

**United States Small Business Administration
Office of Hearings and Appeals**

SIZE APPEAL OF:

Allstates Employer Services II, Inc.

Appellant

Disaster Loan Application
No. 1000073856

SBA No. SIZ-5190

Decided: January 31, 2011

APPEARANCES

Michael R. Miller, Esq., Kunkel Miller & Hament, Tampa, Florida, for Appellant.

DECISION

HOLLEMAN, Administrative Judge:

I. Introduction & Jurisdiction

On December 8, 2010, the U.S. Small Business Administration (SBA) Processing and Disbursement Center in Fort Worth, Texas (PDC) issued a formal size determination in relation to Disaster Loan Application No. 1000073856 finding Allstates Employer Services II, Inc. (Appellant) other than small. For the reasons discussed below, the appeal is denied, and the size determination is affirmed.

SBA's Office of Hearings and Appeals (OHA) decides size determination appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134. Appellant filed the instant appeal within thirty days of receiving the size determination, so the appeal is timely. 13 C.F.R. § 134.304(a)(2). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Loan Application and Denial

On July 8, 2010, Appellant submitted its initial application to the PDC for an economic injury disaster loan. The application reflects that Appellant is affiliated with Allstates Employer Services, Inc. (Allstates) and Smart Employer Services, Inc. (Smart Employer) because all three entities are 100% owned by Mr. Donald Moore, Appellant's President. On August 10, 2010, the

PDC notified Appellant that it required additional information to process the application, including, among other things, Appellant's federal income tax returns for the years 2007, 2008, and 2009, and federal income tax returns for Allstates, Smart Employer, and Mr. Moore for the years 2008 and 2009.

On August 19, 2010, the PDC denied Appellant's disaster loan application, finding Appellant is not a small business because the average annual receipts of Appellant and its affiliates exceeds the size standard for Appellant's industry. Appellant's industry is encompassed by North American Industry Classification System (NAICS) code 561330, Professional Employer Organizations, which employs a size standard of \$13.5 million in average annual receipts.

On November 2, 2010, Appellant requested reconsideration of its loan application, contending the SBA should have used Appellant's net revenues, not its gross revenues, to calculate its size. Appellant also submitted a SBA Form 355. The SBA Form 355 identified two additional affiliates, also owned 100% by Mr. Moore: Smart Employer Services II, Inc. (Smart Employer II) and Employer Services Group, Inc. (Employer Services).

B. Size Determination

On December 8, 2010, the PDC issued its formal size determination. The PDC first explained that Mr. Moore owns 100% of Appellant's stock, as well as 100% of the stock in four affiliated companies: Allstate, Smart Employer, Smart Employer II, and Employer Services.¹ The PDC further explained that Appellant and its affiliates are Professional Employee Organizations (PEOs) that provide employee leasing services in the southeastern United States and operate primarily within NAICS code 561330, which employs a size standard of \$13.5 million in average annual receipts.

The PDC went on to note that Appellant does not challenge its industry classification, but only the calculation of its annual receipts. Appellant claimed the portion of gross revenue received for the purpose of paying payroll to the leased employees should be excluded from its receipts. The PDC explained Appellant attached several documents to its request for reconsideration indicating that a "net revenue accounting" method is appropriate for the industry. Appellant also submitted a 1997 SBA district counsel opinion supporting the idea that employees leased from a PEO should be counted in calculating the employees of a PEO's client, so long as the client retains control over the employees. Appellant apparently reasoned that if a large business cannot become small by leasing employees from a PEO, a PEO should not be deemed large due to its leasing function.

¹ The PDC also determined Mr. Moore owns 50% or more of twelve other entities. The PDC noted: "These entities were not detailed or included in this size determination as their inclusion would have no impact on affiliate primary activity, and would only increase average annual receipts and not alter the decision." (Size Determination 1.)

The PDC then set forth the applicable regulation, which provides that “amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker” may be excluded from a firm’s annual receipts. 13 C.F.R. § 121.104(a). The regulation also provides: “For size determination purposes, the only exclusions from receipts are those specifically provided for in this paragraph.” *Id.* Based on this language, the PDC concluded Appellant may not exclude the portion of its gross revenue paid to leased employees from its receipts because PEOs are not listed in the regulation, which explicitly provides that the only allowable exclusions are those specifically enumerated therein.

The PDC explained that Appellant’s arguments regarding industry accounting standards are not relevant to its calculation of receipts because the PDC is required to calculate Appellant’s receipts based upon its “cost of goods sold” and “total income” as reported on its federal income tax returns. Because Appellant included the amounts it wishes to exclude in its reported revenues, the PDC was unable to exclude those amounts. The PDC also explained that the 1997 district counsel opinion is irrelevant because it deals with counting a firm’s employees, not calculating its receipts.

