Cite as Det. No. 12-0318, 33 WTD 91 (2014)

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. 12-0318 Registration Nos. . . .

[1] RCW 82.04.080; RCW 82.04.220: GROSS INCOME – VALUE PROCEEDING OR ACCRUING – EMPLOYEE WAGES PAID DIRECTLY FROM CUSTOMER'S ACCOUNT. An employer, who contracts to have a customer pay its employees from its customer's checking account, rather than paying its employees from its own bank account, is receiving value from its customer by having its payroll expenses paid. The payroll expenses were incurred by the employer and the payment of those payroll expenses by the customer are properly included in the employer's B&O tax base.

[2] RULE 111; RCW 82.04.080: GROSS INCOME – ADVANCEMENTS OR REIMBURSEMENTS – EMPLOYEE WAGES PAID DIRECTLY FROM CUSTOMER'S ACCOUNT. A taxpayer is not acting as an agent of its customer, when its customer, pursuant to contract, issues payroll payments to taxpayer's employees from the customer's checking account. Unless the taxpayer is an agent of its customer, those payments do not qualify for exclusion under Rule 111.

[3] RCW 82.04.394: B&O TAX – EXEMPTIONS – PROPERTY MANAGEMENT COMPANY - ON-SITE PERSONNEL – EMPLOYEE WAGES PAID DIRECTLY FROM CUSTOMER'S ACCOUNT. When on-site personnel are not engaged in "leasing property units," "collecting rents," or "similar activities," and when the employer of the on-site personnel is not "liable for payment only as an agent of the owner" of the property and is not "the agent of the owner with respect to the on-site personnel," then the employer of the on-site personnel is not engaged in the business of property management and is not eligible for the property management company B&O tax exemption.

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.

Weaver, A.L.J. – Taxpayer, a venue management, marketing, and development company, petitions for an adjustment of business and occupation ("B&O") tax assessed on amounts paid to facility personnel and related costs incurred in the course of managing an event facility. These expenses were paid directly from the "Facility Operating Account" of the public facility district ("PFD") that contracted with Taxpayer to manage a facility on its behalf. Taxpayer argues that B&O tax does not apply because: (1) no value proceeded or accrued to Taxpayer from the payments to facility personnel, and therefore the amounts cannot be considered "gross income of the business;" (2) even if such payments are valid consideration, the amounts paid from the Facility Operating Account qualify for [exclusion from B&O tax] under WAC 458-20-111 ("Rule 111"); and (3) amounts paid to on-site personnel out of the Facility Operating Account are exempt from B&O tax under RCW 82.04.394 for periods prior to June 1, 2010. The Department denies Taxpayer's petition.[1]

ISSUES

1. Whether, under RCW 82.04.220 and RCW 82.04.080, amounts paid directly from a PFD's Facility Operating Account to facility personnel working at the direction of a facility manager (and to pay other obligations of the facility manager) constitute gross income to that facility manager for B&O tax purposes.

2. Whether, under WAC 458-20-111, amounts paid directly from a PFD's Facility Operating Account to facility personnel working at the direction of a facility manager (and for other related expenses of the facility manager) [may be excluded from B&O tax].

3. Whether, under RCW 82.04.394, amounts paid directly from a PFD's Facility Operating Account to facility personnel working at the direction of a facility manager are exempt from B&O tax.

FINDINGS OF FACT

Taxpayer . . . is a . . . venue management group headquartered [outside of Washington State] that specializes in managing publicly owned facilities. During the period in question in this appeal, Taxpayer managed [a Convention Center in Washington], operated by the . . . Public Facilities District (hereinafter "PFD"). The two parties originally entered into the "Contract for Management Services" on November 19, 2003, which provided for the performance of certain Convention Center marketing, management and operations-related services by Taxpayer on behalf of the PFD. The Contract was later amended on January 8, 2008. The 2008 contract incorporated the 2003 contract, and updated and added certain provisions.

The Scope of Work specified in the Contract reads, in relevant part, as follows:

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

II. SCOPE OF WORK

The [Taxpayer] shall provide services and staff, and otherwise do all things necessary for or incidental to the performance of work. The [PFD] shall review and approve marketing plans, operation plans, and any other documents that support the [Taxpayer]'s services, staff and performance of work pertaining to the operation of the [Convention Center] . . . The [PFD] shall have the right to review the qualifications of each individual to be designated as the General Manager of the [Convention Center] and to approve or disapprove the use of such person in such position prior to the commencement of any work by such individual, provided such approval shall not be unreasonably withheld . . . .

