

Cite as Det. No. 17-0148, 39 WTD 072 (2020)

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. 17-0148
)	
...)	Registration No. . . .
)	

[1] WAC 458-20-111; ETA 3181.2013 – ADVANCES AND REIMBURSEMENTS – EMPLOYER OF RECORD – PAYMENTS AS CUSTOMARY REIMBURSEMENTS: Taxpayer, as employer of record, failed to overcome presumption that it is the employer with liability for the employer obligations because it failed to show that individual Affiliates had all control over employees, that it had no control over employees, and the individual Affiliates agreed in writing that they were liable for all employer obligations.

[2] RCW 82.04.43393 – PAYMASTER SERVICES DEDUCTION – FUNCTIONAL EMPLOYMENT RELATIONSHIP: Where evidence indicates that the Affiliates and Taxpayer, collectively, have control over the employees, and there is no evidence that clearly and unequivocally communicates any one Affiliate has control over the employees, we conclude that Taxpayer has failed to show that any one Affiliate has a functional employment relationship with the employees. As such, the employees are not qualified employees and Taxpayer does not qualify to deduct the payments for employee expenses because such amounts were not used to cover the costs of qualified employees.

[3] RCW 82.04.462; WAC 458-20-19402 – APPORTIONMENT – ATTRIBUTION OF EMPLOYER OF RECORD BUSINESS ACTIVITIES: Taxpayer’s employer of record/paymaster service is similar to the human resource services in Example 24 and general management services in Example 25, and both examples conclude that services related to employees are received at the location of the business where the customer’s related business activities occur. Accordingly, we conclude the Affiliates (Taxpayer’s customers) receive the benefit of the employees at their Washington headquarters; WAC 458-20-19402(303) attributes and RCW 82.04.462 apportions, all amounts paid to Taxpayer for employer of record/paymaster services to Washington.

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.

Anderson, T.R.O. – An employer of record disputes the assessment of service and other activities business and occupation (“B&O”) tax on amounts received from affiliates to compensate for the employer of record’s payment of the affiliates’ employee expenses. The employer of record asserts it qualifies as a paymaster and such amounts are excluded from gross income under WAC 458-20-111 and RCW 82.04.43393. Alternatively, should we find these payments are included in gross income, the employer of record asserts these payments should be sourced to the locations of the affiliates’ properties being managed by the employees and apportioned outside Washington. Petition denied.¹

ISSUES

1. Whether an employer of record may exclude amounts received from affiliates to compensate for the employer of record’s payment of the affiliates’ employee expenses under WAC 458-20-111 and ETA 3181.2013.
2. 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.
3. Whether an employer of record may apportion employee expense amounts to the locations of affiliates’ properties managed by such employees, under RCW 82.04.462 and WAC 458-20-19402.

FINDINGS OF FACT

. . . (“Taxpayer”) is the employer of record for employees staffing the following four Washington affiliated businesses: . . . , (collectively, the “Affiliates”). Since 2008, Taxpayer has paid the employees’ payroll, retirement account contributions, and health savings account contributions. In turn, the Affiliates pay Taxpayer the amounts it expends for the payment of these employees’ payroll, retirement account contributions, and health savings account contributions.

The parent corporation of the affiliated group is Taxpayer and the Affiliates are owned (in large part, if not entirely) by . . . and headquartered in Washington. The Affiliates engage in various real estate-related business activities.² Employees staffing the Affiliates provide business support for property management activities such as hiring on-site management, contracting, renting, and maintaining the properties. For example, Taxpayer states the Affiliates may be responsible for contracting out on-site property management activities/grounds maintenance activities such as landscaping and pool maintenance. The employees engage in these activities from the Affiliates’ Washington headquarters and may occasionally travel to the locations of the properties in Washington . . . and various other states.

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

² . . . purchases limited partnership and other financial interests in partnerships that own apartment complexes; . . . manages acquisitions, dispositions, and operations of affordable housing properties; . . . acquires or leases land and builds apartments; and . . . purchases, sells, and manages convention apartment complexes.

