Excise Tax Advisory

Washington State Department of Revenue

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

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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 exemption from gross income for employee costs when the person is providing paymaster services.

This ETA includes 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.

Requirements
As of October 1, 2013, RCW 82.04.43393 allows a deduction for amounts received by a qualified employer of record providing paymaster services to an affiliated business to cover employee costs of a qualified employee.

To qualify, the following requirements must be met:

1. The taxpayer must be a qualified employer of record;

2. The taxpayer must be providing paymaster services;

3. The paymaster services must be provided to an affiliated business only; and

4. The amounts must be paid to cover costs of a qualified employee.

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

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.

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 defined above. In order 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): 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 employees. Here, 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 employee costs. Instead, this is treated as though Company hired the employees to fulfill its contractual obligation to the affiliate. Company is thus obligated to pay the employees for the services they provide and

that cost of doing business is not deductible

Example 2 (contractual obligation to provide staff): 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 provide staff. A contractual obligation to provide staff is treated as a sale of labor and/or employees and therefore Company cannot deduct any of the amounts it receives from the affiliate to pay the employee costs.

Example 3 ("staffing services"): Company is the employer of record and recruits and hires employees. Company provides the employees to its affiliate on a seasonal or project basis. There is no time period associated with employment so 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. Company is selling staffing services under the RCW 82.04.540 and cannot deduct the amounts it receives from the affiliates to pay the employee costs.

Requirement 1: Entity providing paymaster services must be a qualified 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. Only persons acting as the employer of record can qualify for the deduction under RCW 82.04.43393.

The entity providing the paymaster services must also be a "qualified employer of record," as defined in RCW 82.04.43393. Thus, to qualify the 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 do not meet the definition of "qualified employer of record," should refer to ETA 3181.2013 to determine whether they qualify to exclude employer obligations under WAC 458-20-111.

Example 4 (qualified employer of record): Company reports all employees under its UBI or EIN for state or federal tax, employment security and insurance purposes. Therefore, it is considered the employer of record. The employees work for

Company's affiliate and the affiliate determines the work schedules, and compensation levels. The affiliate, not Company, has all control over hiring, firing, and other employment decisions. Company does not provide any significant 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. Because Company does not have a functional employment relationship or a contractual liability with the employee, Company is a qualified employer of record.

Example 5 (unqualified employer of record): Assume the same facts in example 4 and also that Company has an agreement with the employees under which Company provides significant retirement benefits in addition to those provided by the affiliate(s). Company now has a contractual liability to the employee. Therefore, Company is not a qualified employer of record and cannot claim the deduction for the employee costs.

Requirement 2: Employer of record must be providing paymaster services	The employer of record must be providing paymaster services as defined above. **Example 6 (providing only paymaster services)**: 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 it employees. Affiliate controls the work schedule and activities of employee. 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. Here, Company is providing only paymaster services and does not have a functional employment relationship with Employee.
Requirement 3: Services must be provided to an affiliate	To be "affiliated" means that the entities are under common control as defined above. Thus, the 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 qualifies to exclude amounts received to cover employer obligations.
Requirement 4: Amounts received by employer of record must	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 (not the employer of record) may have a functional employment relationship with each employee; shared employees are not qualified employees.

be paid to or on behalf of a qualified employee

A functional employment relationship requires the affiliate to have control over all employment decisions, the work schedule and activities of the employees. Thus, if the employer of record, another affiliate, or a 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."

Stated another way, 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. In these circumstances, the employer of record cannot deduct the employee costs associated with the employee.

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

Example 7 (qualified employee): Employee works for Affiliate A, who has 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 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. In this case, 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 (employee is not qualified): 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. Sometimes the projects extend for a significant period of time. Affiliate C retains the authority to make decisions regarding the salary, discipline, hiring and firing of these employees, but Affiliate D periodically has control over work assignments and schedule of the employees. Under these facts, neither Affiliate C nor Affiliate D have a functional employment relationship with the employee because neither has the requisite control over all required employment decisions as required in the statute. Thus, the employee is not a qualified employee. Additionally, Affiliate C may be selling services or employee labor to Affiliate D.

Example 9 (neither the employer of record nor Affiliate has a functional employment relationship with employees): 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 has all authority over employment decisions such as salary, discipline, hiring, or layoffs. In this case, neither Affiliate nor the employer of record has a functional employment relationship with the employee and the employee is not qualified.

Example 10 (partial qualified employer): Assume that Company is the employer of

record of employees that provide services on behalf of the affiliate. The Company does not have control over the work schedule or activities of the employees or authority over any employment decisions. Assume that the affiliate has control over the work schedule and activities of the employees and all authority over employment decisions such as salary, discipline, hiring, or layoffs.

However, Company is also obligated to provide administrative and management services, in addition to the paymaster services, to the affiliate and uses its own employees to fulfill this obligation. Company has a functional employment relationship with its own employees. Company receives payment from the affiliates for the additional services, which includes the cost of labor. Company's employees are not qualified employees and Company is not a qualified employer of record with respect to these employees because Company has a functional employment relationship with the employees. Thus, the deduction does not apply to amounts that Company receives to pay these employee costs. However, Company may still qualify for the deduction for the qualified employees employed by the affiliates.

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, on its own, must qualify for a deduction in order to exclude the employee costs from its income.

Example 11 (multiple affiliated paymaster entities): Company is 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. In order to receive a deduction, both entities need to individually qualify for a deduction. Thus, Company, as employer of record, could qualify under RCW 82.04.43393 or ETA 3181. Company would receive a deduction for amounts it receives to cover employee costs to the extent it is providing paymaster services and otherwise meets all of the requirements of the deduction in RCW 82.04.43393. If Company does not meet the requirements, Company can still qualify 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): Assume the same facts as above except that Company uses an unrelated third party to process its payroll instead of an affiliate. Company can similarly qualify 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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