Id. at 2 (emphasis added). Specifically, Taxpayer was expected to perform the following relevant services:

B. Operating Services

Within budgets approved by the [PFD], ensure that the Facilities are maintained in good order and repair and in clean, safe and sanitary condition, all to a superior standard, which shall include, but not be limited to:

1. **Provide** operation, maintenance and repair by competent and qualified **employees** or contractors, of all HVAC, mechanical, telephone, electrical and plumbing systems as well as seating, elevator, sound, lighting, security, fire and life safety monitoring systems as well as furniture, fixtures and equipment . . . .

C. Administrative Services

Within budgets approved by the [PFD], provide the following administrative services required in the operation of the Facilities:

4. Maintain an adequate staff of courteous employees on duty at the Facilities and provide appropriate supervision and training of such employees. **Employees hired by the [Taxpayer] will be employees of the entity and not of the [PFD].** The selected firm will employ or otherwise contract for its operations only those persons who by training, appearance and habits are judged to be suitable workers appropriate to the environment of the Facilities. **The [Taxpayer] will be responsible for all personnel related matters to include compensation, labor relations with any union or association, employee training and development, contract negotiation, dispute resolution, provision of employee uniforms and equipment, employee hiring, job assignment and performance evaluation and compliance with equal employment opportunity requirements.** During the period commencing on the date hereof and ending one (1) year after the expiration or termination of this Contract, except with CONTRACTOR's prior written consent, the **[PFD] will not, for any reason, solicit for employment, or hire, the General Manager, Director of Food Service, the Director**

> **of Sales and Marketing or the Director of Finance currently employed by [Taxpayer]** at the Facilities . . . .

Id. at 3-4 (emphasis added). In keeping with this contractual provision, the "Application for Employment" that was utilized by Taxpayer when hiring facility personnel is on Taxpayer's letterhead and otherwise indicates to applicants for employment that Taxpayer would be their employer.

Under the provisions of the Contract, Taxpayer was required to open a "Facilities Operating Account" in the PFD's name, and hold operating revenues in trust for the PFD in the following manner:

> 6. Collect all Operating Revenues generated through the operation of the Facilities. All Operating Revenues collected by the [Taxpayer] from operation of the Facilities shall be the sole property of the [PFD] and will be held in trust by the [Taxpayer] for the [PFD] for application as provided for in the budget and cash flow provisions herein. All Operating Revenues derived from operation of the Facilities shall be deposited by [Taxpayer] into an interest-bearing account in a local qualified public depository to be designated by the [PFD] in writing ("Facilities Operating Account") as soon as practicable upon receipt (but not less often than once each business day). Revenues that are not defined as Operating Revenues that are received by [Taxpayer] shall be disbursed immediately to such accounts as the [PFD] may designate from time to time. The Facilities Operating Account shall be established by the [PFD], in the name of the [PFD] and under the [PFD]'s federal identification number. As provided for in this Contract, CONTRACTOR shall have the right to withdraw and use the funds in the Facilities Operating Account to pay the Operating Expenses. The specific procedures (and authorized individuals) for making deposits to and withdrawals from such account shall be approved by the [PFD], including the procurement of a fidelity bond in an amount approved by the [PFD].

Id. at 5. Taxpayer was authorized, by the Contract, to make payments from the Facilities Operating Account, in the following manner:

> 7. Expend from the Operating Revenues collected all Operating Expenses necessary for the proper management, operation, maintenance and supervision of the Facilities, including the Operating Expenses as required to operate the Facilities as described in the Purpose and Scope of Work, within the scope of the established annual budget . . . .

Id. at 6. Taxpayer provided an exemplar payment to a facility employee that was issued on a check from the PFD's Facilities Operating Account.

In addition, under the Contract, Taxpayer was required to buy employers' liability insurance on its own behalf, comply with the State of Washington's Workers Compensation Coverage requirements, and provide a fidelity bond to the PFD covering Taxpayer's personnel. The Contract also stated that Taxpayer and the PFD had entered into an independent contractor

relationship where Taxpayer's "employees or agents performing under this Contract are not employees or agents of the [PFD]. *Id*. at 14-15.

Taxpayer was audited by the Audit Division of the Department of Revenue ("Department") for the period of January 1, 2007, through September 30, 2010. The Audit Division determined that certain payments issuing from the PFD's Facility Operating Account were being used to pay Taxpayer's obligations, including its payroll obligations. According to the Audit Division, because Taxpayer was responsible for running the Convention Center, including administering all the contracts required to run the Convention Center in the ordinary course of business, amounts used to pay for the expenses that Taxpayer incurred in performing its duties are considered gross income of the business subject to B&O taxation.