On January 1, 2008, Taxpayer and each of the Affiliates entered into a “Reimbursement Agreement” that states, in pertinent parts, as follows:

...

2. Common Paymaster. Paymaster shall act as paymaster for the Affiliate’s employees, provided however, that all employees of the Affiliate shall remain solely employees of the Affiliate and the Affiliate shall reimburse Paymaster for the salaries and other payroll expenses (including employment taxes, insurance premiums and deductibles, and fringe benefits) of such employment.

...

4. General Principles of Cost Allocation.

(a) **No fee.** Paymaster shall receive no fee or other compensation for the Services performed hereunder, however, Paymaster shall receive reimbursement from Affiliate for the costs and expenses paid or incurred by Paymaster in connection with the Services as set forth herein.

(b) **Cost Allocation.** Paymaster and Affiliate agree and acknowledge that Paymaster may utilize its employees, equipment, facilities and other assets for the provision of the Services and for the conduct of Paymaster’s business. All of Paymaster’s expenses paid or incurred in connection with the Services or Affiliate’s business shall be paid or reimbursed by Affiliate in full, upon request. Paymaster hereby agrees to record the cost and expenses separately for the Services and Paymaster’s business.

Each “Reimbursement Agreement” was effective for one year and automatically renewed (for one year) unless a party provided notice to terminate.

On January 10, 2008, Taxpayer and the Affiliates invited all employees to attend a Brown Bag Seminar on Taxpayer’s role as employer of record and the contents of the Reimbursement Agreements. A few days later, on January 13, 2008, . . . , Director of Human Resources/ . . . , sent an e-mail to “. . . All” to further explain Taxpayer’s role as employer of record. In pertinent parts, the e-mail states as follows:

Effective January 1, 2008, . . . will replace . . . and . . . as our paymaster so that our payroll costs can be incurred directly by the new business entities. By setting up this new paymaster entity, we will save approximately \$. . . per year in Washington and [City] B&O Tax. . . has entered into a paymaster/reimbursement contracts with the 4 main business groups. So while your paycheck and future W-2s will be issued by . . . , some of you will actually be employed by one of the four new business entities.

If you work exclusively for one of the new business entities, that particular entity will be your legal “employer.” In other words, . . . all work exclusively for . . . all work exclusively for . . . works exclusively for . . . all work exclusively for . . .

The remainder of us work for the paymaster entity, . . . , as our work is allocated across all of the business units in various percentages.

. . .

Now, if you're saying to yourself that this seems pretty confusing, we understand. Because we all say we work for ". . .," and that is how we are known through our business partners, website, vendors, etc., we have filed the trade name ". . ." to apply to all of our business units. While the legal name of your entity might be . . . -----, you can still identify yourself as an employee of The trade name we filed has no "Inc." on it; it is simply

The Washington State Department of Revenue's (the "Department's") Audit Division ("Audit") reviewed Taxpayer's books and records from January 1, 2010, through March 31, 2014 (the "Audit Period"). On June 1, 2015, Audit issued an assessment against Taxpayer for \$. . . , comprised of \$. . . in service and other activities B&O tax, \$. . . in interest, and \$. . . in 5% assessment penalty.

The entire assessment stems from payments received from the Affiliates, for Taxpayer's payment of, the payroll, retirement account contributions, and health savings account contributions, for employees staffing the Affiliates. Taxpayer excluded these payments from gross income because it believed Taxpayer was acting as a paymaster and entitled to exclude these payments as advances or reimbursements under WAC 458-20-111.

After reviewing Taxpayer's general ledger, payroll contracts, employee contracts, employee handbook, and e-mails, Audit concluded that Taxpayer had failed to demonstrate the arrangement met the first and third elements of WAC 458-20-111. The January 13, 2008, e-mail stated that Taxpayer had its own employees to allocate to the Affiliates and Audit concluded that Taxpayer was liable for the employee obligations with respect to these employees; thus, Taxpayer failed to show that employee expense amounts were customary reimbursements or advances.

