Department of Revenue Washington State

Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

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Paymasters and Employers of Record

Purpose

This excise tax advisory (ETA) clarifies when a taxpayer qualifies as a paymaster able to exclude amounts received to pay the employer obligations of its clients from gross income.

- "Employer obligations" means employee salaries, benefits, payroll taxes, and similar obligations.

This guidance also illustrates the difference between a paymaster that is also an employer of record and a taxpayer who is engaged in the business of selling labor or services performed by its own employees.

For periods beginning on or after October 1, 2013, certain taxpayers may qualify for the new deduction created by ESSB 5882 (Chapter 13, Laws of 2013, 2nd Special Session). That law provides a deduction for employee costs received from an affiliated business by a qualified employer of record engaged in providing paymaster services to its affiliates. For additional information, refer to the Department's web site for the Special Notice addressing this legislation.

Definitions

What is a Paymaster?

The term "paymaster" generally refers to a person that acts as an agent for the purpose of paying the employer obligations of one or more clients. A paymaster may or may not be affiliated with its clients.

- A paymaster providing paymaster services to affiliates and not to unrelated persons is referred to in this ETA as a "**captive paymaster**."
  - "**Affiliate**" means a person under common control.

- "**Control**" means the possession, directly or indirectly, of more than fifty percent of the power to direct or cause the direction of the management and policies of a entity, whether through the ownership of voting shares, by contract, or otherwise.

- A paymaster paying an employer obligation shared by two or more of its clients is referred to as a "**common paymaster**."

What is an Employer of Record?

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.

What is not covered under this ETA?

This ETA does not apply to paymasters that share employees with a client (e.g., concurrent employment by one or more persons, one of whom is the paymaster under 25 CFR §31.3121(s)-1).

Elements of WAC 458-20-111

A taxpayer qualifies as a paymaster and may exclude amounts received to pay client employer obligations only by meeting the requirements of WAC 458-20-111 ("Rule 111") as follows:

1. The amounts received must be customary reimbursements or advances to the taxpayer for paying the employer obligations of a client.

2. The services performed by the employees must be services that the taxpayer does not or cannot render and for which no liability attaches to the taxpayer.

3. The taxpayer may have no liability to pay the employer obligations, except as the agent of the client.

What if the Elements of Rule 111 are not met?

A taxpayer that does not satisfy all requirements of Rule 111 must include all amounts received from its clients as gross income of the business, even if those amounts are used to pay salaries, benefits, or payroll taxes. Depending on the circumstances, the taxpayer may be engaging in business as a staffing company, leasing employees, or other service provider.

First element: Customary reimbursements or advances to pay client obligations

Amounts received by the taxpayer may be excluded only if the amounts are customary reimbursements or advances made to pay the employer obligations of a client.

To meet this element, the reimbursement or advance must be both customary and made for the purpose of paying the employer obligations of the client. In other words, the client must be the employer and have liability for the employer

obligations.

Employers of record – who is the employer liable for the employer obligations?

The employer of record is generally considered to be the employer liable for the employer obligations.

- When the client is the employer of record, the client is deemed to be the employer liable for the employer obligations.
    - For example, a taxpayer who is classified for federal tax purposes as a Form 8655 reporting agent or "payroll services provider" files employment tax returns **under its client's EIN**. Thus, the client is the employer of record. In these circumstances, the client is considered to be the employer with liability for the employer obligations.

- 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.);
        - 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).

Example: Taxpayer is the employer of record for employees that perform services for Taxpayer's affiliate, A. Affiliate A has significant control over the employees, determining and supervising activities, with general hiring and firing authority. By agreement with A, Taxpayer may reject or ratify certain hiring decisions and determines all employee compensation and benefit levels.

Under these facts, Taxpayer does not qualify as a paymaster entitled to exclude payments received from A to cover employer obligations because Taxpayer, as the employer of record, is presumed to be the employer liable for all employer obligations. This presumption is not rebutted when Taxpayer has significant control over the employee, such as decisions over hiring and employee compensation and benefit levels. Thus, Taxpayer cannot establish the first element, that the payments from A are customary reimbursements or advances to pay employer obligations of the client.

Second element: taxpayer does not or cannot render the services and no liability attaches

The services performed by the employees for the client must be services that the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. In other words, the taxpayer cannot be selling the services or the employee labor to the clients.

- For example, when the employees are performing engineering services, the paymaster may not be a staffing company providing engineering employees. Similarly, the paymaster may not be selling engineering services to the client. *See* WAC 458-20-274 for information on staffing companies.

For purposes of this ETA, this second element is met if the taxpayer:

- Has no obligation to provide the services;
- Has no obligation to furnish the employee or their labor to the client; and
- Has no liability for the services or the employee's performance (*e.g.*, as to quality or any other property or characteristic).

The taxpayer cannot establish that it has no obligation or liability regarding the services merely because the taxpayer lacks the ability to physically or legally perform the services.

If the taxpayer is the employer of record and in the business of selling to same services to others that the employees perform for to the client, then the Department presumes that the taxpayer is selling those services to the client.

Example: Taxpayer is a construction business whose employees perform construction services for Taxpayer's customers. Taxpayer is also a paymaster for Taxpayer's affiliate, A, and is the employer of record for employees over whom A alone exercises control. These employees perform construction services on the construction projects for A's customers. Under these facts, the Department presumes that Taxpayer is leasing employees, selling employee labor, or selling construction services to A.

