

Excise Tax Advisory

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ETA 3196.20XX

Issue Date: , 20XX

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B&O Deduction for Affiliated Qualified Employers of Record

Purpose

This Excise Tax Advisory (ETA) clarifies when a person is a qualified employer of record eligible for a business and occupation (B&O) tax deduction from gross income for employee costs when the person is providing paymaster services. RCW 82.04.43393.

There are four requirements that a person must meet to qualify for the B&O deduction:

1. The person must be a qualified employer of record;
2. The person must be providing paymaster services;
3. The person's paymaster services must be provided to an affiliated business; and
4. The amounts the person is paid must be to cover the costs of a qualified employee.

This ETA addresses amounts not covered by the deduction, the four requirements above, and provides a number of examples under specific sets of facts. The examples provided are not exhaustive and should be used only as a general guide. The tax results of other situations must be determined separately after a review of all of the facts and circumstances.

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Definitions

“Affiliated” means under common control and has the same meaning as provided in RCW 82.32.655(7).

“Control” means the possession, either directly or indirectly, of more than fifty percent of the power to direct the management and policies of a person, whether through ownership of voting shares, contract, or otherwise.

“Employee costs” are the actual costs of wages and salaries, benefits, workers’ compensation, payroll taxes, withholding, or other assessments paid to or on behalf of an employee.

“Functional employment relationship” means having all control over the work schedule and activities of the employees and control over all employment decisions such as salary, discipline, hiring or layoffs. Only one entity may have a functional employment relationship with an employee.

“Paymaster services” means providing payroll and related human resource services. Related human resource services include processing paperwork, distributing paychecks and W2s, etc., but do not include control over salary, hiring, firing, or any other element of a functional employment relationship.

Amounts not covered by the deduction

The deduction is not allowed for any employee costs incurred in connection with a contractual obligation to provide services, including staffing services as defined in RCW 82.04.540. RCW 82.04.43393(1).

A contractual obligation is generally a contract where the employer of record is required to provide services to the affiliate. Such services can include, but are not limited to: management, professional, financial, accounting, regulatory, and technical services.

However, a contractual obligation to provide paymaster services (payroll and related human resource services) is allowed by RCW 82.04.43393. A qualified employer of record may receive a deduction when it provides related human resource services as described above. To receive the deduction, the qualified employer of record cannot have control over employment decisions that will amount to a functional employment relationship. An employer of record having a functional employment relationship, or any element of a functional employment relationship, with an employee is not entitled to the deduction under RCW 82.04.43393 for that employee.

Example 1 (contractual obligation to provide services):

- **Facts:** Company has an agreement with its affiliate under which Company is obligated to provide engineering services to the affiliate. Company is the employer of record for the employees providing engineering services.

However, the affiliate has the functional employment relationship with the engineering employees.

- **Result:** Company cannot deduct any of the amounts it receives from the affiliate to pay the employee costs. Because Company has a contractual obligation to provide engineering services to the affiliate, Company cannot deduct the amounts it receives from the affiliate to pay the engineering employee costs. Instead, Company hired the employees to fulfill its contractual obligation to the affiliate.

Example 2 (contractual obligation to provide staff):

- **Facts:** Company has an agreement under which it is obligated to provide its affiliate with staff sufficient to allow affiliate to operate a resort park. The affiliate locates and interviews permanent employees and has ultimate control over hiring and firing decisions. The affiliate also has control over the work schedules, activities, and other employment decisions for the employees. Although the Company does not have a functional employment relationship with the employees, Company has a contractual obligation to the affiliate to provide staff.
- **Result:** Company cannot deduct any of the amounts it receives from the affiliate to pay the employee costs. A contractual obligation to provide staff is treated as a sale of labor and/or employees.

Example 3 (staffing services):

- **Facts:** Company recruits and hires employees and is the employer of record for these employees. Company provides the employees to its affiliate on a seasonal or project basis. There is no time period associated with employment, and as a result, the employees may remain with affiliate, be assigned to another affiliate, or terminated. The affiliate provides input on the hiring decisions and has control over the work schedule, activities, and other employment decisions.
- **Result:** Company is selling staffing services under RCW 82.04.540 and cannot deduct the amounts it receives from the affiliates to pay the employee costs.

**Requirement 1:
qualified employer
of record**

The person providing paymaster services must be a qualified employer of record.

