JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2008-01-08-02 / NON-PRECEDENTIAL**
ID: **P-07-064-H**
DATE: **JANUARY 8, 2008**
DISPOSITION: **SUSTAINED IN PART / DENIED IN PART**
TAX TYPE: **WITHHOLDING**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

PARTNER 1, PARTNER 2, and PARTNER 3 d/b/a AUTO REPAIR SHOP and as General Partners and as Individuals ("Protestants") appear by and through attorney, ATTORNEY, LAW FIRM. The Field Audit Section of the Compliance Division f/k/a the Audit Division ("Division"), Oklahoma Tax Commission, appears by and through OTC ATTORNEY, Assistant General Counsel, and OTC ATTORNEY 2, Assistant General Counsel, Office of General Counsel, Oklahoma Tax Commission.

PROCEDURAL HISTORY

On April 19, 2007, the protest file was received by this office for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure Before the Oklahoma Tax Commission.[2] On April 30, 2007, a letter was mailed to the Protestants stating that this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-07-064-H. The letter also advised the Protestants that a Notice of Prehearing Conference would be sent by mail and enclosed a copy of the *Rules of Practice and Procedure Before the Oklahoma Tax Commission.* On May 11, 2007, the Notice of Prehearing Conference was mailed to the last known address of the Protestants, setting the prehearing conference for June 11, 2007, at 2:30 p.m.[3]

The prehearing conference was held as scheduled by teleconference on June 11, 2007, at 2:30 p.m. On June 12, 2007, a letter was mailed to the parties directing that pursuant to the prehearing conference a status report was due on or before July 11, 2007. On July 11, 2007, the Division filed the Status Report advising that attempts to settle had been unsuccessful and that the parties requested a scheduling order be issued.

On June 27, 2007, the Scheduling Order was issued setting this matter for hearing on September 25, 2007, at 9:30 a.m., with position letters or briefs due on or before September 18, 2007. On July 11, 2007, ATTORNEY filed an Entry of Appearance, as counsel for the Protestants. The history of procedural filings, from July 11, 2007, to September 17, 2007, is

[1] OKLA. STAT. ANN. tit. 68, § 201 et seq. (West 2001).

[2] OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-47.

[3] OKLA. STAT. ANN. tit. 68, § 208 (West 2001). The notice was mailed to the Protestants at PROTESTANTS' ADDRESS.

being omitted herein. On September 18, 2007, the Brief of the Audit Division and the Pretrial Brief-Position Letter of the Protestants were filed in accordance with the Scheduling Order.

An open hearing[4] was held as scheduled on September 25, 2007, at approximately 9:30 a.m. The Protestants called four (4) witnesses, PARTNER 3, MECHANIC 2, CPA, and PARTNER 2, who testified regarding the Protestants' business practices. The Protestants' Exhibits 1 through 4 were identified, offered, and admitted into evidence. The Division called one (1) witness, AUDITOR, Field Auditor, Field Audit Section of the Compliance Division f/k/a the Audit Division, Oklahoma Tax Commission, who testified regarding the procedures utilized in conducting the audit and as custodian of the Division's records. The Division's Exhibits A, F, G, H, I, M, Q2, Q3, and Q4 were identified, offered, and admitted into evidence.

Upon conclusion of the hearing, the record was held open to allow the Protestants to execute and return wage statements to the Division on or before October 8, 2007. Within ten (10) days of receipt of the executed wage statements, the Division was directed to file a memorandum reporting the results, at which time the record would be closed.[5] On October 12, 2007, the Division filed the Division's Report of Wage Statement Results. On October 15, 2007, the record in this matter was closed and this case was submitted for decision.[6]

STIPULATION

At hearing, the Protestants, through ATTORNEY, stipulated that the Protestants are partners of the general partnership and are liable for withholding taxes as partners and individuals during the Audit Period.[7]

FINDINGS OF FACT

Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, and the briefs, the undersigned finds:

1. The Protestants are general partners[8] operating an automotive service located in TOWN, Oklahoma.[9] The general partnership registered with the Tax Commission on

[4] The Protestants, through counsel, waived their right to a confidential hearing. *See* OKLA. STAT. ANN. tit. 68, § 205 (West Supp. 2007).

[5] On September 27, 2007, the parties were so notified by letter.