The audit resulted in two separate assessments issued on November 12, 2011.[2] The first assessment, . . . for the period January 1, 2007, through October 31, 2007, consisted of $. . . in service and other activities B&O tax, $. . . . in use tax/deferred sales tax, $. . . in interest, and a 5% assessment penalty of $. . . ., for a total of $. . . . The second assessment . . . for the period November 1, 2007, through September 30, 2010, consisted of $. . . in service and other activities B&O tax, $. . . in use tax/deferred sales tax, $. . . in interest, and a 5% assessment penalty of $. . . , for a total of $. . . . Taxpayer filed a timely appeal of these assessments.

ANALYSIS

In Washington, "there is levied and collected from every person that has a substantial nexus with this state a tax for the act or privilege of engaging in business activities." RCW 84.04.220. The B&O tax is a gross receipts tax, meaning that it applies to all value proceeding or accruing to the company, and not only to its profit margins. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788, 791 (2011). Within the statute, the term "business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly." RCW 82.04.140. The statute was written broadly because the legislature intended to impose the B&O tax on virtually all business activities carried on within the state. *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971). In this case, the Taxpayer makes three separate arguments as to why it should not be held liable for B&O tax on the amounts in question, and we will address each argument below.

I. Amounts paid from the Facility Operating Account for Taxpayer's legal obligations to its employees and its other operating expenses constitute gross income to Taxpayer.

Taxpayer's primary argument is that the payment of certain operating expenses that came out of the PFD's "Facility Operating Account" were used to pay the expenses of the PFD, rather than Taxpayer's own expenses, and that the payment of those expenses were not properly included in

[2] These separate assessments are a result of a structural change in the form of Taxpayer's legal entity. This change resulted in a separate tax reporting account, but Taxpayer's counsel has represented to the Department that the party to the appeal ("Taxpayer") is responsible for both assessments and is appealing both assessments.

Taxpayer's gross receipts subject to B&O taxation. The tax is measured against the value of products, gross proceeds of sales, or gross income of the business. RCW 82.04.220. In this case, because Taxpayer is subject to service and other activities B&O tax, the measure of tax is the gross income of the business. *See* RCW 82.04.290.

RCW 82.04.080 defines "gross income of the business" in the following manner:

> "Gross income of the business" means 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, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, 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.

RCW 82.04.080 (emphasis added). Under this broad definition, a service provider may not deduct from its gross income any of its own costs of doing business, including its labor costs. *Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989); *Pilcher v. Dep't of Revenue*, 112 Wash. App. 428, 436, 49 P.3d 947 (2002).

Taxpayer argues that its "facilitation of the payment of operating expenses" did not result in gross income of the business for B&O tax purposes because the PFD is ultimately liable for the operating expenses of the Facilities. Taxpayer claims that it never actually received nor accrued any consideration, or benefit, by virtue of its contractual responsibility to administer payments to both on-site personnel and third party vendors. Taxpayer concedes the Contract states that it "shall pay all Operating Expenses for the operation, maintenance, supervision and management of the Facilities from the funds in the Facility Operating Account," but Taxpayer contends this provision is not dispositive on the issue as to which party has ultimate liability for the payment of the salaries of facility personnel or other facility expenses.

An employer has an enforceable legal obligation to pay all wages it owes to its employees. RCW 49.48.040; RCW 49.48.060. Therefore, in order for Taxpayer to prove that no value accrued to it from payments from the PFD's Facility Operating Account to the facilities personnel, it would need to show that it was not, in fact, the employer of those employees. As is stated in more detail below, Taxpayer has failed to meet this burden. The fact that Taxpayer's employees were being paid from the PFD's Facility Operating Account, instead of out of Taxpayer's own bank account does not shield those payments from B&O taxation. The operative question for application of the B&O tax is whether the payments that came from the Facility Operating Account constituted value proceeding or accruing to Taxpayer by reason of the business engaged in. RCW 82.04.080. This is clearly the case, as Taxpayer's payroll obligations were met by these payments and the payroll obligations were incurred as a result of Taxpayer fulfilling its duties under the services Contract. Moreover, Taxpayer is not entitled to deduct its labor costs. RCW 82.04.080. Here, because the payments from the PFD's Facility Operating

Account to Taxpayer's employees relieved Taxpayer of the obligation to pay its labor costs directly they are "gross income of the business" subject to B&O taxation. RCW 82.04.080.