In addition, the example employment contract dated June 3, 2014, and the January 13, 2008, e-mail, state that Taxpayer and the Affiliates are part of "the Company," and instructs employees to identify themselves as employees of ". . ." Audit concluded that these references to the collective group of related companies failed to establish who held control over the employees for purposes of supervising, compensation, hiring and firing, etc., in the eyes of the employees. Audit determined the documents assigned control to the parent corporation, Taxpayer, and Affiliates, collectively; thus, Taxpayer failed to show that employee expense amounts were customary reimbursements or advances.

Audit also concluded that Taxpayer had failed to establish that it is a bona fide agent of the individual Affiliates and has no liability for employer obligations, other than as agent. Although Audit found consent and control sufficient to establish Taxpayer as a bona fide agent, Audit determined Taxpayer had potential for primary or secondary liability for employer obligations because it had not informed employees of the agency relationship and received written acknowledgement and consent to the arrangement. Further, as mentioned above, Audit found clear liability for the employer obligations for those employees that worked for Taxpayer.

For the later portion of the Audit Period (October 1, 2013 – March 31, 2014), Audit concluded that Taxpayer did not qualify to deduct employee expense amounts from gross income under RCW 82.04.43393. (Beginning October 1, 2013, a qualified employer of record engaged in providing paymaster services for affiliated businesses, who met the statutory criteria, could deduct amounts received for such services under RCW 82.04.43393.) Audit found the collective control over the employees prevented any one Affiliate from having a “functional employment relationship” with employees serving as staff (for such one Affiliate) and the employees were not “qualified employees” under RCW 82.04.43393.

Taxpayer disputes the full assessment and asserts that the employee expense payments are excluded from gross income under WAC 458-20-111. Taxpayer asserts that it was acting as an agent of the Affiliates and notified the employees that Taxpayer was not the employer.

In the course of the appeal, Taxpayer gathered and provided acknowledgements signed September 30, 2015, to October 15, 2015, from every employee of the Affiliates, which state:

Acknowledgement made as of the _____ day of _____, 2015, by _____ (the “Employee”).

- . . . :
- . . . (formerly . . .)
- . . . (formerly . . .)
- . . . (formerly . . .)

It is understood and agreed that any liability for employer obligations with regards to the Employee’s compensation, benefits, or other employer obligations is solely that of the above . . . entity. It is further understood and agreed that . . . acts as the agent of the above . . . entity in administering and paying the payroll of the Employee. As such, . . . has no primary or secondary liability for the employer obligations to the Employee.

It is understood and agreed that the above . . . entity has exclusive authority to supervise the Employee, determine the Employee’s activities, conduct the Employee’s performance reviews, and perform other common employer functions and duties. As such, . . . only acts as a paymaster and has no functional employment relationship with the Employee.

It is understood and agreed that the Employee performs services related to the real property related business activities of the above . . . entity

The above statements apply to all periods dating back to the date the Employee was first employed by the above . . . entity.

Employee Signature Date

Taxpayer asserts that the January 13, 2008, e-mail and these acknowledgements establish:

. . . (1) . . . has never been liable for the employees' salaries, benefits, payroll taxes, and similar obligations of the employees of its affiliates new business entities; (2) . . . has never exercised control over the employees of its affiliates in terms of supervision, compensation, hiring, and firing; and (3) the employees of the affiliates were informed of and acknowledged the agency relationship between . . . and its affiliates.

Taxpayer also states that its own employees (those that the January 13, 2008 [email], stated Taxpayer would allocate amongst the Affiliates) were not included in the assessment, and it reported and paid business and occupation tax on any employee expense payments received for these employees.

Taxpayer asserts that Audit wrongly concluded no one Affiliate has a functional employment relationship with the employees staffing it and Taxpayer is not entitled to deduct employee expense payments under RCW 82.04.43393.

Should we determine that employee expense payments are included in Taxpayer's gross income, Taxpayer asserts that we should apportion the payments to the location of the Affiliates' properties managed by the employees.

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. Department of Rev.*, 120 Wn.2d 357, 841 P.2d 752 (1992). We measure the tax 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 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 expenses whatsoever paid or accrued. RCW 82.04.080.

