusion is allowed under this section for any employee costs incurred in connection with a contractual obligation of the taxpayer to provide services, including staffing services as defined in RCW 82.04.540.

Taxpayer asserts that the Department erred when the Department refused to examine whether Taxpayer met the requirements of RCW 82.04.43393 separately from whether Taxpayer met the requirements of WAC 458-20-111. Taxpayer is correct.

WAC 458-20-111 and RCW 82.04.43393 are separate and distinct legal theories why a taxpayer's receipts may not be subject to taxation. . . .

. . .

The Department issued Excise Tax Advisory 3196.2015 ("ETA 3196") regarding the Paymaster Services from Affiliated Businesses deduction in RCW 82.04.43393:

> To qualify [for the RCW 82.04.43393 deduction], the following requirements must be met:
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> 1. The taxpayer must be a qualified employer of record;
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> 2. The taxpayer must be providing paymaster services;
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> 3. The paymaster services must be provided to an affiliated business only; and
>
> 4. The amounts must be paid to cover costs of a qualified employee.

ETA 3196 at 1.[3]

[3] ETA 3196 also requires that a person claiming the deduction under RCW 82.04.43393 to be the actual employer of record, which means the person who reports employees under its own UBI or EIN for state or federal tax, employment security, or insurance purposes. There is no dispute that Taxpayer is the employer of record.

"Qualified employer of record" is a person who has "no functional employment relationship with a qualified employee" and . . . "has no contractual liability with a qualified employee for the employee costs." RCW 82.04.43393(2)(f).

"Functional employment relationship" is defined in RCW 82.04.43393(2)(c) as "having control over the work schedule and activities of the employees and control over . . . all employment decisions such as salary, discipline, hiring, and layoffs." "Qualified employee" is defined in RCW 82.04.43393(2)(e) as "an employee with whom the affiliated business has a functional employment relationship. Neither the employer of record, nor any other affiliate, may have a functional employment relationship with the employee."

. . . [T]axpayers bear the burden of showing that they qualify for a tax deduction. *Budget Rent-A-Car v. Dep't of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972). Further, taxpayers are required to maintain suitable records as may be necessary for the Department to determine a person's tax liability. RCW 82.32.070. Taxpayers must maintain records to demonstrate the amounts of any deductions, exemptions, or credits claimed. WAC 458-20-254(3)(b)(ii).

From July 1, 2014, to December 31, 2015, there is not enough documentation to determine whether Taxpayer has no functional employment relationship with the [Restaurant] Entities employees. Taxpayer asserts that the staffing, hiring, firing, and scheduling of employees of each [Restaurant] Entity is handled by the managers of each restaurant location; there is no documentation to support this assertion.[4] Regarding scheduling, the Handbooks state that employees are to e-mail one e-mail address, . . ., to request specific days off; because this is one specific e-mail for all three [Restaurant] Entities, it appears that scheduling is handled by one entity rather than each [Restaurant] Entity on their own.

Taxpayer states there is no documentation between any of the [Restaurant] Entities and Taxpayer regarding their agreements as to who is responsible for staffing, hiring, firing, and scheduling of employee. Under RCW 82.32.070 and WAC 458-20-254(3)(b)(ii), Taxpayer was required to keep suitable records to demonstrate that only [Restaurant] Entities had a functional employment relationship with the [Restaurant] Entities' employees. Based on the lack of documentation for July 1, 2014, through December 31, 2015, we conclude that Taxpayer has not met its burden of producing suitable records to show it qualified for the . . . deduction for amounts received for [qualified] Employee Costs under RCW 82.04.43393.

From January 1, 2016, through September 30, 2016, the 2016 Handbook states that Taxpayer is responsible for "50% of the 'base' health insurance plan offered for the employee only." 2016 Handbook at 10. Taxpayer also gets to determine who qualifies as a "full time employee." *Id.* at 11. Because Taxpayer had control over employment decisions, such as whether or not an employee

[4] Taxpayer cites the Auditor's Detail of Differences and Instructions to Taxpayer, which states "[Taxpayer] is the employer of record. [[Restaurant] Entities] has control over the employees. [Taxpayer] has no such control." According to Taxpayer, this establishes there is no functional employment relationship between Taxpayer and the [Restaurant] Entities' employees. However, Taxpayer stated at the hearing there is no documentation between Taxpayer and the [Restaurant] Entities, so there is no documentation to support this statement. Accordingly, we decline to give weight to the statement in the Auditor's Detail of Differences and Instructions to Taxpayer that Taxpayer has no control over the [Restaurant] Entities employees where there is no documentation showing who has control over them.

is "full time" for the purposes of health insurance and was responsible for paying for half of the insurance plan, Taxpayer had a functional employment relationship with the [Restaurant] Entities employees. RCW 82.04.43393(2)(c). This means Taxpayer was not a "qualified employer of record." RCW 82.04.43393(2)(e). Taxpayer therefore did not qualify for the . . . deduction for amounts received for [qualified] Employee Costs between January 1, 2016, through September 30, 2016, under RCW 82.04.43393.

Finally, Taxpayer asserts it was entitled to rely on the e-mails sent by the Department employee in 2014. RCW 82.32A.020(2) grants taxpayers the "right to rely on specific, official written advice and written reporting instructions from the [Department] to that taxpayer. . . ." The employee's 2014 e-mails . . . were not official; the Department employee repeatedly emphasized the need for Taxpayer to seek a ruling from the Department. Petition, Attachment 2, Exhibit A, at 2 and 5. Taxpayer also understood the e-mails were not to be relied on, as evidenced by [Owner 1's] statement in the September 17, 2014, e-mail that he was planning on obtaining "Legally Binding" advice. Finally, because Taxpayer was told and understood the e-mails were not specific, official written instructions, Taxpayer has no right to rely on the e-mails and cannot cite them as authority for taking the deductions for the Employee Costs.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 2nd day of July 2018.