Likewise, Taxpayer has failed to provide evidence that the non-payroll-related operating expenses that were paid from the Facility Operating Account were being used to pay expenses of the PFD rather than Taxpayer's own expenses. In this case, Taxpayer contracted to perform management services for the PFD. The Contract authorizes Taxpayer to operate the Convention Center and specifically grants Taxpayer the right to withdraw and use funds in the Facility Operating Account to pay the operating expenses it incurs. Contract, pg. 5. The fact that Taxpayer paid the expenses it incurred from the PFD's Facility Operating Account instead of from its own account does not change the nature of the expenses. The expenses in operating the Convention Center were incurred by Taxpayer and Taxpayer paid its own expenses from the PFD's Facility Operating Account, as it was authorized to do contractually. The ability to pay its own expenses from the Facility Operating Account is certainly a value proceeding or accruing to Taxpayer by reason of its facility management service and those payments are properly included in Taxpayer's B&O tax base.

II. Amounts paid from the Facility Operating Account for Taxpayer's legal obligations to its employees are not entitled to [be excluded from gross income] under WAC 458-20-111.

Taxpayer's first alternative argument why it should not be liable for the assessed amounts of B&O tax is that the amounts paid to it should qualify for "pass-through treatment" under WAC 458-20-111 ("Rule 111"). Generally speaking, all receipts of a company are subject to B&O tax, without any deductions for costs such as labor, materials, taxes, or any other expense. RCW 82.04.080. However, Rule 111 articulates that certain payments may be excluded from the measure of B&O tax, when those payments are qualified "advancements" and "reimbursements." *See generally Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989).

For . . . a Rule 111 "advancement" or "reimbursement" [to qualify], the payment [must be a customary reimbursement for advances made to procure a service for the client, it must involve services that the taxpayer did not or could not render, and the taxpayer must not be liable for paying the third party except as the agent of the client. The agency element has two components. The taxpayer must prove both that the payment in dispute was made pursuant to an agency relationship and that the taxpayer's liability to pay the funds to a third party constituted solely agent liability. *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 177-78, 60 P.3d 79 (2003); *Rho*, 113 Wn.2d at 568-73]. Thus, advancements or reimbursements transferred by a taxpayer can be deducted from the [taxpayer's] gross income for B&O tax purposes [only] where the liability of the taxpayer is solely that of an agent. *City of Tacoma v. William Rogers Company, Inc.*, 148 Wn.2d 169, 175, 60 P.3d 79 (2002).

. . . Taxpayer argues that it did not render the services performed by the facilities personnel, but that that it simply managed the facilities personnel who were actually PFD employees. In support of its claim that the facilities personnel were employed by the PFD, Taxpayer claims the PFD had pervasive control with respect to hiring, compensating, evaluating, disciplining, and

terminating on-site personnel. Taxpayer cites as evidence the fact that all payroll checks are issued in the name of PFD from the Facility Operating Account. Taxpayer claims the PFD has the right to approve or disapprove of Taxpayer's choice for General Manager, the Annual Plan, and operating budgets. Taxpayer maintains that the PFD determines the days and hours of work for facilities personnel, and that the PFD provides work premises. Taxpayer argues that these facts prove that the PFD is the true "common law employer" for B&O tax purposes, despite the fact that Taxpayer is the employer of record for federal and state employment law purposes.

Taxpayer cites Det. No. 86-234, 1 WTD 103 (1986), as authority for the proposition that the Department will not find the employer of record determination conclusive as to who is the employer for B&O tax purposes. We agree that the employer of record determination is not conclusive to as to who is the employer for B&O tax purposes, but it does raise a presumption that the taxpayer is the employer. 1 WTD 103, at 3.[3] Unfortunately for Taxpayer, it has provided insufficient justification for a rebuttal of that presumption.

The Contract clearly states that Taxpayer is the employer[.] [It also demonstrates that the facility personnel were Taxpayer's employees and establishes that the work performed by Taxpayer's employees] is an "essential part of the service provided" to the PFD. *See City of Tacoma v. William Rogers Co., Inc.*, 148 Wn.2d 169, 179, 60 P.3d 79, 84 (2002). The application for employment states that Taxpayer is the employer. Taxpayer was contractually responsible for all personnel matters. Contract, at 5. Taxpayer purchased employers liability insurance. *Id.* at 14. Taxpayer complied with Workers Compensation and OSHA laws and contractually held PFD harmless for any claims arising from those laws. *Id*. at 15. Given the overwhelming weight of evidence tending to show that Taxpayer was the employer of the facility personnel, we hold that Taxpayer is indeed the employer.