WAC 458-20-111: Advance or Reimbursement

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. WAC 458-20-111 is the Department's Administrative Rule setting forth the criteria for excludable advances and reimbursements and 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." WAC 458-20-111.

WAC 458-20-111 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).

In total, WAC 458-20-111 sets forth the following three requirements:

1. The payments are customary reimbursements for advances made to procure a service for the client;
2. The payments involve services that the taxpayer does not or cannot render; and
3. The taxpayer is not liable for paying the employer obligations, except as the agent of the client.

WAC 458-20-111; see also *Washington Imaging Services, LLC*, 171 Wn.2d at 561-562. A payment must meet all of these requirements to be excludable from gross income. *Id.* Here, our focus is on the first and third requirements.

The Department has issued guidance on the application of WAC 458-20-111 to paymasters and employers of record. Excise Tax Advisory 3181.2013 (“ETA 3181”) provides guidance in determining when a taxpayer qualifies as a paymaster and is able to exclude amounts received to pay the employer obligations of its clients from gross income. A “paymaster” is “generally . . . a person that acts as an agent for the purpose of paying the employer obligations of one or more clients,” and, the term “employer obligations” includes employee salaries, benefits, payroll taxes, and similar obligations.

ETA 3181 goes on to explain that, when the taxpayer is an employer of record – as here – certain safe harbors apply to the first and third, requirements.³

As to the first requirement, 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.);

³ By way of background, “An ‘employer of record’ is the person who reports employees under its own UBI or EIN for state or federal tax, employment security, or insurance purposes.” ETA 3181.

- 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).

As to the third requirement, ETA 3181 states, in pertinent part:

An employer of record may have liability for certain employer obligations under common law and state and federal statutes. However, for purposes of this ETA, a taxpayer that is an employer of record will be deemed to satisfy this element when either:

- Each employee agrees in writing that the paymaster has no liability to the employee to pay any employer obligations; or
- In the case of a captive paymaster, the paymaster is a Form 2678 Agent for the clients under 26 U.S.C. §3504 and the employees are provided with written notice of the paymaster arrangement, including the client's status as employer liable to the employees for all employer obligations.

(Emphasis added.)

Taxation is the rule and exemption is the exception. *Budget Rent-A-Car of Washington-Oregon, Inc. v. Washington Dep't of Revenue*, 81 Wn.2d 171, 174 – 175, 500 P.2d 764 (1972), citing, *Fibreboard Paper Prods. Corp. v. State*, 66 Wn.2d 87, 401 P.2d 623 (1965). Anyone claiming a benefit or deduction from a tax has the burden of showing that she qualifies for it. *Budget Rent-A-Car of Washington-Oregon Inc.*, 81 Wn.2d at 174-175, citing, *Group Health Coop. of Puget Sound, Inc. v. Washington State Tax Comm'n*, 72 Wn.2d 422, 433 P.2d 201 (1967).

With respect to the first requirement, Taxpayer must provide the Department with evidence to establish that the individual Affiliates were the employers with liability for the employer obligations. ETA 3181; WAC 458-20-111. For example, Taxpayer can do this by showing the individual Affiliates had all control over employees; Taxpayer had no control over employees; and the individual Affiliates agreed in writing that they were liable for all employer obligations. Here, Taxpayer has provided the following pieces of evidence: (1) the January 13, 2008 e-mail; (2) the Reimbursement Agreement; (3) a sample employment letter; and (4) employee acknowledgments signed after the Audit Period. After considering this evidence, we conclude that Taxpayer has not met its burden to show that individual Affiliates were the employers with liability for the employer obligations.

January 13, 2008 E-mail

The January 13, 2008, e-mail to employees explains Taxpayer's role as "our paymaster" and states that Taxpayer will issue paychecks and W-2s while "some of you will actually be employed by one of the four new business entities." We conclude the January 13, 2008 e-mail does not show that the individual Affiliates were the employers with liability for employer obligations.

