JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2002-01-08-011 / NOT PRECEDENTIAL**
ID: **P0000021**
DATE: **01-09-02**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

NOW on this 26th day of November, 2001, the above styled and numbered cause comes on for consideration pursuant to assignment made by the Oklahoma Tax Commission to AN Administrative Law Judge. By agreement of the parties, this matter was submitted for decision without a hearing. Representative for Protestant, CPA, and the Audit Division, by and through its representative, AN Assistant General Counsel, General Counsel's Office of the Oklahoma Tax Commission, submitted a Stipulation of Facts, Addendum to the Stipulation of Facts and filed briefs in support of their respective positions, all in accordance with Oklahoma Administrative Code 710:1-5-38.

FINDINGS OF FACT

The parties stipulated to the following facts:

1. By letter dated November 15, 1999, from AN Individual Income Tax Auditor, the Commission proposed to assess additional income tax penalty and interest for the 1996 tax year against the Protestants.

2. By letter dated December 6, 1999, from THE Individual Income Tax Auditor, the Commission proposed to adjust the assessment of additional income tax, penalty and interest for the 1996 tax year against the Protestants.

3. The Protestants timely filed a formal protest to the proposed assessment by letter dated December 14, 1999.

4. A Pre-Hearing Conference was held on March 13, 2000.

5. By memorandum to the Administrative Law Judge ("ALJ") dated April 10, 2001, the Division advised that the parties would prefer to submit the case on briefs in lieu of a formal hearing and offered a litigation schedule.

6. By letter dated April 12, 2001, the ALJ issued a litigation schedule.

7. The protest of PROTESTANTS is properly before the Commission.

8. The Protestants filed a joint Oklahoma individual income tax return for the 1996 tax year on March 18, 1997.

9. The Protestants filed a joint Federal income tax return for the 1996 tax year on April 11, 1997.

10. The Division examined the Protestants' 1996 Oklahoma individual income tax return and compared it with information received from the internal Revenue Service ("IRS") under the authority of the Internal Revenue Code ("IRC") Section 6103(d). The Division informed the Protestants of this fact in a letter dated November 15, 1999.

11. The assessment of income tax penalty and interest for the 1996 tax year issued on November 15, 1999, was Two Thousand Four Hundred Fifty-Five Dollars and Eleven Cents ($2,455.11).

12. The revised assessment of income tax penalty and interest for the 1996 tax year, issued on December 6, 1996, was Two Thousand Three Hundred Fifty-Eight Dollars and Sixty Cents ($2,358.60).

13. The only issue in controversy involves the Protestants' claim of out-of-state business income which the Division denied.

ISSUE

Whether Protestants' income earned in the State of Texas is includable in Oklahoma adjusted gross income.

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission has jurisdiction of this protest. 68 O.S. §§ 207, 221.

2. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect, Enterprise Management Consultants, Inc. v. Oklahoma Tax Commission, 1988 OK 91, 768 P.2d 359. Failure to provide evidence which is sufficient to show an adjustment to the proposed assessment is warranted will result in the denial of the protest, Continental Oil Co. v. Oklahoma Tax Commission, 1976 OK 23, 570 P.2d 315.

3. The Protestants have the burden of proof to show in what respects the proposed assessments are incorrect pursuant to OAC 710:1-5-47. The standard burden of proof in administrative proceedings is "preponderance of evidence," Oklahoma Tax Commission Order No. 91-10-17-061. "Preponderance of evidence" is evidence 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. It also means evidence which is more credible and convincing to the mind or that which best accords with reason and probability.

4. The stipulated facts do not provide any indication of the character of the income at issue. However, PROTESTANT attached a Schedule C-EZ to his 1996 Federal 1040 income tax return, submitted herein as Exhibit G, which indicates that PROTESTANT's principal business or profession is "consulting engineer" with a business address in BIG CITY, Oklahoma. The principal business code indicated on the Schedule C-EZ is THE CODE for engineering services. PROTESTANT lists gross receipts from this business of $32,240.00 less total expenses of $1,961.01 which calculates a net profit of $30,278.99 which is reported on line 12 of PROTESTANT's 1996 Federal 1040 form. In Exhibit F, PROTESTANT submits his 1996 Oklahoma form 511 income tax return which claims out of state income on line 8 as $32,912.00 as set out in an attached Schedule 1. On Schedule 1, PROTESTANT reports $31,500.00 as "Texas income" and $1,411.56 as "Texas and Kansas royalty income." The Division disallowed PROTESTANT's exclusion of these two items of income from Oklahoma adjusted gross income and assessed him for additional income tax. PROTESTANT timely filed a protest on December 14, 1999, submitted herein as Exhibit "C" in which he contended that Texas and Kansas royalty income was not taxable pursuant to 68 O.S. § 2358(A)(4)(a) and the Texas income was not taxable pursuant to 68 O.S. § 2358(A)(4)(c) which provides:

> 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.