Upon aggregating the average annual receipts of Appellant and its affiliates (without Appellant’s requested exclusions), the PDC concluded Appellant is other than a small firm under the applicable \$13.5 million size standard.

C. Appeal Petition

On January 3, 2011, Appellant filed the instant appeal claiming the size determination is based upon clear errors of fact and law. Appellant first describes the nature of its PEO business. Appellant explains that a PEO relationship is unlike a temporary help or facilities management relationship because a PEO does not have its own core of employees that it sends to its clients. Instead PEOs “lease employees . . . by placing the client’s own employees onto the PEO’s payroll. In this unique relationship, the employees who are placed on the PEO’s payroll at all times retain their status as ‘employees’ of the client.” (Appeal Petition 2.) That is, the PEO’s client retains the same employees after entering into the PEO relationship and may hire and fire employees at will. The PEO merely adds and deletes employees from its payroll at the client’s direction. The client submits its employees’ hours to the PEO, which pays the employees. “[M]ost of the revenues paid by clients of PEOs to their PEOs merely fund the clients’ payroll, tax, and benefit obligations. . . . [S]uch funds never become income to a PEO such as [Appellant] and are not a PEO’s actual receipts.” (Appeal Petition 4.)

Appellant attaches numerous state regulatory agency opinion letters and federal agency determinations to support its position that a PEO’s client always remains the employer of the leased employees because the PEO cannot control the employees. Appellant points specifically to two SBA determinations finding that a PEO’s client’s employees are not employees of the PEO. Appellant emphasizes that PEOs are permitted to lease employees to highly regulated employers, including doctors, accountants, and airlines. Appellant highlights this point by submitting written opinions of various state bar associations that allow lawyers, who are part of a tightly regulated profession, to be leased.

Appellant argues that whether Appellant and its clients are in joint employment relationships is a critical issue on appeal. According to Appellant, the size determination is only correct if Appellant jointly employs its client's employees. Otherwise, contends Appellant, it was inappropriate for the PDC to include pass-through receipts in its calculation of Appellant's average annual receipts. To support its assertion that a PEO's client's employees are not the PEO's employees, Appellant points to numerous federal cases and agency decisions. *See, e.g., Administaff Cos., Inc. v. N.Y. Joint Bd., Shirt and Leisureware Div.*, 337 F.3d 454 (5th Cir. 2003); *Astrowsky v. First Portland Mortgage Corp.*, 887 F. Supp. 332 (D. Me. 1995); Occupational Safety Health Review Comm'n v. Team America Corp., 18 O.S.H. Cas. (BNA) 1572 (Oct. 19, 1998); Occupational Safety Health Review Comm'n v. Murphy Enters., Inc., 17 O.S.H. Cas. (BNA) 1477 (Sept. 7, 1995); *Williams v. Southeast Mgmt. Co.*, Fla. Comm'n on Human Relations Case No. 22-00528 (July, 2003). Each of these decisions centered on whether the PEO or employee leasing company had the power to control its client's employees, and each decided the PEO held no such control.

Appellant goes on to explain that numerous cases decided under the Fair Labor Standards Act (which employs a broad definition of "employee") have also determined that a PEO is not in a joint employment relationship with its client because the PEO does not have actual control over the client or its employees, even where contractual language offers the possibility of such control. *See, e.g., Beck v. Boce Group*, 391 F. Supp. 2d 1183 (S.D. Fla. 2005); *Jeanneret v. Aron's East Coast Towing, Inc.*, No. 01-8001-CIV, 2002 WL 32114470 (S.D. Fla. Jan. 29, 2002). Appellant also cites various state court cases and National Labor Relations Board decisions holding that a PEO is not a joint employer and pass-through wages and benefits are not revenue of the PEO. *See, e.g., LeSaint Logistics, Inc.*, 324 N.L.R.B. No. 157 (Nov. 7, 1997); *Rho Co. v. Dep't of Revenue*, 782 P.2d 986 (Wa. 1989); *Aabakus, Inc. v. Huddleston*, No. 01A-01-9505-CH-00215, 1996 WL 548148 (Tenn. Ct. App. Sept. 25, 1996); *Roe v. Dep't of Revenue*, 16 Or. Tax 395 (Or. T.C. 2001).