The January 13, 2008, e-mail goes on to tell employees, "While the legal name of your entity might be . . . -----, you can still identify yourself as an employee of . . ." This statement communicates

to the employees that all the related entities, i.e. all Affiliates and Taxpayer, have collective control over the employees. The January 13, 2008, e-mail does not establish that any one Affiliate has pervasive control of the employees staffing it.

Reimbursement Agreement

The Reimbursement Agreement also communicates collective control over employees. It states that Taxpayer shall serve as a paymaster for the Affiliate's employees, all employees of the Affiliate shall remain solely employees of the Affiliates, and the Affiliates shall reimburse Taxpayer (as paymaster) for the salaries and other payroll expenses of such employment. (Paragraph 2.) But, then, the Reimbursement Agreement states, "Paymaster [Taxpayer] and Affiliate agree and acknowledge that Paymaster may utilize its employees, equipment, facilities and other assets for the provision of the Services and for the conduct of Paymaster's business." This statement communicates that even employees staffing the Affiliates are subject to Taxpayer's use and control for any conduct of Taxpayer's business. The Reimbursement Agreement does not establish that any one Affiliate has pervasive control of the employees staffing it nor that Taxpayer had no control over the employees.

Sample Employment Letter

Lastly, the sample employment letter also communicates this collective control over employees. . . . – the tradename for Taxpayer and the Affiliates – offers the employment opportunity and sets the terms (salary, benefits, duties of employment, etc.) of such employment. The sample employment letter does not specify the actual Affiliate the prospective employee will be staffing. Using a trade name instead of a specific Affiliate communicates that every entity using the trade name (including Taxpayer) will have collective control over the prospective employee, rather than a specific Affiliate with pervasive control.

We agree with Audit's conclusion that the evidence fails to establish that the individual Affiliates were the employers with liability for the employer obligations, as the January 13, 2008, e-mail, Reimbursement Agreement, and sample employment letter, do not show the individual Affiliates had pervasive control over employees and Taxpayer had no control over such employees.

Employee Acknowledgments

We note that Taxpayer has provided employee acknowledgments that state the employee understands the individual Affiliate is liable for any employer obligations and has pervasive control over such employee. The employee acknowledgments also state that Taxpayer has no liability for employer obligations, acts only as paymaster, and has no functional employment relationship with the employee. These employee acknowledgments contain the key language required by ETA 3181 for a paymaster to exclude employee expense reimbursements and advances from gross income. However, the employee signed the employee acknowledgments after the Audit Period.

With these employee acknowledgments, Taxpayer asserts that it has presented the Department with the same information as the taxpayer in Det. No. 12-0166ER, 35 WTD 82 (2013). In 35 WTD

82, the Department found an affiliated payroll agent was entitled to exclude affiliate's payroll reimbursements from gross income, subject to the verification of employee acknowledgments. The taxpayer in 35 WTD 82 presented the Department with a reimbursement agreement stating the affiliates had pervasive control over the employees and employee acknowledgments signed and dated, contemporaneous to the date the taxpayer and affiliates entered into the Reimbursement Agreement. The Department granted taxpayer's petition subject to verification that every employee had signed an employee acknowledgment contemporaneous with affiliates signing the Reimbursement Agreement.

Here, the signature date of Taxpayer's employee acknowledgments distinguishes this Taxpayer from the taxpayer in 35 WTD 82. The holding in 35 WTD 82 – granted, subject to verification of the signatures of the employee acknowledgments – illustrates the importance of contemporaneous employee acknowledgment and consent (signature). Further, as explained above, the retroactive employee acknowledgments are inconsistent with the contemporaneous documents (January 13, 2008, e-mail, Reimbursement Agreement, and sample employment letter).

Because Taxpayer has failed to establish that it meets the first requirement of WAC 458-20-111, we conclude that Audit properly determined that WAC 458-20-111 does not exclude the employee expense payments from Taxpayer's gross income.

RCW 82.04.43393: Paymaster Services Deduction

On October 1, 2013, (during the Audit Period) a deduction for certain amounts received from providing paymaster services to an affiliated business became effective. RCW 82.04.43393 reads, in pertinent part, as follows:

(1) 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.