[6] OKLA. ADMIN. CODE § 710:1-5-39 (June 25, 1999).

[7] *See* OKLA. STAT. tit. 68, § 2385.3(E) (West Supp. 2005).

[8] PARTNER 1 and PARTNER 2 are husband and wife. PARTNER 3 is their son. Testimony of PARTNER 3.

[9] Division's Exhibit A.

September 12, 2001, indicating that the Protestants did not "intend to withhold Oklahoma Income Tax from employees."[10]

2. The Division conducted a withholding tax audit on the Protestants for the period of October 1, 2001, through December 31, 2005 ("Audit Period").[11]

3. The Protestants' payroll ledgers were used in preparing the audit work papers.[12]

4. On February 16, 2007, the Division issued proposed withholding tax assessments[13] against the Protestants for the Audit Period, as follows, to-wit:

Tax Due:	$3,811.00
Interest @ 15% through 04/02/07:	1,661.64
Tax & Interest Due Within 60 Days:	$5,472.64
30 Day Delinquent Penalty:	865.75
Tax, Interest & Penalty Due After 60 Days:	$6,338.39

5. On February 23, 2007, the Division received a timely filed protest to the proposed withholding tax assessments.[14]

6. The Protestants consulted with CPA, their CPA, prior to starting business, concerning the different ways the proposed business could be conducted, i.e., partnership, corporation, and the pros and cons of hiring mechanics as "Employees" or as "Independent Contractors".[15] CPA provided the Protestants with a form contract titled "Independent Contractor Agreement for Work Made for Hire" ("IC Contract").[16]

7. On October 12, 2001, the Protestants entered into an IC Contract with MECHANIC 1, as a "Mechanic".[17] On January 11, 2002, the Protestants also entered into an IC

[10] Division's Exhibit A.

[11] Division's Exhibit F.

[12] Division's Exhibit G. Testimony of AUDITOR. PARTNER 2 acts as the bookkeeper for the business. Testimony of PARTNER 2.

[13] Division's Exhibit H.

[14] Division's Exhibit I.

[15] Testimony of CPA. CPA testified that he has been a CPA for thirty-seven (37) years, with experience with a number of small businesses, including automotive repair businesses such as the Protestants, and familiar with IRS Guidelines for "Employees" and "Independent Contractors".

[16] Testimony of CPA. *See* Protestants' Exhibits 2 and 3. The copies of the IC Contracts were provided to the Division post-audit.

[17] Protestants' Exhibit 2.

Contract with MECHANIC 2, as a "Mechanic".[18] These were the only IC Contracts produced by the Protestants for the Mechanics hired during the Audit Period. The terms of the IC Contracts are identical, and in pertinent part, provide as follows, to-wit:

> Payment
> In consideration for the services performed by Contractor, Client agrees to pay Contractor 45% of collected labor.
>
> …
>
> Expenses
> Contractor shall be responsible for all expenses incurred while performing services under this Agreement. This includes license fees, memberships, and due; automobile and other travel expenses; meals and entertainment; insurance premiums; and all salary, expenses, and other compensation paid to employees or contract personnel the Contractor hires to complete work under this Agreement.
>
> Independent Contractor Status
> Contractor is an independent contractor, not Client's employee. Contractor's employees or contract personnel are not Client's employees. Contractor and Client agree to the following rights consistent with an independent contractor relationship.
>
> - Contractor has the right to perform services for others during the term of this Agreement.
> - Contractor has the sole right to control and direct the means, manner, and method by which the services required by this Agreement will be performed.
> - Contractor will furnish all equipment and materials used to provide the services required by this Agreement.
> - The Contractor or Contractor's employees or contract personnel shall perform the services required by this Agreement; Client shall not hire, supervise, or pay any assistants to help Contractor.
> - Neither Contractor nor Contractor's employees or contract personnel shall receive any training from Client in the skills necessary to perform the services required by this Agreement.
> - Client shall not require Contractor or Contractor's employees or contract personnel to devote full time to performing the services required by this Agreement.
>
> State and Federal Taxes
> Client will not:
>
> - Withhold FICA (Social Security and Medicare taxes) from Contractor's payments or make FICA payments on Contractor's behalf
> - Make state or federal unemployment compensation contributions on Contractor's behalf, or

[18] Protestants' Exhibit 3.

- Withhold state or federal income tax from Contractor's payments.

