

JURISDICTION: OKLAHOMA TAX COMMISSION - DECISION
CITE: 98-11-12-009 / NOT PRECEDENTIAL
ID: P9300182
DATE: 11-12-98
DISPOSITION: DENIED
TAX TYPE: INCOME
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. At all times relevant herein, Protestants were residents and domiciliaries of the State of Oklahoma.

2. MR.PROTESTANT is an attorney licensed to practice law in THREE STATES.

3. During the period at issue, MR. PROTESTANT received two (2) separate legal fees for his representation of an individual in two (2) proceedings, a criminal case and a civil case, in AN ANONYMOUS STATE. MR. PROTESTANT'S representation of the individual in the criminal case began in March, 1985 and ended with his acquittal on June 18, 1987. His representation in the civil case began in 1988, although the initial pleadings were filed by AN ANONYMOUS ATTORNEY in June, 1986, and ended with a verdict in April, 1991.

4. The fees for the criminal and civil cases were paid by AN ANONYMOUS insurance carrier, the defendant in the civil case, in accordance with the settlement agreement reached by the parties in the civil case. The criminal case legal fee was issued to MR. PROTESTANT, individually. The civil case legal fee was issued TO THE CORPORATION (hereinafter "Corporation"). According to the testimony of MR. PROTESTANT, the check was not run through the Corporation's account, but was split between he and MR. ANONYMOUS ASSOCIATE, P.C. pursuant to their percentages of the Corporation and deposited in their personal accounts.

5. For the 1991 tax year, Protestants reported the legal fee from the criminal case as out-of-state income on their Oklahoma income tax return.

6. On their 1991 federal income tax return, Protestants reported the criminal case legal fee on schedule C as business income of MR. PROTESTANT from a sole proprietorship. The OKLAHOMA address of the Corporation was listed on schedule C as the business address of the sole proprietorship.

7. The Division did not adjusted the initial Oklahoma income tax return filed by Protestants.

8. In June, 1992, Protestants filed an amended Oklahoma income tax return for the purpose of adding some partnership income which had not been previously reported.

9. The Division audited the amended return, denied the exclusion of the criminal case legal fee as out-of-state income and assessed additional income tax in the amount of \$171,856.00. The explanation for the denial of the exclusion was "your schedule C income does not qualify as out of state income."

10. Protestants timely protested the proposed adjustment and assessment.

11. In March, 1994, Protestants filed a second amended Oklahoma income tax return. On this return, Protestants also reported the civil case legal fee as out-of-state income. A refund of \$170,703.00 was claimed on the return.

12. Attached to the second amended return were IRS forms making corrections to the W-2 issued to MR. PROTESTANT from the Corporation, a corrected W-2 and a Form 1099-Misc. The forms correcting the W-2 issued to MR. PROTESTANT shows a reduction in the wages paid to him by the amount of the civil case legal fee. The Form 1099-Misc. reports the civil case legal fee as nonemployee compensation. The payer on the Form 1099-Misc. is reported as the Corporation.

13. Protestant, testified that he does not know whether the Corporation's Oklahoma and federal corporate income tax returns for 1991 were amended to report the correction made to the W-2 issued to him. A review of the forms suggests that amended corporate income tax returns were not filed. The W-2 and 1099-Misc. forms are unsigned and indicate that an adjustment to the employment tax returns had not been made.

14. Schedule E of the Corporation's federal return reports the amount of compensation paid to MR. PROTESTANT which includes the civil case legal fee and reports the percentage of time devoted to the business as 100% for MR. PROTESTANT.

15. The Division denied the adjustment and refund claimed on the second amended return. The explanation for the denial was "personal service income for an Oklahoma resident whether reported as wages or as federal schedule C as self employment income is taxed in Oklahoma."

16. According to the testimony of MR. ANONYMOUS ASSOCIATE, P.C., the Corporation was formed sometime during 1985. Prior to this time and after the breakup of ANONYMOUS ASSOCIATES, MR. PROTESTANT officed out of OKLAHOMA. The 1991 Oklahoma corporate income tax return of the Corporation shows an incorporation date and business start date of September 1, 1987.

17. During the relevant time period, the Corporation did not have an office in any state other than Oklahoma. MR. PROTESTANT testified that when he is hired in Oklahoma, his law firm is hired and when he is hired in AN ANONYMOUS STATE, he is hired. The testimony indicated that during this time period, the ANONYMOUS STATE cases were worked out of a condo in ANONYMOUS CITY "A" OF ANONYMOUS STATE, out of AN ANONYMOUS ATTORNEY'S office in ANONYMOUS CITY "A" OF ANONYMOUS STATE, out of AN ANONYMOUS PARTNERS' office in ANONYMOUS CITY "B" OF ANONYMOUS STATE, or out of the OKLAHOMA office of the Corporation.

Sixty to Sixty-five percent of his time was spent in ANONYMOUS STATE during the relevant time period and thirty-five percent of his cases were ANONYMOUS STATE cases during this period. Schedule C to the 1991 federal return does not report any expenses for a ANONYMOUS STATE office. Additionally, Schedule E to the 1991 federal return reports rents received from the condo in ANONYMOUS CITY "A", ANONYMOUS STATE.

