BEFORE THE
CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

THIS DECISION DESIGNATES FORMER TAX DECISION NO. T-2320 AS A PRECEDENT DECISION PURSUANT TO SECTION 409 OF THE UNEMPLOYMENT INSURANCE CODE.

In the Matter of:	Referee Dec. No.	Case No.	
JAMES D. SADLER	SF-T-278	T-58-1	PRECEDENT TAX DECISION
SADLER PROPERTIES, INC.	SF-T-279	T-58-2	No. P-T-403
PENINSULA HOTEL COMPANY	SF-T-280	T-58-3	FORMERLY TAX DECISION No. T-2320
VALLEY HOTEL COMPANY, INC.	SF-T-281	T-58-4	
GARETH W. and MARY ANN SADLER, dba SHERMAN HOTEL	SF-T-282	T-58-5	
GENEVIEVE SADLER, dba MOUNTAIN VIEW HOTEL	SF-T-283	T-58-6	
SADLER HOTEL COMPANY (Petitioners-Appellants)	SF-T-284	T-58-7	
DEPARTMENT OF EMPLOYMENT (Respondent)			

STATEMENT OF FACTS

The petitioners in each of the seven tax cases set forth above have appealed from the referee's consolidated decision which denied each of their respective petitions for reassessment of assessments levied by the Department of Employment as follows:

Case No.	Date of Assessment	Code Sec.	Period Included From	To	Contributions	Penalty
T-58-1	3-12-57	1127	1-1-54	12-31-56	$514.84	Ø
T-58-2	3-6-57	1127	1-1-54	12-31-56	134.64	Ø
T-58-3	3-6-57	1127	1-1-54	12-31-56	248.77	Ø
T-58-4	3-12-57	1127	1-1-54	12-31-56	244.23	Ø
T-58-5	3-6-57	1127	1-1-55	12-31-56	113.15	Ø
T-58-6	3-12-57	1126	1-1-54	12-31-56	350.51	35.06
T-58-7	3-12-57	1127	1-1-54	12-31-56	230.12	Ø

With respect to each assessment, interest was added as provided by law. Both written and oral argument have been presented to the Appeals Board.

All of the petitioners are interrelated. The petitioner, James D. Sadler, is also the president of the four corporate petitioners. He is the brother of the petitioner Gareth W. Sadler, and the son of the petitioner, Genevieve Sadler. The petitioner Mary Ann Sadler is the wife of Gareth W. Sadler. The majority of the stock in two of the corporations is held by James D. Sadler and in the other two by Gareth W. Sadler. At the hearing before the referee, James D. Sadler testified upon behalf of all of the petitioners to the similarity of all of the transactions involved.

During the period in question, each of the petitioners was a lessee of one or more premises which he furnished and equipped for operation as a hotel. With certain exceptions noted later, each petitioner entered into like arrangements with various persons or couples for the operation and management of each of his hotels. The nature of these arrangements, and in particular whether they are employment relationships under the provisions of the Unemployment Insurance Code, is the subject of this proceeding.

Each arrangement had its documentary foundation in a written instrument denominated a sublease. Each petitioner executed one of these instruments as the sublessor with each person or couple engaged to operate one of his hotels as the sublessee. Each of the instruments so executed was identical in form.

Under each instrument, the sublessor engaged to lease to the sublessee not only the physical premises to be used as a hotel, but also all of the furniture and fixtures with which the sublessor had equipped it. In addition, the sublessor undertook to provide all of the equipment, materials and supplies needed to operate the hotel, and needed to maintain the premises and personal property. He also undertook to pay the costs of laundering, utility charges, and insurance premiums incurred in the operation of the business. For all of this, the sublessor was to receive 85% of the gross revenues which the sublessee derived out of the hotel operation.

By the instrument, the sublessee agreed to devote his entire time and effort to his hotel's management and operation; to keep the hotel open to the public at all times, and to maintain a high standard of service, cleanliness and quality in its operation. The sublessee engaged to provide the labor necessary to operate the hotel and to maintain the premises and personal property. He could engage such help as he wished to assist him, but the wages of any such labor as well as any employment taxes and workmen's compensation premiums payable in connection with it would be a charge against the 15% of the gross revenues which he retained.