…

The IC Contract does not provide for "Fringe Benefits", "Workers' Compensation", "Unemployment Compensation", or "Insurance. The IC Contract does contain a provision which provides that either party can terminate the agreement "with reasonable cause" in writing.

8. The Protestants do not require the Mechanics to arrive, leave, or eat lunch at a specific time. The Mechanics set their own schedules and are required to provide their own tools and training.[19] MECHANIC 2 has approximately $50,000.00 invested in tools of the trade.[20] MECHANIC 1 also has a significant amount invested in tools of the trade, but in a lesser amount than MECHANIC 2.[21]

9. The Mechanics can accept or refuse to work on a vehicle brought to the Protestants for repair. If the Mechanics accept the work, they examine the vehicle and determine which repair(s) are necessary. The Mechanics exercise their own judgment as to what repairs are required on a vehicle. The Mechanics fill out a "work order", which advises the Protestants what repairs are necessary. The Mechanics use the shop's "ALLDATA" computer system[22] to determine what parts are necessary and the time allotted for labor in increments of tenths of an hour.[23] The Mechanics turn the "work order" in to the Protestants. If the customer approves the repair(s), the Protestants order the parts listed by the Mechanics, which are purchased by the Protestants from a variety of parts shops in the area. The Protestants pay for the parts. The parts are provided to the Mechanics to perform the repair(s). If ALLDATA indicates that the repair should take 1.5 hours, then the Mechanics are paid forty-five percent (45%) of the labor for their services. If the Mechanics take more time than allotted, they are not paid for the extra time, unless an unexpected problem is encountered during the repair, such as a bolt breaking requiring additional time. In the same situation, if the Mechanics are able to perform the repair in one (1)

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[19] Testimony of PARTNER 3 and MECHANIC 2. Protestants' Exhibit 1, which is a form the Protestants received from the Tax Commission titled "Are You Erroneously Treating Your Employees as Independent Contractors?" The form states that "If you answered YES to any of these questions and are currently treating your worker as Independent contractors rather than as employees, you may be in violation of Federal and Oklahoma tax labor laws. As a result you may potentially be accruing a large withholding and employment tax liability and substantial penalties." PARTNER 3 answered all the questions "no", with detailed responses to each question.

[20] Testimony of MECHANIC 2 and CPA. CPA also prepares MECHANIC 2'S tax returns.

[21] Testimony of PARTNER 3.

[22] *See* ALLDATA online at http://www.alldatapro.com (October 18, 2007). The computer system contains information (parts and repair) for 1982-to-current vehicles. The system is updated quarterly.

The Administrative Law Judge is taking judicial notice of the ALLDATA website for completing the factual details and background of this audit. OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999).

[23] Testimony of PARTNER 3 and MECHANIC 2. AUDITOR also confirmed the use of ALLDATA. *See* Protestants' Exhibit 4. During the hearing, the replacement of a water-pump was used as an example. The Mechanics input the data on the vehicle. The computer system lists the parts necessary to replace a water-pump and the amount of time it should take to perform the job.

hour, they are still paid for forty-five percent (45%) of the 1.5 hours. This is how having the most efficient tools and training can either help the Mechanics to make money or lose money. If the customer is not happy with the repair, the Mechanics are responsible for correcting the problem, not the Protestants. The Mechanics are not paid for the additional time it takes to correct the repair.[24]

10. The Protestants' shop has three (3) vehicle lifts, an air compressor system (which is hard piped into the garage), a brake lathe, and ALLDATA, which is available for use by the Mechanics.[25] The Protestants also provide supplies such as cleaners and rags, which are used by the mechanics.[26]

11. On October 12, 2007, the Division's Report of Wage Statement Results was filed, with attachments thereto. The Mechanics executed wage statements for the tax years 2001 through 2006.[27]

12. According to the records of the Tax Commission, the Mechanics filed income tax returns for the tax years 2001 through 2006, and the tax liabilities were paid.[28]

13. The Division reduced the withholding liability (interest and penalty remain) assessed against the Protestants on the Mechanics' wages to zero, resulting in a revised proposed withholding assessment,[29] as follows, to-wit:

Tax:	$ 439.00
Interest (thru 04/02/07):	447.45
Penalty:	764.35
Total	$1,650.80

14. IC Contracts and Wage Statements were not provided for the following "mechanics" by the Protestants for the Audit Period:

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[24] Testimony of PARTNER 3 and MECHANIC 2.