Employer of Record

An employer of record is the person who reports employees under its own Unified Business Identifier (UBI) or Employer Identification Number (EIN) for state or federal tax, employment security, or insurance purposes. Only persons acting as the employer of record can qualify for the deduction under RCW 82.04.43393.

Qualified Employer of Record

A “qualified employer of record,” can have neither:

- A functional employment relationship with a qualified employee; nor
- A contractual liability with a qualified employee for employee costs.

However, a qualified employer of record generally does and is allowed to have statutory or common law liability to employees or third parties for employee costs.

Entities that are providing paymaster services, but are not the employer of record or a “qualified employer of record,” should refer to ETA 3181.2013 to determine whether they are eligible to exclude employer obligations under WAC 458-20-111.

Documentation

Although RCW 82.04.43393 does not have specific substantiation requirements, the following list provides examples of the types of documents that will help establish that the taxpayer is a qualified employer of record:

- Contracts
- Employment agreements
- Hiring letters
- Employee handbooks
- IRS Forms (i.e., Form 2678)
- Employment annual reviews

The Department may request these types of documents under RCW 82.32.070 and RCW 82.32.100 when evaluating eligibility for the deduction.

Contracts or other documents do not need to use the terms “qualified employer of record” or “no functional employment relationship”. However, the contracts and documents should not have any indication that the taxpayer has control over hiring, firing, or salary decisions. For purposes of Requirement 3, which is listed below, it should also be clear that only one entity retains this type of control or decision making. Further, the contracts and documents should not contain any contractual liability for employee costs or benefits by the employer of record. Contracts or other documents that clearly identify the related entities and their respective roles as they relate to company policies, decision making authority, and employee relationships are relevant.

Example 4 (qualified employer of record):

- **Facts:** Company reports all employees under its UBI. The employees work for Company's affiliate and the affiliate determines the work schedules, and compensation levels. Nothing in the employment agreements, hiring letters, or employee handbooks suggest that the Company has any control over the employee. Instead, the affiliate is identified as the person who has all control over hiring, firing, and other employment decisions. Company does not provide any retirement benefits to the employees in addition to those provided by affiliate. Company does not have a contract with the employees regarding terms of employment or compensation.
- **Result:** Company is the employer of record. Accordingly, because Company does not have a functional employment relationship or a contractual liability to the employee for employee costs, Company is a qualified employer of record.

Example 5 (not a qualified employer of record):

- **Facts:** Assume the same facts in example 4 and also that Company has an agreement with the employees under which Company provides retirement benefits in addition to those provided by the affiliate(s). Company has a contractual liability to the employee for these benefits.
- **Result:** Company is the employer of record. However, Company has a contractual liability to the employees. Accordingly, Company is not a qualified employer of record.

**Requirement 2:
Paymaster services**

The qualified employer of record must provide paymaster services, which means the person must provide payroll and related human resource services.

Example 6 (providing paymaster services):

- **Facts:** Company is the employer of record. Affiliate is responsible for making all hiring and firing decisions for its employees. Affiliate determines salary, policies, and benefits for its employees. Affiliate controls the work schedule and activities of its employees. Company processes applications and contacts potential employees based on applications received on behalf of Affiliate. Company processes paperwork associated with Affiliate's hiring or firing the employees, updating, or terminating health insurance and retirement benefits (that are provided and set by Affiliate), issuing paychecks for employees, and distributing training materials to new hires. Employee is aware that it is being hired by Affiliate and not Company. Employee does not perform work on behalf of Company or any other affiliate.
- **Result:** Company is providing paymaster services.

**Requirement 3:
Services must be
provided to an
affiliate**

The qualified employer of record must provide the paymaster services to an affiliate. To be “affiliated” means two or more entities are under common control as defined above. Thus, the qualified employer of record providing the paymaster services and the affiliate receiving the services, must be under common control.

An entity providing paymaster services to a non-affiliate should refer to WAC 458-20-111 and ETA 3181.2013 to determine whether it is eligible to exclude employer obligations.

**Requirement 4:
Amounts paid must
be to covered costs
of a qualified
employee**

A qualified employee is an employee with whom a single affiliated business has a functional employment relationship. To be a qualified employee, only one affiliated entity (and not the employer of record) may have a functional employment relationship with each employee; shared employees are not qualified employees.