Next, Appellant submits an affidavit of a certified public accountant (CPA)² that discusses a Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) abstract and a Securities and Exchange Commission (SEC) bulletin. FASB, EITF Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (2000); SEC Staff Accounting Bulletin No. 101 (1999). Appellant asserts the EITF abstract recognizes that some pass-through wages and benefits should be designated as net revenue instead of gross revenue, and the SEC bulletin discusses financial reporting fraud resulting from the overstatement of revenues. The CPA thus opines that a PEO's pass-through wages and benefits are not true revenues of the PEO and can be reported on a net revenue basis. Appellant attempts to further support its position by providing the text of recent congressional discussions regarding PEOs, which indicate that certain tax credits pertaining to employee retention and benefits would apply

² Appellant submitted a Motion to Admit New Evidence seeking to admit this affidavit. Appellant contends the affidavit does not enlarge the issues, but serves to clarify the facts at issue on appeal. 13 C.F.R. §134.308(a)(2) provides that new evidence may be admitted upon the filing of a motion and a showing of good cause. Because I agree with Appellant that the affidavit does not raise new issues and merely supports its arguments, the motion is GRANTED, and the affidavit is ADMITTED to the record for consideration as part of this appeal.

to the PEO's clients, not the PEOs themselves. 156 Cong. Rec. S1,989 (daily ed. Mar. 24, 2010) (statements of Sens. Nelson, Baucus, and Grassley); 156 Cong. Rec. S1,501 (daily ed. Mar. 15, 2010) (statements of Sens. Nelson, Baucus, and Grassley).

Appellant then argues the PDC failed to adequately consider the application of 13 C.F.R. § 121.103(b)(4), which provides: "Business concerns which lease employees from concerns primarily engaged in leasing employees to other businesses or which enter into a co-employer arrangement with a Professional Employer Organization (PEO) are not affiliated with the leasing company or PEO solely on the basis of a leasing agreement." Appellant asserts that no part of a regulation should be treated as meaningless and that individual sections of a regulation should be construed together. Appellant argues that, despite these rules of construction, the PDC failed to recognize that taking 13 C.F.R. §§ 121.104(a) and 121.103(b)(4) together indicate that PEOs and clients are separate and distinct entities.

Finally, Appellant contends the United States District Court for the District of Columbia has reviewed the SBA's approach to pass-through funds and declared that allowing an exclusion of such funds for real estate and travel agents but not for advertising agents is arbitrary and capricious. *Stellacom, Inc. v. United States*, 783 F. Supp. 647 (D.D.C. 1992). Consequently, explains Appellant (without citation), the SBA initiated a rulemaking in 1992, enunciating a five part test to determine when the exclusion of pass-through receipts is appropriate. Appellant contends its industry meets each of these five factors, and its pass-through receipts should be excluded. Appellant requests that OHA reverse the size determination and find Appellant to be a small business eligible for an economic injury disaster loan.

III. Discussion

A. Standard of Review

The standard of review for this appeal is whether the PDC based the size determination upon clear error of fact or law. 13 C.F.R. § 134.314. In evaluating whether there is a clear error of fact or law, OHA does not consider Appellant's size *de novo*. Rather, OHA reviews the record to determine whether the PDC made a patent error of fact or law based on the record before it. Consequently, the administrative judge may not disturb the PDC's size determination unless he has a definite and firm conviction that the PDC made key findings of law or fact that are mistaken. *Size Appeal of Taylor Consulting, Inc.*, SBA No. SIZ-4775, at 10-11 (2006).

B. Analysis

The regulation primarily at issue in this matter provides in full:

Receipts means "total income" (or in the case of a sole proprietorship, "gross income") plus "cost of goods sold" as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms (such as Form 1120 for corporations; Form 1120S and Schedule K for S corporations; Form 1120, Form 1065 or Form 1040 for LLCs; Form 1065 and Schedule K for partnerships; Form 1040, Schedule F for farms; Form 1040, Schedule C for other sole

proprietorships). Receipts do not include net capital gains or losses; taxes collected for and remitted to a taxing authority if included in gross or total income, such as sales or other taxes collected from customers and excluding taxes levied on the concern or its employees; proceeds from transactions between a concern and its domestic or foreign affiliates; and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker. For size determination purposes, the only exclusions from receipts are those specifically provided for in this paragraph. All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, and employee-based costs such as payroll taxes, may not be excluded from receipts.

13 C.F.R. § 121.104(a).

Appellant mischaracterizes the issue at hand. Appellant frames its argument as if it had been found affiliated with its clients pursuant to 13 C.F.R. § 121.103. But Appellant does not have an affiliation problem, it has a receipts problem. The PDC did not determine that Appellant is affiliated with its clients or employs its client's employees. The PDC merely calculated Appellant's average annual receipts based upon the income Appellant itself reported to the IRS.

The question here, then, is not whether Appellant employs the leased employees. The size standard applied to Appellant's industry is measured in average annual receipts, not total number of employees. Under 13 C.F.R. § 121.104(a), annual receipts are calculated on the basis of a firm's federal income tax returns. Thus, whether Appellant employs its client's employees is simply irrelevant to the calculation of its average annual receipts. Accordingly, the only issue here is whether the PDC erred in including in its calculation of Appellant's average annual receipts the receipts paid from Appellant's clients to Appellant and intended for the client's employees.