The Division concluded that the Texas and Kansas royalty income was properly excluded from Oklahoma adjusted gross income pursuant to Section 2358(A)(4)(a), however, the Division did not agree that the Texas income should be excluded and therefore adjusted the assessment to assess additional income tax on the Texas income item.

5. The taxability of the Texas income item rests on the controverted fact of whether the income was earned in the practice of a profession or in the conduct of a business. The Supreme Court of Oklahoma has held in Colchensky v. Oklahoma Tax Commission, 1938 OK 612, 86 P.2d 329, that the income derived from property owned or business transacted was limited to the income derived from property owned or business transacted within the State, but the tax on the income of a resident individual derived from wages, salaries, and commissions was placed on the entire income without regard to the place wherein the services were performed. The Court stated:

> A state has constitutional power to tax its own citizens on their net income though derived wholly from activities carried on by them outside of the state. Domicile in itself establishes a basis for taxation.

This holding was reiterated in Davis v. Oklahoma Tax Commission, 1971 OK 109, 488 P.2d 1261. The distinction between compensation for personal services and income from business activity is made in the Oklahoma Income Tax Code at 68 O.S. § 2357(B) where a credit against tax is provided for an amount of tax paid another state by a resident individual upon income received as compensation for personal services in such other state. Title 68 O.S. § 2358(A)(4)(c) provides an exclusion for, "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."

6. This distinction between compensation for personal services and income from a business activity was considered by the Oklahoma Supreme Court in Oklahoma Tax Commission v. Benham, 1947 OK 104, 179 P.2d 123. The Supreme Court found that the taxpayer, a resident of Oklahoma county, as architect-engineer, did everything necessary for the construction at Camp Polk, Louisiana, of an army camp for housing, feeding and hospitalization of 14,000 men, including sewer and warehouses, except the actual construction of the buildings and improvements. In the performance of these duties, which required 295 days, he had an average total of some 200 or more employees. He hired them, fixed their compensation, paid their salaries and wages,
carried all the different forms of insurance necessary to cover them, paid their social security and payroll taxes. The taxpayer operated on a cost-plus-fixed-fee basis under the contract. The Court held:

> It is not necessary to enter upon an ethical discussion of the difference between a livelihood gained by the practice of a profession and that by a business vocation. The law is practical. It is not concerned with abstractions, but with the actual affairs of men, and it recognizes the distinction between the practice of a profession and the conduct of a mercantile business. One is purely personal, depending upon the skill or art of the individual.

The Supreme Court in Benham found that even though the taxpayer was an engineer by profession, the duties and responsibilities required of him under the contract placed him in the category of transacting a business rather than practicing a profession because his duties and responsibilities under the contract were more in the nature of those of a contractor than of an engineer.

7. In the case at bar, the facts presented by PROTESTANT are more closely associated with practicing the profession of engineering rather than transacting a business. PROTESTANT indicates that the nature of his business was to identify equipment needs, locate suppliers and facilitate the purchases of equipment needed by AN oil company. PROTESTANT did not purchase equipment on his own account nor did he capitalize the transaction.

PROTESTANT did not hire and supervise employees and provide a payroll or pay bills from his own funds. PROTESTANT only provided his services as an engineer to a venture which included many other parties. Although PROTESTANT argues that he had an office at the project headquarters in Houston, Texas, there are no facts on the record which indicate that he paid for the rental, staffing, supply or maintenance of the office. The expenses claimed by PROTESTANT on his Schedule C-EZ are not itemized, however, the expenses claimed appear to be too low to include maintenance of an office and staff in Houston. It would not be unreasonable to conclude that a company which hires a consultant would also provide office space for his use if he is required to provide services on site because it would be more cost effective to do so. PROTESTANT's claims that he operated an office in Houston are too vague and no facts were presented on the record which would demonstrate that he transacted business in Houston, Texas. The facts presented indicate that PROTESTANT provided professional services to a venture located in Texas for which he received compensation taxable in Oklahoma.

8. Protestants' protest to the proposed assessment should be denied.

DISPOSITION

It is the recommendation of the OKLAHOMA TAX COMMISSION, based upon the specific facts and circumstances of this case, that the income tax protest be denied.

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.