Because Taxpayer is the employer of the facilities personnel, it cannot claim that it "does not render the service." The Washington Supreme Court has recently held:

> "Business" for purposes of the B&O tax liability at issue "includes all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. A business that employs an independent contractor does not thereby become exempt from B&O tax liability for any income derived in whole or in part because of the work the independent contractor does for the taxpayer. For example, a general contractor is liable for B&O taxes on its gross income without any reduction in income for amounts that it pays to independent subcontractors.

Washington Imaging Services v. Dep't of Revenue, 171 Wn.2d 548, 558, 252 P.3d 885 (2011). If a company that delegates work to subcontractors may not thereby absolve itself of its B&O tax liability then, *a fortiori*, a company cannot do so by delegating the work to its own employees.

[3] [*See also* ETA 3181.2013 ("When the taxpayer is the employer of record, the taxpayer is presumed to be the employer with liability for the employer obligations.")]

In other words, because Taxpayer was the employer of the workers performing the service, Taxpayer, by definition, rendered the services performed by those employees. . . .

Having decided that Taxpayer was the employer of the facilities personnel, Taxpayer likewise must fail the . . . Rule 111 [agency requirement]. Because Taxpayer was liable to pay its own employees, it was not liable for those payments in its capacity as an agent for the PFD. Taxpayer admits it is the employer of record for security and tax reporting purposes, but it argues that it is not the employer for B&O tax purposes and is merely an agent of PFD with respect to the payment of the facility personnel. Of course, as stated above, this position is contradicted by multiple provisions of the Contract, including the one that specifically states that "[Taxpayer] and his or her employees or agents performing under this Contract are **not** employees or agents of the [PFD]." Contract, at 25 (emphasis added).

Taxpayer correctly points out that existence of an agency relationship is not controlled by the manner in which the parties contractually describe their relationship. *Rho*, 113 Wn.2d 561, 569, 782 P.2d 986 (1989). However, the plain language of the contract is a starting point and is important evidence in determining whether an agency relationship exists. If Taxpayer wants to prove that the language of the contract is not controlling, it must make more than a blanket assertion that this is the case. The burden is on the taxpayer to establish that a B&O tax assessment is incorrect. *Ford Motor Co. v. City of Seattle, Exec. Servs. Dep't*, 160 Wn.2d 32, 41, 156 P.3d 185 (2007). Taxpayer has failed to meet that burden.

As the employer of the facility personnel, Taxpayer is not acting as an agent when those personnel are paid, even though the payroll checks come from the PFD's Facility Operating Account. Likewise, as Taxpayer was contracted to perform management services for the PFD, the expenses it incurs in performing those services are not incurred solely as an agent of the PFD. This is especially true in light of the fact that Taxpayer had the contractual right to pay its operating expenses from that account. *See* Contract, at 7. Taxpayer has not proved that it was acting as an agent of the PFD when it authorized payments made from PFD's Facility Operating Account to its own employees and for its own operating expenses and, as such, those payments do not qualify for [exclusion] under Rule 111.

III. Taxpayer is not engaged in the business of leasing property units and therefore is not entitled to statutory "property management" B&O tax [exemptions].

Prior to its repeal in 2011, there was a B&O tax exemption for amounts received by a property management company for wages of certain personnel. That statute provides:

> (1) This chapter does not apply to amounts received by a property management company from the owner of a property for gross wages and benefits paid directly to or on behalf of on-site personnel from property management trust accounts that are required to be maintained under RCW 18.85.310.
>
> (2) As used in this section, "on-site personnel" means a person who meets all of the following conditions: (a) The person works primarily at the owner's property; (b) the

> person's duties include leasing property units, maintaining the property, collecting rents, or similar activities; and (c) under a written property management agreement: (i) The person's compensation is the ultimate obligation of the property owner and not the property manager; (ii) the property manager is liable for payment only as agent of the owner; and (iii) the property manager is the agent of the owner with respect to the on-site personnel and that all actions, including, but not limited to, hiring, firing, compensation, and conditions of employment, taken by the property manager with respect to the on-site personnel are subject to the approval of the property owner.

RCW 82.04.394 (1998).

This exemption does not apply to Taxpayer for numerous reasons. First, the "on-site personnel" in this case are not engaged in "leasing property units," "collecting rents," or "similar activities." RCW 82.04.394(2)(b). As stated above, the facility personnel are Taxpayer's employees, so the Taxpayer is not "liable for payment only as an agent of the owner" and is also not "the agent of the owner with respect to the on-site personnel." RCW 82.04.394(2)(c)(ii), (iii). In short, Taxpayer is not engaged in the business of property management and this statute is therefore inapplicable.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 13th day of November 2012.