(Emphasis added.)

RCW 82.04.43393 allows a deduction when each of the four requirements are met: (1) the taxpayer is a qualified employer of record; (2) the taxpayer is providing paymaster services; (3) the paymaster services are provided to an affiliated business only; and (4) the amount are paid to cover the costs of a qualified employee. Excise Tax Advisory 3196.2014 ("ETA 3196"). Audit concluded that Taxpayer's and the Affiliates' collective control over the employees prevented them from being "qualified employees." Our focus is on the fourth requirement.

"'Qualified employee' means 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." RCW 82.04.43393(2)(e). (Emphasis added.)

“Functional employment relationship’ means having control over the work schedule and activities of the employees and control over all employment decisions such as salary, discipline, hiring, or layoffs.” RCW 82.04.43393(2)(c). Or, stated differently, functional employment relationship means pervasive control.

As explained above, the evidence indicates that the Affiliates and Taxpayer, collectively, have control over the employees. There is no evidence that clearly and unequivocally communicates any one Affiliate has control over the employees. We conclude that Taxpayer has failed to show that any one Affiliate has a functional employment relationship with the employees. As such, the employees are not qualified employees and Taxpayer does not qualify to deduct the payments for employee expenses because such amounts were not to cover the costs of qualified employees.

Apportionment

Because we have determined that the employee expenses payments are included in Taxpayer’s gross income, we now consider Taxpayer’s alternative argument to attribute such amounts to the individual locations of the Affiliates’ properties managed by the employees.

Effective June 1, 2010, RCW 82.04.460(1) provides:

Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person’s apportionable income derived from business activities performed within this state.

“Apportionable income” is gross income of the business generated from engaging in apportionable activities. RCW 82.04.460(4)(a). “Apportionable activities” specifically include those taxed under RCW 82.04.290, the service and other activities B&O tax classification. RCW 82.04.460(4)(a)(vi). Here, Taxpayer provided employer of record/paymaster services, which are taxable under RCW 82.04.290. Therefore, Taxpayer was engaged in “apportionable activities” in Washington and earned “apportionable income.”

WAC 458-20-19402 is the Department’s Administrative Rule explaining the application of single factor receipts apportionment. It defines “[t]axable in another state” to mean either:

- (A) The taxpayer is subject to a business activities tax by another state on the taxpayer’s income received from engaging in apportionable activity; or
- (B) The taxpayer is not subject to a business activities tax by another state on the taxpayer’s income received from engaging in apportionable activity, but the taxpayer meets the substantial nexus thresholds described in WAC 458-20-19401 for that state.

WAC 458-20-19402(105)(h)(i). Taxpayer has failed to show us that it is also taxable in another state. The record before us does not reflect that Taxpayer was subject to a business activities tax nor met the substantial nexus threshold in WAC 458-20-19401, in another state, for employer of

record/paymaster activities. Thus, Taxpayer's apportionable income does not appear eligible for apportionment under RCW 82.04.460.

However, both Taxpayer and Audit agree that Taxpayer's gross income from employer of record/paymaster services is subject to apportionment under RCW 82.04.460. Therefore, we assume that Taxpayer has satisfied Audit that it earned apportionable income from employer of record/paymaster services also taxable in another state and apply the applicable laws to determine the appropriate apportionment methodology.

Attribution

Washington employs a "receipts factor" fraction to apportion income to Washington. RCW 82.04.462. Taxpayers multiply apportionable income by the receipts factor fraction, where the numerator is the gross income of the business attributable to Washington and the denominator is the gross income of the business worldwide. RCW 82.04.462(1), (3)(a). The product is the amount of gross income apportioned to Washington.

Gross income is attributed to Washington based on a series of cascading rules set forth in RCW 82.04.462(3)(b). The first rule attributes receipts to the location where the customer received the benefit of the taxpayer's service. RCW 82.04.462(3)(b)(i), WAC 458-20-19402(301). Taxpayer and Audit agree that this rule governs the attribution of Taxpayer's gross income but disagree as to the location where the customer received the benefit of Taxpayer's services.