18. ANONYMOUS ATTORNEY, the defendant in the criminal case and the plaintiff in the civil case, testified that MR. PROTESTANT was hired to try the criminal and civil cases. The testimony indicates that MR. PROTESTANT'S involvement in these cases up to the point of trial was minimal, that all motions and pleadings were prepared by ANONYMOUS ATTORNEY or a ANONYMOUS STATE attorney who assisted MR. PROTESTANT in the criminal case and that no one from the OKLAHOMA office of the Corporation assisted or worked on these cases. The pleadings and motions in each of these cases list a OKLAHOMA address for MR. PROTESTANT. Some of these pleadings and motions are signed by MR. PROTESTANT, some identify the MR. PROTESTANT law firm and some are written on the letterhead of the law firm. Not one motion or pleading from either of these cases was entered into evidence showing a ANONYMOUS STATE address for MR. PROTESTANT.

19. ANONYMOUS ATTORNEY testified that a written contract of representation was not entered into between MR. PROTESTANT and himself. He stated that MR. PROTESTANT might have advanced him some money on the cases, but that such money was immediately repaid. He further stated that MR. PROTESTANT and he worked on some other cases together out of his ANONYMOUS CITY "C" office. He further testified that MR. PROTESTANT did not pay rent on the ANONYMOUS CITY "C" office and that any fees from the other cases were not run through the partnership, but were split between them.

20. In regard to his association with AN ANONYMOUS PARTNER, MR. PROTESTANT testified that they formed two separate corporations and then formed a partnership. No formal partnership agreement was entered into between AN ANONYMOUS PARTNER and MR. PROTESTANT.

ISSUE AND CONTENTIONS

The issue presented for decision is whether the ANONYMOUS STATE legal fees were properly excluded as out-of-state income from Oklahoma taxable income.

Protestants contend that the ANONYMOUS STATE legal fees are excludable from Oklahoma taxable income pursuant to 68 O.S. 1991, § 2358(A)(4)(c). In support of this contention, Protestants argue that the ANONYMOUS STATE legal fees were from a business activity conducted by MR. PROTESTANT within the ANONYMOUS STATE which was separate and distinct from the business activity conducted by MR. PROTESTANT within the State of Oklahoma.

The Division contends that the ANONYMOUS STATE legal fees are subject to taxation in the State of Oklahoma. In support of this contention, the Division argues that the evidence fails to show either a unitary business or separate business activity which would allow Protestants to allocate the income under Section 2358(A)(4)(c).

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 1991, § 207.

2. A state has the power to tax its own residents on their net incomes though derived wholly from activities carried on by them outside of the state. **Davis v. Oklahoma Tax Commission**, 488 P.2d 1261 (Okl. 1971); **Colchensky v. Oklahoma Tax Commission**, 184 Okl. 207, 86 P.2d 329 (1939). Domicile itself establishes a basis for taxation. **Colchensky**, supra at 184 Okl. 208.

3. Income received by a resident individual as compensation for personal services in a state other than Oklahoma is subject to Oklahoma income tax. 68 O.S. 1991, § 2357(B)(1). See, **Oklahoma Tax Commission v. Benham**, 198 Okl. 384, 179 P2d 123 (1947). A credit against the tax imposed on such income by Oklahoma is allowed for the amount of tax paid on the income in the other state. *Id.*

4. In **Benham**, supra, the Court in a syllabus to the decision concluded:

The entire income of an individual Oklahoma resident derived from wages, salaries, commissions, professional or occupational earnings, or other compensation received from personal services is taxable in this state without regard to the place wherein the services were performed. That portion of the income, however, derived from 'business transacted' outside the state as distinguished from 'professional' or 'personal' services is nontaxable in this state.

5. Net income or loss from a business activity which is not a part of business carried on within or without the state of a unitary character shall be separately allocated to the state in which such activity is conducted. 68 O.S. 1991, § 2358(A)(4)(c). See, Rule 23.007.05(A) of the *Oklahoma Tax Commission Permanent Rules*.¹ The provisions of Section 2358(A)(4)(c) apply equally to corporations and individuals. See, *Oklahoma Tax Commission Order No. 92-07-14-003*.

6. A "business activity" is one in which capital, time, attention, labor, and intelligence are invested for gain and profit for private benefit, purposes and use. *Black's Law Dictionary* 179 (5th ed. 1979). A "business activity" entails a possibility of a personal profit or loss.

¹ Adopted March 3, 1989. Currently codified as Rule 710:50-15-52 of the *Oklahoma Administrative Code*. This rule provides, "[F]or resident individuals, 'out-of-state income' consists of income from real or tangible personal property or business income in another state. Any amount deducted must be substantiated with the appropriate Federal schedule which sets out the Oklahoma portion."

7. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. Rule 710:1-5-47 of the *Oklahoma Administrative Code*. See, ***Enterprise Management Consultants, Inc. v. Oklahoma Tax Commission***, 768 P.2d 359 (Okl. 1988). The burden of proof standard in administrative proceedings is "preponderance of evidence". *Black's Law Dictionary* 1064 (5th ed. 1979). See, *Oklahoma Tax Commission Order No. 91-10-17-061*. "Preponderance of evidence" means "[E]vidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the fact sought to be proved is more probable than not." *Id.*

8. Here, the evidence as a whole does not show that the ANONYMOUS STATE legal fees were from a business activity separate and distinct from the business activity conducted by MR. PROTESTANT within Oklahoma. The evidence supports a conclusion that the fees were compensation for his professional services performed for a ANONYMOUS STATE client in AN ANONYMOUS STATE. Accordingly, the fees were improperly excluded as out-of-state income.

9. Protestants' claim for refund and protest to the proposed assessment should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it WAS DETERMINED that the claim for refund and the protest to the proposed assessment of Protestants, be denied. It is further DETERMINED that the amount of the proposed assessment, inclusive of any additional accrued and accruing interest be fixed as the deficiency due and owing.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was **NOT** deemed precedential by the Commission. This means that the legal conclusions are not generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.