0019 1799 18 (June 29, 2017) – Claimant, a co-owner of the employer LLC, was monetarily eligible for benefits because tax returns present sufficient evidence that the employer elected to be taxed as an S-corporation for federal tax purposes during the base period. For unemployment purposes, the claimant is treated as an employee of the corporation.

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Issue ID: 0019 1799 18

BOARD OF REVIEW DECISION

Introduction and Procedural History of this Appeal

The claimant appeals a decision by a review examiner of the Department of Unemployment Assistance (DUA), to deny unemployment benefits. We review, pursuant to our authority under G.L. c. 151A, § 41, and reverse.

The claimant last received payment from this employer for his services on March 11, 2016. He filed a claim for unemployment benefits with the DUA on July 6, 2016, which was denied in a determination issued on November 17, 2016. The claimant appealed the determination to the DUA hearings department. Following a hearing on the merits, attended only by the claimant, the review examiner affirmed the agency's initial determination and denied benefits in a decision rendered on January 6, 2017. We accepted the claimant's application for review.

Benefits were denied after the review examiner determined that the claimant had insufficient base period wages upon which to establish a claim for benefits, since he failed to provide substantial and credible evidence to support his claim that the employer, of which he is a partner, operates and pays taxes as an "S-corporation," and, thus, he was disqualified, under G.L. c. 151A, §§ 1(h), 1(i), and 1(k). After considering the recorded testimony and evidence from the hearing, the review examiner's decision, and the claimant's appeal, we remanded the case to the review examiner to take additional testimony and evidence. Both parties attended the remand hearing. Thereafter, the review examiner issued her consolidated findings of fact. Our decision is based upon our review of the entire record.

The issue before the Board is whether the review examiner's conclusion that the claimant failed to establish that he performed services for the employer, of which he is an equal partner, in the capacity of an employee is supported by substantial and credible evidence and is free from error of law.

Findings of Fact

The review examiner's consolidated findings of fact are set forth below in their entirety:

1. The claimant and a business partner formed a limited liability company (LLC) in Massachusetts in 2012. The claimant and his partner each own 50% of the shares issued by the LLC. The business subsequently relocated to and continues to operate in the state of Washington.

2. The claimant relocated to Massachusetts in 2016 after having a disagreement with his business partner. The two have made offers to purchase the other's shares of stock; no agreement has been reached for such a purchase. The partners have agreed to have a detailed appraisal conducted in order to determine the value of the business and, presumably, an equitable division of its assets. The claimant does not plan to return to work for the business. The claimant last performed his regular duties sometime in February, 2016. The claimant was last paid his weekly salary of $1000 in a check dated 3/11/16. It is unknown the period of time for which this payment was intended to cover. The claimant and his partner sometimes delayed receipt of their paychecks in order for the money to be used by the business.

3. The employer has not filed a Form 8832 with the IRS. The employer indicated on its 2013 Income Tax Return (Form 1120S) that it was electing to be an S-corporation beginning with the 2013 tax year.

4. The claimant is an officer of the S-corporation.

5. The claimant was paid by the S-corporation to perform services during the base period of 7/1/15 through 6/30/16. The services performed by the claimant involved discussing legal matters with the company's attorney regarding licensing; maintaining contact with licensors; and ensuring the company's finances were kept in order. The claimant was paid wages of $1000 per week for his services; he was not issued payment in any other form. The employer stopped paying the claimant in February 2016. After the employer stopped paying the claimant, the claimant retained access to the employer's UI Online account with the DUA because he is still a 50% owner of the company and continues to have contact with the employer and keep tabs on things. The claimant did not think it was necessary to relinquish access to the employer's online account. The claimant continues to perform intermittent services for the employer by being available to answer questions. The claimant is not being paid for any of these services.

6. The claimant has resided in an area nearby the employer's business location. When the business relocated from Massachusetts to [City A], Washington, the claimant relocated but continued to use his parents' residential address in [City B], Massachusetts. The employer does not have any employees working in Massachusetts. After the business relocated to Washington, the claimant traveled to Massachusetts for personal visits; however, during these visits he continued to perform services on behalf of the employer through telephone

calls and emails. The claimant's travels to Massachusetts were not necessary in order to perform the employer's business.

7. The claimant filed an initial claim for unemployment insurance benefits, effective 7/3/16.

8. The DUA determined that the claimant had not earned sufficient base period wages in order to establish a claim.

9. On 11/17/16, the DUA issued the claimant a Corrected Notice of Disqualification, finding the claimant ineligible for benefits under Section 6(d) of the law.

10. On 11/22/16, the claimant appealed the Notice.

Ruling of the Board

In accordance with our statutory obligation, we review the decision made by the review examiner to determine: (1) whether the consolidated findings are supported by substantial and credible evidence; and (2) whether the review examiner's ultimate conclusion is free from error of law. Upon such review, the Board adopts the review examiner's consolidated findings of fact and deems them to be supported by substantial and credible evidence. However, contrary to the review examiner, we conclude that the claimant earned wages as an employee and is monetarily eligible for benefits.

In order to be eligible for unemployment benefits, the claimant must have earned wages of at least $3,900.00 in his base period. G.L. c. 151A, § 24(a).[1] Wages are defined under G.L. c. 151A, § 1(s), which provides, in relevant part, as follows:

> (A) "Wages", every form of remuneration of an employee subject to this chapter for employment by an employer . . . .