As discussed above, a functional employment relationship requires the affiliate to have control over all employment decisions, all control over the work schedule and activities of the employees and control over all employment decisions such as salary, discipline, hiring, or layoffs. If the employer of record, another affiliate, or any third party has control over any of these elements, then the affiliate does not have a functional employment relationship under the statute and the employee is not a “qualified employee.”

Only one entity can have the requisite control over the above decisions. If two or more entities share these decision-making capabilities, then neither of them has a functional employment relationship as defined in the statute.

Whether a person has a functional employment relationship with an employee is a fact specific determination.

Example 7 (qualified employee):

- **Facts:** Employee works for Affiliate A, who has all control over employee’s work schedule and activities and makes all employment decisions relating to Employee. Employee is transferred to Affiliate B for what is anticipated to be a permanent move. Affiliate A terminates its employment relationship with Employee. Affiliate B hires Employee and takes control over all employment and work decisions. Employee does not do any additional work for Affiliate A. Nothing in the facts or circumstances suggests that employee works for Affiliate A.
- **Result:** Affiliate A and B are not sharing the employee and do not share the employment decisions. Thus, only Affiliate B has a functional employment relationship with Employee. Employee meets the definition of a qualified employee.

Example 8 (not a qualified employee):

- **Facts:** Affiliates C and D each have their own employees. Some employees work primarily for Affiliate C, but occasionally do temporary or project specific work for Affiliate D. The projects extend for a significant period of time. Affiliate C retains the authority to make decisions regarding the salary, discipline, and hiring and firing of these employees. Affiliate D periodically has control over work assignments and schedule of the employees.
- **Result:** Neither Affiliate C nor Affiliate D have a functional employment relationship with the employees because neither has the requisite control over all employment decisions as required in the statute. Thus, the employees are not qualified employees. Additionally, Affiliate C may be selling services or employee labor to Affiliate D.

Example 9 (employee is not a qualified employee):

- **Facts:** Affiliate has control over the work schedule and activities of an employee. The employer of record has no control over the work schedule and activities of the employee, but the employee handbook and other documents suggest that the employer of record retains ultimate authority over employment decisions such as salary, discipline, hiring, or layoffs and other employee policies.
- **Result:** Neither Affiliate nor the employer of record has a functional employment relationship with the employee and the employee is not a qualified employee.

Example 10 (arrangements with multiple employee groups):

- **Facts:** Company is the employer of record of Z group employees that provide services on behalf of Affiliate. Company does not have control over the work schedule or activities of the Z group employees or authority over any employment decisions. Affiliate has the sole functional employment relationship with Z group employees. Company is also obligated to provide administrative and management services, in addition to the paymaster services, to the affiliate and uses its own Y group employees to fulfill this obligation. Company has the sole functional employment relationship with the Y group employees. Company receives payment from the affiliates for the administrative and management services, which includes the cost of labor.

- **Result:** Company's Y group employees are not qualified employees because Company has a functional employment relationship with the employees. Z group employees are qualified employees of Affiliate.
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The following are examples of when the Employer of Record uses a third-party entity to provide paymaster services. Regardless of whether the third party is an affiliate, each entity must individually qualify for a deduction in order to exclude the employee costs from its income.

Example 11 (multiple affiliated paymaster entities):

- **Facts:** Company is qualified employer of record of all employees of an affiliated group of entities. However, Company does not process the payroll. Instead, one of the affiliates ("Affiliate P") provides payment processing services, including the processing of payroll and employee costs.
- **Result:** In order to receive a deduction, both entities need to individually qualify for a deduction. Thus, Company, as the qualified employer of record, is eligible for deduction under RCW 82.04.43393 or ETA 3181. Company would qualify for a deduction for amounts it receives to cover employee costs to the extent it is providing paymaster services, assuming it otherwise meets all of the requirements of the deduction in RCW 82.04.43393. If Company does not meet the requirements of RCW 82.04.43393, Company may be eligible for a deduction if it meets the requirements in ETA 3181. Affiliate P is not the employer of record, and therefore, could not qualify for a paymaster deduction under RCW 82.04.43393. In order for Affiliate P to deduct payroll or employee costs, it would need to qualify under ETA 3181.

Example 12 (third party paymaster):

- **Facts:** Assume the same facts as above, except that Company uses an unrelated third party to process its payroll instead of an affiliate.
 - **Result:** Company is eligible for a deduction under RCW 82.04.43393, if it meets all of the requirements as described in the above example and in this ETA.
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