Cite as Det. No. 14-0313, 34 WTD 133 (2015)

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. 14-0313
. . .	)	Registration No. . . .

[1] RULE 111: ADVANCES AND REIMBURSEMENTS – PERSONAL LIABILITY FOR PAYMENT OF PAYROLL EXPENSES. Where the available documentation indicated that the taxpayer was personally liable for payment of payroll expenses, as opposed to merely being liable as an agent, the taxpayer was properly precluded from excluding from the measure of its tax liability any amounts the taxpayer received for payment of such payroll expenses.

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.

Yonker, A.L.J. – An out-of-state corporation (Taxpayer) that reported wages in Washington as the employer of record for film crews working in Washington protests the assessment of service and other activities business and occupation (B&O) tax on Taxpayer's full gross income, arguing that amounts it received for payroll and benefits from its Washington client are excludable reimbursements under WAC 458-20-111. Because Taxpayer failed to prove that it was not personally liable for the payment of payroll and benefits expenses associated with the film crews, we conclude those expenses were not excludable under WAC 458-20-111. The petition is denied.[1]

ISSUE

Is Taxpayer personally liable for payment of certain payroll and benefits expenses, such that those expenses are not excludable from gross income under WAC 458-20-111?

FINDINGS OF FACT

[Taxpayer] is an [out of state] corporation that provides "employment services" and camera crew booking for the entertainment and media production industry. . . .

. . .

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

. . . Taxpayer advertises that it is the employer of the employees engaged by Taxpayer's clients and is responsible for all aspects of their employment.

In addition to employment services, Taxpayer also offers camera crew booking. . . .

. . .

During the time period at issue, Taxpayer had one Washington client . . . On June 30, 2008, Taxpayer entered into a Master Vendor Agreement (contract) with [the Client] to provide certain services over five years during which the contract was valid. The services Taxpayer was to provide under the contract were not specifically defined in the contract, but in separate statements of work (SOWs).[2] Taxpayer represented on appeal that the nature of the service it provided to the client was "fulfilling crewing positions" that are not staffed by the client's own production studio for various projects during the life of the contract. Relevant terms in the contract include the following:

- Taxpayer will "recruit, select and train its personnel in accordance with the requirements of the applicable SOW." (Section 2.4(a)).
- Taxpayer will "use persons qualified to perform" the services required under the applicable SOW. (Section 2.4(a)).
- Taxpayer will not charge fees for services performed by personnel who are not qualified to perform those services. (Section 2.4(a)).
- The client "will pay [Taxpayer] those fees described in each SOW. . . . [Taxpayer] will be responsible for all expenses it incurs (including, for example, providing equipment, insurance coverage and training of its employees) other than those [the client] agrees to pay in the SOW." (Section 5.1(a)).
- Any expense the client "agrees to pay will be reimbursed as pass-through costs with no markup" unless otherwise "expressly provided in the applicable SOW." (Section 5.1(a)).
- Taxpayer will perform the services under the SOWs "in a professional manner" and Taxpayer's performance "will be of high grade, nature and quality; and [Taxpayer] will dedicate appropriate facilities, skilled employees, and resources to complete" the services as indicated in the SOWs. (Section 7.6).
- "Under no circumstances will [Taxpayer's] employees or Subcontractors be construed as [the client's] employees." (Section 13.1).
- Taxpayer "will be held responsible for all obligations as employer of record for the personnel under its employ and on assignment at [the client]; including the proper calculation and payment of all payroll tax withholding, unemployment, benefits, and all other applicable employer obligations in accordance with state and federal regulations." (Section 13.1).

During the relevant time periods in this case, Taxpayer reported all of its business activity under the service and other activities business and occupation (B&O) tax classification. On November

[2] Taxpayer has not provided any examples of SOWs to TAA or during the appeal process.

16, 2012, Taxpayer submitted amended returns covering the period of January 1, 2010 through December 31, 2010 and July 1, 2011 through September 30, 2011, and requested a refund for a portion of the service and other activities B&O tax which Taxpayer previously paid during those periods. Taxpayer explained in its refund request that the refund was appropriate because Taxpayer had "overstated" its gross income in its original combined excise tax returns for each of the time periods identified, stating "[t]his is because we reported taxable wages instead of gross income."

A comparison of the amounts of gross income Taxpayer originally reported on its combined excise tax returns for each tax period and the amounts of gross income Taxpayer reported on its amended combined excise tax returns and associated refund requests is as follows:

Tax Period	Original Gross Income Reported	Amended Gross Income Reported
Q1 2010	$. . .	$. . .
Q2 2010	$. . .	$. . .
Q3 2010	$. . .	$. . .
Q4 2010	$. . .	$. . .
Q3 2011	$. . .	$. . .

The Department's Taxpayer Account Administration Division (TAA) reviewed Taxpayer's refund request. TAA requested additional documentation from Taxpayer to substantiate the refund request. On February 26, 2013, TAA denied Taxpayer's refund request because Taxpayer failed to provide any further documentation or explanation to substantiate its refund request.