The consolidated findings establish that, in 2012, the claimant and another individual formed a partnership and registered as a limited liability company (LLC) in Massachusetts[2] as equal partners. *See* Consolidated Finding # 1. Where the claimant is part owner of the business entity that he works for, we take a close look at the employer's tax classification. It matters whether

[1] G.L. c. 151A, § 24(a), states that a claimant must have earned $2,000.00 in the base period. However, this amount changes periodically, as required under the statute, based on changes to the minimum wage. The minimum amount of wages needed for a valid unemployment claim at the time the claimant filed his 2016 claim was $3,900.00.

[2] Because the unemployment benefits at issue are subject to the Federal Unemployment Tax Act, 26 U.S.C. § 3301, *et seq.*, we are bound by U.S. Department of the Treasury regulations. An employer's tax classification is dictated by federal tax law, not how the employer is recognized as an entity under state law. 26 C.F.R. § 301.7701-1(a)(1). The employer's LLC status is a state-law designation, and it is not material for purposes of our analysis. *See* U.S. Department of Labor Unemployment Insurance Program Letter (UIPL) No. 26-08 (Sept. 8, 2008), p. 1. "When the states created LLCs, the IRS did not create a new tax classification, but instead applied the three tax entity classifications it had always used for business taxpayers: corporation, partnership, or sole proprietor. . . ." Id. at p. 1–2.

the employer elected to be treated as a partnership or a corporation while the claimant was drawing his salary.[3] As explained by the Massachusetts Appeals Court:

> Corporations, unlike partnerships, are treated as separate legal entities for the purposes of the unemployment compensation statute. Spaneas v. Travelers Indem. Co., 423 Mass. 352, 354 (1996) ("A corporation is an independent legal entity, separate and distinct from its shareholders, officers, and employees.") Therefore, a corporate shareholder may be an employee and qualify for unemployment benefits provided other conditions are met.

Herder v. Dir. of Division of Unemployment Assistance, 82 Mass. App. Ct. 701, 704 (2012) (further citations omitted).

We remanded in order to find out whether the employer had elected to be treated as a corporation for federal tax purposes. If the claimant's employing entity remained classified as a partnership, his earnings would not qualify as "wages" for purposes of monetary eligibility, under G.L. c. 151A, §§ 1(s)(A) and 24(a). However, if the partnership elected to be treated as a corporation for federal tax purposes, then we would recognize the wages as remuneration to an employee.

Specifically, we remanded for evidence that the employer had filed an Internal Revenue Service (IRS) Form 8832, which is the general mechanism for a partnership to expressly elect to be taxed as an association taxable as a corporate entity. *See* 26 C.F.R. § 301.7701-3(c)(1)(i)(the "check-the-box" regulation). The employer did not produce Form 8832. However, on remand it presented copies of its tax returns from 2013 through 2015, representing that in 2013, the employer had filed IRS Form 2553, electing to become an S-corporation. *See* Remand Exhibits ## 5, 6, and 11, page 1.[4] Although the best evidence would have been for the employer to present as evidence its completed Form 2553, we accept the fact that it continued to file federal tax returns as an S-corporation in subsequent years to be substantial evidence that the partnership did actually change its tax classification to that of an S-corporation in 2013.[5]

Since the evidence shows that during the base period of this claim, the claimant earned wages from an entity that is treated as a corporation for federal tax purposes, we conclude as a matter of law that the claimant's base period earnings from the employer constituted qualifying wages, under G.L. c. 151A, §§ 1(s)(A) and 24(a).

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[3] "A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership." 26 C.F.R. § 301.7701-2(a).

[4] The employer's statement on Remand Exhibit # 11, its 2013 federal income tax return, that it elected to be an S-corporation beginning with the 2013 tax year, while not explicitly incorporated into the review examiner's findings, is part of the unchallenged evidence introduced at the hearing and placed in the record, and it is thus properly referred to in our decision today. *See* Bleich v. Maimonides School, 447 Mass. 38, 40 (2006); Allen of Michigan, Inc. v. Deputy Dir. of Department of Employment and Training, 64 Mass. App. Ct. 370, 371 (2005).

[5] Pursuant to 26 C.F.R. § 301.7701-3(c)(1)(v)(C), the Treasury Department treats an entity, which elects to be treated as an S-corporation and meets all other requirements of a small business corporation, as having made the election to be treated as a corporation under 26 C.F.R. § 301.7701-3.

The review examiner's decision is reversed. The claimant is monetarily eligible for benefits in connection with his 2016 unemployment claim. Our decision does not render the claimant automatically eligible for unemployment benefits, as the DUA must determine whether the claimant's separation from the employer was qualifying under a different section of law, G.L. c. 151A, § 25(e).

BOSTON, MASSACHUSETTS
DATE OF DECISION - June 29, 2017

Paul T. Fitzgerald, Esq.
Chairman

Charlene A. Stawicki, Esq.
Member

Member Judith M. Neumann, Esq. did not participate in this decision.

ANY FURTHER APPEAL WOULD BE TO A MASSACHUSETTS STATE DISTRICT COURT OR TO THE BOSTON MUNICIPAL COURT
(See Section 42, Chapter 151A, General Laws Enclosed)

The last day to appeal this decision to a Massachusetts District Court is thirty days from the mail date on the first page of this decision. If that thirtieth day falls on a Saturday, Sunday, or legal holiday, the last day to appeal this decision is the business day next following the thirtieth day.

To locate the nearest Massachusetts District Court, see:
www.mass.gov/courts/court-info/courthouses

Please be advised that fees for services rendered by an attorney or agent to a claimant in connection with an appeal to the Board of Review are not payable unless submitted to the Board of Review for approval, under G.L. c. 151A, § 37.

JPC/AB/rh