To start, we determine the identity of the customers. WAC 458-20-19402 defines "[c]ustomer" to mean "a person or entity to whom the taxpayer makes a sale, grants the right to use intangible property, or renders services or from whom the taxpayer otherwise directly or indirectly receives gross income of the business." WAC 458-20-19402(106)(e). Here, Taxpayer is providing employer of record/paymaster services to the Affiliates; thus, Taxpayer's customers are the Affiliates.

Next, we determine the location where the Affiliates (customers) received the benefit of Taxpayer's services. Taxpayer asserts such locations were the locations of the properties managed by employees and Audit asserts such locations were the location of the employees at the headquarters of the Affiliates. WAC 458-20-19402(303) sets forth a framework to determine where the benefit of service was received.

Services Related to Real Property

If the taxpayer's service relates to real property, then the benefit is received where the real property is located. WAC 458-20-19402(303)(a). "The following is a nonexclusive list of services that relate to real property: (i) Architectural; (ii) Surveying; (iii) Janitorial; (iv) Security; (v) Appraisals; and (vi) Real estate brokerage." WAC 458-20-19402(303)(a).

Taxpayer asserts that the Affiliates receive the benefit of Taxpayer's employer of record/paymaster service at the location of the properties managed by the Affiliates because such service relates to real property. WAC 458-20-19402(303)(a). We disagree. Taxpayer's employer of

record/paymaster service does not relate to real property because it is not a service directly connected to real property, such as architectural, surveying, etc.

Services Unrelated to Real or Tangible Personal Property, Provided to a Customer in Business, and Related to the Customer's Business Activities

If the taxpayer's service does not relate to real or tangible personal property, the service is provided to a customer engaged in business, and the service relates to the customer's business activities, then the benefit is received where the customer's related business activities occur. WAC 458-20-19402(303)(c). "The following is a nonexclusive list of business related services: (i) Developing a business management plan; (ii) Commission sales (other than sales of real or tangible personal property); (iii) Debt collection services; (iv) Legal and accounting services not specific to real or tangible personal property; (v) Advertising services; and (vi) Theater presentations." WAC 458-20-19402(303)(c).

Several examples illustrate the application of this framework. *See* WAC 458-20-19402(304)(c). There is no example that explains the receipt of the benefit of employer of record/paymaster services; however, the following two examples aid us in our analysis:

Example 24. Company A provides human resources services to Racko, Inc. which has three offices that use those services in Washington, Oregon, and Idaho. Racko sells widgets and has customers for its widgets in all 50 states. The benefit of the service performed by Company A is received in Racko's locations in Washington, Oregon, and Idaho. Assuming that each office is approximately the same size and uses the services to approximately the same extent, then attributing 1/3 of the receipts to each of the states in which Racko has locations using the services is a reasonable method of proportionally attributing Company A's receipts from Racko.

Example 25. Director serves on the board of directors for DEF, Inc. Director's services relate to the general management of DEF, Inc. DEF, Inc. is Director's customer and receives the benefit of Director's services at its corporate domicile. Therefore, Director must attribute the receipts earned from Director's services to DEF to DEF's corporate domicile.

WAC 458-20-19402(304)(c).

Employer of record/paymaster services are similar to the human resource services in Example 24 and general management services in Example 25. Taxpayer provides all the employees that staff the Affiliates and the employees perform the business tasks of the Affiliates. Both examples conclude that services related to employees (human resource and general management) are received at the location of the business – where the customer's related business activities occur.

Here, Taxpayer's employees engage in property management (the business activities of the Affiliates) and are assigned to work at the Affiliates' headquarters in Washington. Taxpayer has stated that employees may travel in the course of their property management activities; however, such travel appears to be occasional and limited to certain employees. We conclude the Affiliates

(Taxpayer's customers) receive the benefit of the employees at their Washington headquarters; WAC 458-20-19402(303) attributes and RCW 82.04.462 apportions, all amounts paid to Taxpayer for employer of record/paymaster services to Washington.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 8th day of June 2017.