However, assume that Taxpayer and A enter into an agreement that clearly states that Taxpayer has no obligation to provide construction services to A or A's clients; no obligation to provide A with employees or staffing; and no liability for the employees' performance, including the quality or quantity of performance.

Assume further that the agreement contains no contrary provisions, such as a provision for Taxpayer to indemnify A for any costs or damages arising out of any activities of the employees. Assume further that this agreement is enforceable and consistent with the actions of the parties. Under these facts, Taxpayer is not selling employee labor or construction services to A, meeting the second element.

Example: Taxpayer is the employer of record for employees that perform medical services for Taxpayer's client, Hospital. Assume the following facts:

Taxpayer has an agreement with Hospital, under which Taxpayer agrees to provide

all necessary services to operate Hospital's emergency room. Taxpayer is not licensed to provide medical services and expressly disclaims any liability for the quality of medical services performed by the personnel.

Under these facts, Taxpayer is selling the service of operating and staffing a hospital emergency room and cannot meet the second element. Moreover, although Taxpayer has disclaimed liability for the quality of the medical services performed, Taxpayer is still contractually obligated to provide the services. It is not relevant that Taxpayer is not licensed to provide medical services.

Third element: No liability except as an agent

The taxpayer may have no liability to pay the employer obligations, except as the agent of the client. To meet this element, the taxpayer must:

1. Be a bona fide agent of the client; and
2. Have no liability to pay the employer obligations, except its agency liability.

These requirements are discussed below.

1. The taxpayer must be a bona fide agent of the client.

Standard common law agency principles are used to determine whether an agency relationship exists. The essential requirements of common law agency are mutual consent and control. Therefore:

- The client and the taxpayer must have consented to the taxpayer acting on behalf of and in accordance with the directions of the client; and

- The taxpayer must be acting in some material degree under the direction and control of the client.

2. The taxpayer must have no liability to pay the employer obligations, except its agency liability.

- The paymaster may not have any primary or secondary liability to the employees or to any other person, to pay the employer obligations.

- Secondary liability includes the liability of a surety or guarantor. It also includes any liability that does not arise until some event occurs ("conditional" liability).

- The paymaster may have only its agency liability, meaning the agent's liability to its principal (the client) to pay the employer obligations as directed.

Employers of

An employer of record may have liability for certain employer obligations under

record 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 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.

Examples **Example 1.** Paymaster provides paymaster services to an unrelated entity, Y. Assume the following facts:

- Paymaster is the employer of record for employees that perform services for Y.
- Y has all control over the employees (e.g., determining and supervising activities, setting compensation, and hiring and firing authority, etc.) Paymaster has no such control.
- Paymaster and Y enter into an agreement under which the parties expressly agree that (1) Y is the employer liable for all employer obligations; (2) the agreement is enforceable by the employees; (3) Paymaster has no obligation to provide employee labor or services to Y; and (4) Paymaster has no liability for the quality of services provided by the employees.
- Paymaster is appointed an agent for purposes of paying Y's employer obligations. Paymaster in fact acts at the instance of and in some material degree under the direction and control of Y.
- Paymaster and/or Y obtain an enforceable written agreement from each employee that Paymaster is only an agent with no liability to the employee to pay any employer obligations.

Under these facts, Paymaster may exclude payments received from Y to cover employer obligations.

Example 2. A captive Paymaster provides paymaster services to its wholly-owned subsidiary, Affiliate X. Assume the following facts:

- Paymaster is the employer of record for employees that perform services for Affiliate X.
- Affiliate X has all control over the employees (*e.g.,* determining and

supervising activities, setting compensation, and hiring and firing authority, etc.)

- Paymaster and Affiliate X enter into an agreement under which the parties expressly agree that (1) Affiliate X is the employer liable for all employer obligations; (2) the agreement is enforceable by the employees; (3) Paymaster has no obligation to provide the employee labor or services to Affiliate X; (4) Paymaster has no liability for the quality of services provided by the employees.

- Paymaster is appointed a Form 2678 Agent under 26 U.S.C. §3504, and Paymaster or Affiliate X provide each employee with written notice that Paymaster is an agent and that Affiliate X is directly liable to the employees for all employer obligations.

Under these facts, Paymaster may exclude payments received from X to cover employer obligations.

Common paymasters and sales between clients

Even if a paymaster is entitled to exclude amounts received from clients to pay employer obligations, the paymaster's clients may be engaged in the purchase and sale of employee labor or service among themselves, using the paymaster as a payment mechanism.

Example. Assume that paymaster, P, is entitled to exclude amounts received from its clients to pay employer obligations of its clients: A and B. Assume that the employees work primarily for A, but perform some services for B as well. Assume that A and B each reimburse Paymaster for a share of the employer obligations, based on the number of hours of work the employees perform for each of A and B.

Under these facts, A is potentially an employer selling the services of its employees to B, with B satisfying a portion of A's employer obligations when B reimburses Paymaster. The Department will evaluate all relevant facts to determine if A is the employer selling the services of its employees to B. If that is the case, A constructively receives payment for the sale of the services when B reimburses Paymaster (A's agent), and A must include those amounts in gross income.