On May 5, 2013, Taxpayer submitted a new refund request, this time for the period of January 1, 2010 through March 31, 2013. TAA discussed the refund request directly with Taxpayer, questioning how gross income, as reported in the amended returns, could be so significantly less than the amounts Taxpayer originally reported. TAA explained to Taxpayer that if the originally-reported amounts were only Taxpayer's "wages" as opposed to total gross income, TAA would expect the amended total gross income amounts to be higher. Taxpayer stated it would reconsider its position, but did not respond to further inquiries from TAA. In addition, TAA reviewed Taxpayer's contract with the client and requested additional supporting documentation to substantiate the second refund request, including invoices and a completed Schedule of Gross Income. Taxpayer did not respond to TAA's request for additional documentation.

Because of TAA's concern that Taxpayer was not correctly reporting its gross income, TAA conducted a review of Taxpayer's books and records for the period of January 1, 2009 through June 30, 2013 (audit period). As a result of that review, TAA found that Taxpayer owed additional B&O tax on gross income Taxpayer failed to report. On November 25, 2013, the Department issued a tax assessment for $. . . , which included $. . . in additional estimated tax liability, a $. . . five percent assessment penalty, and $. . . in interest.

. . .

Taxpayer timely appealed the full amount of the tax assessment and also appealed the balance due notice issued by the Department as a result of Taxpayer failing to pay its tax liability for the subsequent time period of July 1, 2013 through September 30, 2013 (subsequent tax period). On appeal, at our request, Taxpayer provided a sample of invoices Taxpayer issued to the client during the audit period. These invoices include separate line items for the following categories: (1) salaries, (2) fringe (OASDI, Medicare, FUI, SUI, WC), (3) fringe (pension, H&W, VAC/HOL), (4) reimbursements,[3] (5) salary advances, (6) employee deduction credits, and (7) handling fee. Only one invoice, issued on August 31, 2011, included an invoiced amount for "reimbursements." None of the invoices included invoiced amounts for "salary advances."

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, 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.

Taxpayers engaged in an activity that is not specifically classified for B&O tax purposes under Chapter 82.04 RCW report their "gross income of the business" under the service and other activities tax classification. 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 other expense whatsoever paid or accrued**." 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. Det. No. 12-0318, 33 WTD 91 (2014) (citing *Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989)).

However, certain receipts are recognized as merely reimbursements for expenses advanced for a client, and, therefore, are not considered income for that business. WAC 458-20-111 (Rule 111). Rule 111 allows a taxpayer to [exclude] "reimbursements" and "advances" from gross income when the taxpayer's 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, 561-62, 252 P.3d 885 (2011); *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 a traditional 'pass through' scenario, 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").

We note that Taxpayer has the burden of establishing its entitlement to any deduction or exemption from tax liability. *See Budget Rent-A-Car, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972) ("Exemptions to the tax law must be narrowly construed. Taxation

[3] The invoices do not provide any detail or description of the nature of the "reimbursement" category.

is the rule and exemption is the exception. Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it"); *see also Lacey Nursing v. Dep't of Revenue,* 128 Wn.2d 40, 905 P.2d 338 (1995); *Port of Seattle v. State,* 101 Wn. App. 106, 1 P.3d 607 (2000); Det. No. 13-0279, 33 WTD 75 (2014). Thus, in order for Taxpayer to be entitled to [exclude] its payroll expenses from its gross income under Rule 111, Taxpayer has the burden of proving that it is not personally liable for the payroll expenses.

Here, the contract between Taxpayer and the client contains numerous terms that indicate Taxpayer – not the client – was personally liable for the payroll expenses associated with the work employees did under the contract. First, the contract specifically states that Taxpayer "will recruit, select and train its personnel in accordance with the requirements" of a SOW. Second, the contract states that Taxpayer "will be responsible for all expenses it incurs (including, for example, providing equipment, insurance coverage and training of its employees) other than those [the client] expressly agrees to pay in a SOW." Taxpayer did not provide any SOWs that might show certain expenses for which the client agreed to be personally liable. Third, the contract states that "[u]nder no circumstance will [Taxpayer's] employees or Subcontractors be construed as [the client's] employees." Finally, the contract states that Taxpayer "will be held responsible for all obligations as employer of record for the personnel under its employ and on assignment" to the client. Given these contract terms, we conclude that Taxpayer was clearly the employer of the employees at issue and was personally liable for all employment and payroll expenses for those employees, which employees were merely "assigned" to the client. Indeed, the contract expressly states that the client is not the employer of the employees.

Taxpayer has provided no other evidence to challenge our conclusion that Taxpayer is personally liable for payroll expenses under the contract. While Taxpayer provided some invoices on appeal in which it apparently sought payment from its client for "salaries," other benefit expenses, certain "reimbursements" and "salary advances," and also certain "handling fees," such invoices do not indicate whether Taxpayer had personal liability to pay for any of those expenses as part of its service to its client. Based on the evidence before us, we conclude that Taxpayer has failed to meet its burden of proving that it was not personally liable for payment of the payroll expenses at issue during the audit period. As such, we affirm the tax assessment.[4]

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of September, 2014.

[4] We make no findings regarding the propriety of the method TAA used in estimating Taxpayer's tax liability as Taxpayer has made no argument that the method was improper and has offered no evidence in support of an alternative method.