The instrument provided that the sublessor's share of the gross receipts should be turned over to him at specified ten-day intervals. The sublessee obligated himself to maintain a complete and accurate record of the hotel's gross receipts open to the sublessor's inspection and audit at all times. The sublessee was given the right to occupy a manager's apartment rent free, and the sublessor was given the right to the use, rent free, of four guest rooms at each hotel by any persons he designated.

Under the terms of the instrument, the sublessor specifically retained a right to inspect the hotel premises and personal property at all reasonable times. He retained a right to enter the hotel premises for any reasonable purpose including the making of alterations, repairs, and the posting of certain notices. He agreed, however, that any such entry would be made in a manner that would not interfere with the management or operation of the hotel business.

By the provisions of the instrument, the sublessee agreed to procure the sublessor's prior written consent before making any purchases or sales other than in the ordinary course of business, or before entering into any contracts related to the business other than for the hiring of employees, or before making any alteration in the hotel premises or furnishings. He agreed to pay the lessor's reasonable attorney's fees and costs in any suit brought against him by the lessor based upon or pertaining to the instrument.

The instrument provided for the termination of the relationship concurrent with the termination of the master lease under which the sublessor held his interest in the property. The instrument also provided for automatic termination of the relationship upon the death of the sublessee, and also in the event of an assignment or subletting without the sublessor's prior written consent. Usual provisions for surrender and re-entry upon termination and for release of the sublessor from liability were included.

Aside from the foregoing, the relationship was also made terminable at the will of either party for cause, and upon 14 days' notice by either party without cause. What would constitute "cause" was not further defined in the instrument. The sublessee expressly waived the provisions of section 789 of the California Civil Code which requires a lessor to give a notice of not less than 30 days in order to terminate a tenancy at will.

In actual practice, each of the sublessors did provide each of his respective sublessees with a fully equipped hotel. Throughout the period of their relationship, the sublessor continued to maintain the hotel in a ready-to-operate condition, regularly furnishing to each of his sublessees all of the supplies, materials, and equipment needed for an efficient hotel operation.

The sublessor or his auditor visited each hotel at frequent intervals. He thoroughly checked over the condition of the hotel and the efficiency of the sublessee's operation of it. He regularly examined the books and records which were kept by the sublessee usually on forms that the sublessor provided. He discussed various details of the operation of the hotel with the sublessee, and made suggestions.

Each sublessee managed his hotel within the framework of the sublessor's well developed pattern of operation. He made usual decisions respecting the registration of individual guests, the rates to be charged, the check-out time, and, if he extended credit, the sublessee personally bore any loss that resulted. He lived at the hotel and devoted at least most of his time to its management and maintenance. He and his spouse did most of the work themselves, engaging very little additional help to assist them. No sublessee invested any significant amount of capital. Whenever local business licenses were obtained by a sublessee, he was reimbursed for the expense by his sublessor.

In general when sublessees changed, the hotels which they managed continued to operate uninterruptedly. When new sublessees were needed to take over a hotel, they were procured through such sources as want ads in the newspaper, recommendations of current or past sublessees or of hotel schools, occasional drop-ins, and discoveries by the sublessors' auditor. All applicants were carefully investigated before the relationship was established. Only once during the period in question was a relationship terminated by a sublessor, and in that instance it was allegedly terminated for cause, but nevertheless 14 days' notice was given.

The Uptown Hotel in Santa Cruz was not operated according to the above-described pattern until after May 11, 1956, because the petitioner, James D. Sadler, was not able to procure his own lessor's consent to its sublease. Until May 11, 1956, the managers of this hotel were admittedly employees of this petitioner. A more direct control was maintained over the performance of their responsibilities.

The Sherman Hotel at 8869 Santa Monica Boulevard in Los Angeles was not operated by the petitioners Gareth W. Sadler and Mary Ann Sadler in accordance with the above-described pattern until September 1, 1956. At no time during the assessment period was the Palace Hotel in Fresno operated in accordance with the pattern. At all times, its manager was admittedly an employee of the petitioner, Sadler Properties, Inc.