Consequently, all the opinion letters, federal determinations, and cases Appellant submitted in support of its argument that it does not employ its client's employees are irrelevant to the question I must answer. Similarly, Appellant's argument that the PDC failed to read 13 C.F.R. § 121.104(a) in conjunction with 13 C.F.R. § 121.103(b)(4) is unpersuasive. The PDC's interpretation of § 121.104(a) does not render § 121.103(b)(4) meaningless, and the two regulations are not related. Whereas § 121.104(a) deals with SBA's method of calculating receipts, § 121.103(b)(4) relates to whether certain concerns are affiliated. Again, Appellant attempts to frame its arguments as if it has an affiliation problem, but it does not. The fact that a PEO's client is not affiliated with its PEO on the basis of a leasing agreement means the SBA will not include a PEO's receipts in the client's receipts (or, presumably, vice versa) for size determination purposes. It does not change or affect the way SBA will calculate either firm's own receipts.

The only marginally persuasive argument Appellant makes is with regard to the SBA's 1992 proposed rule. 57 Fed. Reg. 38,452 (proposed Aug. 25, 1992). Appellant notes the SBA set forth five factors to be used when determining whether to allow exclusions from a firm's receipts for amounts collected for another:

First, a broker or agent-like relationship between a firm and a third party provider exists that represents a dominant or crucial activity of firms in these industries. Second, the pass-through funds associated with the broker or agent-like relationship is a significant portion of total receipts. Third, as the normal business practice of firms in the industry, a firm's income remaining after the pass-through funds are remitted to a third party is typically derived from a standard commission or fee. Fourth, firms in these industries do not usually consider billings that are reimbursed to other firms as their own income, preferring instead to count only those receipts that are retained for their own use. Finally, Federal government agencies which engage in the collection of statistics and other industry analysts typically represent receipts of the firms on an adjusted total basis.

57 Fed. Reg. at 38,452. Appellant argues its industry meets these criteria, and its client payroll receipts should be excluded from its own receipts. Again, however, Appellant's argument fails.

When the SBA enumerated the above factors in 1992, it was determining whether it should include in its regulation a specific exclusion for the pass-through receipts of firms in the advertising services industry. Based upon its analysis of the industry in light of these factors, the SBA did ultimately include an exclusion for advertising agencies in the regulation. *See* 13 C.F.R. § 121.104(a). In 1995, the SBA considered whether there should be a similar exclusion for conference management service providers. 60 Fed. Reg. 57,982 (proposed Nov. 24, 1995). Again, the SBA analyzed the industry in light of the five factors set forth above and determined such an exclusion was warranted. 60 Fed. Reg. at 57,985-96. Eventually, the conference management service provider industry was also included in the list of industries explicitly permitted to exclude pass-through receipts. *See* 13 C.F.R. § 121.104(a).

Thus, the five factors Appellant relies upon are to be used by SBA in rulemaking to determine whether a certain industry should be allowed a pass-through receipts exclusion in the regulation. The factors do not comprise a test that the Area Office or this Office may apply in determining whether a specific company should be allowed to exclude receipts for size determination purposes. The Agency has reserved the discretion embodied in the five factors to the rulemaking process. The Area Office and this Office and are bound by the regulations governing the size determination process, and the applicable regulation itself is very clear: "For size determination purposes, the only exclusions from receipts are those specifically provided for in this paragraph." 13 C.F.R. § 121.104(a).

The only industries that may exclude amounts collected for another according to the regulation are "travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker." 13 C.F.R. § 121.104(a). PEOs are not listed in the regulation, and, therefore, Appellant is not permitted to exclude its pass-through receipts. *See, e.g., Size Appeal of Mission Solutions, Inc.*, SBA No. SIZ-4828 (2006) ("This Office's precedent limits the exclusion of pass-through receipts only to those industries enumerated in the regulation." (citing *Size Appeal of SDS Nat'l, LLC*, SBA No. SIZ-4676 (2004))); *Size Appeal of Recycling Resources LLC*, SBA No. SIZ-4324 (1998) (finding a recycling company's pass-through receipts were not excludable in part because the industry is not specifically listed in the regulation). This Office has no authority to rewrite the regulations, or entertain any challenge to

them. *Size Appeal of Eagle Helicopter, Inc. d/b/a Kachina Aviation*, SBA No. 4810, at 7-8 (2006). I conclude the PDC made no error based upon the record before it.

IV. Conclusion

Appellant failed to meet its burden of proving that the PDC committed clear errors. Accordingly, this appeal is DENIED, and the size determination is AFFIRMED.

This is the final decision of the Small Business Administration. 13 C.F.R. § 134.316(b).

CHRISTOPHER HOLLEMAN
Administrative Judge