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An Anomalous Tax Situation

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A rather anomalous situation has arisen in Colorado with reference to liability of small corporations in connection with the Unemployment Compensation Act.

In *Brannaman v. Richlow Mfg. Co.*, decided by the Colorado Supreme Court on July 1, 1940, 104 Pac. 2d 897, the opinion, written by Mr. Justice Knous, holds that non-compensated officers of corporations are not to be included in ascertaining whether the corporation is subject to the Colorado Unemployment Compensation Act.

This act provides that each employer who employs eight or more employes on any part of any day during each of twenty weeks in any calendar year shall be subject to the act and shall be required to pay to the Colorado Unemployment Compensation Fund unemployment compensation benefits aggregating 2.7 per cent of the employe's wages.

The federal act provides for the payment to the federal government of 3 per cent of such employe's wages, but allows the employer a credit of 90 per cent thereof (or 2.7 per cent of said wages) in the event said amount theretofore has been paid to the state. The result is that the employer pays 2.7 per cent of the employe's wages to the state and receives a credit in that amount upon the 3 per cent due the federal government, and thus pays the federal government .3 of 1 per cent of the employe's wages, *after and if* the amount due the state has been paid.

The difficulty in this matter has arisen in determining whether the word "employe" includes non-salaried officers of corporations with few employes which would not be subject to the act except for the inclusion of non-salaried officers as employes.

There are many corporations in this state which would be subject to the act if non-salaried officers are to be counted as employes, whereas these corporations would not be subject to the act if non-salaried officers are not to be counted as employes.

The conflict between the Colorado Supreme Court interpretation of the Colorado act and the fedral act and regulations thereunder is illustrated by the following:

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Section 19 (g) (1) of the Colorado act provides "Employment * * * means service * * * performed for wages or under any contract of hire, written or oral, express or implied."

Section 19 (f) (7) of the Colorado act provides that "employer" means "(7) any employing unit which becomes an employer subject to the provisions of *Title IX* of the Social Security Act."

On February 4, 1939, the treasury department issued Mimeograph No. 4880, in explanation of said Title IX, which defined "employe" as including an officer of a corporation unless he were an honorary officer.

Section 6 of the mimeograph then stated:

> "An officer of a corporation is an 'honorary' officer within the meaning of the foregoing rule if
>
> (1) he is specifically designated an honorary officer;
>
> (2) such designation is solely to do him honor or to have him included in the organization because of his name, prominence or standing in the community;
>
> (3) it would not ordinarily be necessary to fill his office should he die or resign;
>
> (4) as such officer, he does not actually perform any service and is not required or expected to perform any; and
>
> (5) as such officer, he does not receive, and is not entitled to receive, remuneration."

It is apparent, of course, from the foregoing definition of honorary officer that practically every officer of any type of business corporation, regardless of compensation, must be considered an employe within the meaning of Title IX of the Federal Social Security Act, if that act applies in the interpretation of "employe" in the Colorado act.

In the *Brannaman* case, the Supreme Court said:

> "As has been pointed out our act contains one definition of 'employment,' 19 (g) (1), supra, while Title IX of the federal law, 42 U. S. C. A., pp. 1101 et seq., contains an entirely different and distinct definition of the same term. PP. 1607 (c), Title 26, U. S. C. A. Int. Rev. Code. We cannot conceive that in adopting section 19 (f) (7) the General Assembly contemplated that the fundamental express definitions of the state act, which has an independent basis, either should be restricted or broadened by the federal act."

The Colorado Supreme Court having held that Title IX of the Federal Social Security Act does not apply in the interpretation of the word "employe" in the Colorado Act, and that non-compensated officers are not to be counted as employes, it would seem to follow that Colorado employers of a total of less than eight compensated officers and employes need not comply with the Colorado act.

An anomalous situation has arisen, however, from the fact that the federal government now has taken the position that because the federal act requires the full payment of 3 per cent of the wages of employees as defined by the federal act, unless the employer prior thereto has paid 90 per cent thereof to the state agency, the Colorado employer is bound by the definition of employes in the federal act and will be required to pay the full 3 per cent of the wages of his employes to the federal government, unless theretofore he has paid 90 per cent thereof to the state, and that the question of the liability of the employer to the state under a Colorado interpretation of the Colorado act is immaterial.

The effect of the government's position is to nullify the practical benefit of the Supreme Court decision referred to above.

As a possible means of avoiding this anomalous situation, we submit the following queries: May the Colorado employer not subject to the Colorado act under this decision pay the Colorado tax under protest and having obtained his receipt therefor, then pay the federal tax less the amount paid the state, and having obtained the federal receipt, then sue for a refund of the Colorado tax and, second, if the Colorado employer succeeds in obtaining a refund after having paid the federal government, has the federal government then any right to impose penalties and collect the amount refunded to the Colorado employer by the Colorado Unemployment Compensation Fund?

The purpose of the unemployment compensation acts being to provide benefits for employes when they are out of employment, why should payment be made by an employer for a non-compensated officer who will not be entitled to any benefits under the act when he is not employed? The federal act recognizes that directors are not to be counted as officers, and it would seem to be apparent that non-compensated officers likewise should not be counted.

We anticipate the federal courts will hold that the mimeograph above mentioned is beyond the terms of the statute and will follow the Colorado interpretation.

The matter should be tested as soon as possible.

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