Upon behalf of all of the petitioners, James D. Sadler expressed their understanding of the relationship as being one entered into for the lease and hire of property without any intention thereby of creating any relationship for the employment of any persons. Each respective sublessee was considered by the petitioner to be a self-employed individual independently engaged in his own business as a hotel operator. To them, each sublessee entered into his relationship with his respective sublessor as an independent contractor.

From the petitioners' point of view, such control as each retained over the activities of his sublessees was associated with his legitimate interest as sublessor in the protection and security of the leasehold and with achieving a maximum rental return from it on a percentage basis. The petitioners urge that their controls were of a type that are customarily included for this purpose in the usual percentage lease.

Most of the sublessees who appeared as witnesses regarded themselves as managers, and acknowledged some feeling of independence in the conduct of their activity, especially in contrast to an ordinary employment situation, but expressed little sense of any feeling of ownership of an independent business. Most of the sublessees were sufficiently satisfied with their relationship not to be too concerned about its nature.

Sometime prior to January 25, 1954, a former sublessee at the Mountain View Hotel of the petitioner, Genevieve Sadler, requested a ruling from the Bureau of Internal Revenue with respect to his status under the federal employment tax laws. By letter under that date the District Director of Internal Revenue advised him that upon consideration of all of the facts available, it was the opinion of the Bureau that Mrs. Sadler neither exercised, nor had the right to exercise such control as was necessary under common law rules to establish an employment relationship for purposes of federal employment taxes. This former sublessee did not manage a hotel at any time during the period in issue.

The issue presented from our determination is whether the various sublessees were employees within the meaning of the Unemployment Insurance Code.

REASONS FOR DECISION

The basis for requiring contributions under the Unemployment Insurance Code is the existence of an employment relationship. "Employment" is defined in section 601 of the code as meaning service performed for wages or under any contract of hire, written or oral, express or implied. "Wages" are further defined in section 926 of the code as meaning all remuneration payable for personal services including commissions and bonuses, and the reasonable cash value of all remuneration payable in any medium other than cash.

A person may operate an independent business on premises which he occupies, or with personal property which he holds under lease from another. Reasonable restraints upon the lessee's use of the property related to the preservation of the lessor's reversionary estate or to the protection of his rental return do not of themselves constitute a right of control over manner and means of rendering personal service. The ordinary relationship of lessor and lessee does not come within the scope of the Unemployment Insurance Code (Empire Star Mines Company, Ltd. v. California Employment Commission (1946), 28 Cal. 2d 33, 168 P. 2d 686; Tax Decisions Nos. 512 and 2173).

Experience in connection with the administration of the Unemployment Insurance Act and Code has shown, however, that what is in fact an employment relationship is sometimes set up under the form of a lease of property. The actual rendition of services is given the appearance of a hire of property by a person supposedly engaged in a distinct business of his own. The employer's right to control the manner and means of carrying on the activity is established by a combination of various lease provisions restraining, obligating, and imposing practical limitations upon the person designated as the lessee (Bemis v. California Employment Stabilization Commission (1952), 109 Cal. App. 2d 253, 240 P. 2d 638; Tomlin v. California Employment Commission (1947), 30 Cal. 2d 118, 180 P. 2d 342; Tax Decisions Nos. 56 and 449).

In the administration of the Unemployment Insurance Code, it is essential to distinguish between these two situations - the true lease on the one hand and the form lease setting up an actual employment relationship on the other. The question is one of fact to be determined in each instance from a full evaluation of all of the evidence. Where the evidence reveals that an employer's right of control over manner and means is actually being retained under the form of a lease, then the realities involved in the imposition of tax liability require that the apparent form of the relationship be disregarded and its true character recognized (Bemis v. California Employment Stabilization Commission, supra; Tax Decision No. 2218).

In the matter before us, the seven petitioners established a uniform pattern for the operation of all but a few of their hotels. Those few hotels present no problem because they were admittedly operated by employees.

But the general pattern of operation calls for rather careful discrimination as to its true nature because of the presence of certain features of control that seem to be much more closely associated with the usual active and promotive direction of an employer than with the more passive and restrictive methods by which a lessee ordinarily protects his rental and reversionary interests in property.

The petitioner's pattern of operation was organized in a very strong and efficient way. This automatically imposed a very substantial degree of control over the activities of the individual lessee. Eighty-five per cent of the gross return from the business was taken out immediately by the sublessor in exchange for his supplying according to his pattern everything needed to maintain and operate the hotel, except labor. From the evidence before us, it seems apparent that it was not the sublessor's purpose to leave the sublessee any significant measure of free choice to deviate from this operating pattern in any material way, and that this purpose was adequately effectuated by making the arrangement terminable upon 14 days' notice without cause, and with cause (not defined) at the sublessor's will (Tax Decision No. 2233).

Under this arrangement, there is no real difference between the position of the sublessee and that of a manager employed on a 15% commission basis who can be let go on two weeks' notice. Like such a manager, the sublessee is accorded an area of independent judgment that is usual to a manager's occupation, but above this level he must either accept the petitioner's strongly organized pattern of operation or terminate. Like such a manager, he may extend credit at his own risk where it is not the organization's policy to do so, but aside from this there is little possibility of a sublessee sustaining a loss of anything but his labor. The sublessee has no minimum rental requirement to meet, nor is there any maximum rental above which he reaps for himself the real fruit of unusual enterprising skill. The nature of the hotels was such that generally a married couple could and did handle the entire operation, and little other assistance was either contemplated or utilized.

The pattern of the petitioner's control was sufficiently complete that the various hotels continued to operate uninterruptedly whenever the managers changed. The pattern of replacing managers bore all the characteristics of replacing employees rather than that of one independent owner winding up a business of his own and another independent owner establishing one. The frequent visits of the sublessor and especially of his auditor when viewed in the overall setting of the relationship reflect an important note of supervision and were a constant reminder to the sublessee of the real nature of his position.

Most of the direct manifestations of employer control are stated in terms having some relationship to a lessor's property interest, and in language bearing the usual terminology of leases. When viewed, however, in connection with the uniform pattern of operation imposed upon all of the sublessees in identical terms, the true character of the subleases as instruments of employer control is readily identifiable. It is not characteristic of a lease relationship even on a percentage basis, for the lessor to restrain his lessee's right to enter into contracts or make purchases and sales above the level of discretion that would ordinarily be accorded to an employed manager; or for the lessor to resort to such regular and close supervision of his lessee's activities solely for the protection of the lessor's rental and reversionary interests; or for the lessor to provide his lessee, an ostensibly independent business man, with so detailed and complete a provision of supplies and services of the lessor's choice in package form under the conditions of tenure and remuneration established.

We are not unmindful of the fact that the District Director of Internal Revenue has previously found a former sublessee of one of the petitioners to be a self-employed person. While this former sublessee did not manage a hotel at any time during the period under review, we believe that the action of the District Director, while not binding upon us, still merits our thorough consideration.

It appears to us, however, that we have probably had a much more complete presentation of the facts of the case before us than did the District Director. We note that he qualified his opinion upon the basis of his consideration of the facts available to him. We believe that in the exercise of our independent duty of determining status under the Unemployment Insurance Code, the record before us requires that we reach a different conclusion.

From a consideration of all of the evidence we are of the opinion that the department and the referee have correctly appraised the petitioner's pattern of operation as one of lease in form only, and as one of employment in fact. We so hold.

DECISION

The decision of the referee is affirmed.

Sacramento, California, May 14, 1959.

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

ARNOLD L. MORSE

ERNEST B. WEBB

Pursuant to section 409 of the Unemployment Insurance Code, the above Tax Decision No. 2320 is hereby designated as Precedent Decision No. P-T-403.

Sacramento, California, February 27, 1979.

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

DON BLEWETT, Chairperson

MARILYN H. GRACE

HARRY K. GRAFE

RICHARD H. MARRIOTT

HERBERT RHODES