[25] Testimony of PARTNER 3 and MECHANIC 2 The Protestants also have racks for new tires, a tire balancing machine, etc. This equipment is not used by the Mechanics. PARTNER 3 performs all the tire work in the shop.

[26] Testimony of PARTNER 3 and MECHANIC 2.

[27] *See* Division's Report of Wage Statement Results, Exhibits R1 through R11.

[28] The Division notes that interest and penalty totaling $101.43 was assessed against MECHANIC 1'S wages because the tax liability was paid when the return was filed, not quarterly, as the liability became due.

The Division also notes that interest and penalty totaling $848.33 was assessed on MECHANIC 2'S wages because the tax liability was paid when the return was filed, not quarterly, as the liability became due.

[29] *See* Division's Report of Wages Statement Results, Exhibit S.

Name	Pay Period	Gross Wages	
MECHANIC 3:	08/03/03-12	$5,362.87	
	01/08/04-03/17/04	$2,432.50	
MECHANIC 4:	0/06/04-04/09/04	$1,800.00	($200.00 weekly)
MECHANIC 5:	09/24/04-10/01/04	$ 360.00	($180.00 weekly)
MECHANIC 6:	01/04/05-01/28/05	$1,076.00	
MECHANIC 7:	10/28/05-12/16/05	$3,413.61	

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.[30]

2. Every employer is required to deduct and withhold tax and pay over the amount so withheld as taxes to the Oklahoma Tax Commission.[31]

3. Every employer, including a member of a partnership, who is required to withhold and remit taxes to the Tax Commission, shall be held personally liable for failure to do so.[32]

4. If an employer fails to withhold the required tax and thereafter the income tax is paid by the employee, the amount required to be withheld shall not be collected from the employer but such employer shall not be relieved from liability of penalties and interest applicable to the failure to withhold.[33]

5. The term employee includes every individual performing services if the relationship between him and the person for whom services are performed is the legal relationship of employer and employee.[34] Generally, the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.[35] If an employer-employee relationship exists, the designation of the relationship by the parties as anything other than that of employer and employee is immaterial.[36]

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[30] OKLA. STAT. ANN. tit. 68, § 221(D) (West Supp. 2007).

[31] OKLA. STAT. ANN. tit. 68, § 2385.2(A) (West Supp. 2001).

[32] OKLA. STAT. tit. 68, § 2385.3(D) (West Supp. 2005).

[33] OKLA. STAT. tit. 68, § 2385.3(F) (West Supp. 2005).

[34] OKLA. ADMIN. CODE § 710:90-1-2(A) (June 25, 1999).

[35] OKLA. ADMIN. CODE § 710:90-1-2(A) (i) (June 25, 1999).

[36] OKLA. ADMIN. CODE § 710:90-1-2-(A)(iv) (June 25, 1999).

6. To determine whether an individual is an "Employee" or an "Independent Contractor" under the common law, the relationship of the worker and the business must be examined. In any "Employee-Independent Contractor" determination, all information that provides evidence of the degree of control and the degree of independence must be considered. Facts that provide evidence of the degree of control and independence fall into three (3) categories:

Behavioral Control

Instructions that the business gives to the worker:

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

Training that the business gives to the worker:

The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Financial Control

Facts that show whether the business has a right to control the business aspects of the worker's job include:

- The extent to which the worker has unreimbursed business expenses.
- The extent of the worker's investment.
- The extent to which the worker makes his or her services available to the relevant market.
- How the business pays the worker.
- The extent to which the worker can realize a profit or loss.

Type of Relationship

Facts that show the parties' type of relationship include:

- Written contracts describing the relationship the parties intend to create.
- Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.
- The permanency of the relationship.
- The extent to which services performed by the worker are a key aspect of the regular business of the company.[37]

7. If an employee fails to provide the employee a Form W-4, the employer must withhold tax as if the employee were a single person who has claimed no withholding allowances.[38]

[37] Division's Exhibit M. IRS Publication 15-A.

8. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.[39] A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.[40]

9. In this matter, the Protestants have met their burden of proof as to MECHANIC 2 and MECHANIC 1. The Mechanics were "Independent Contractors" during the Audit Period.

10. However, as to the remaining "mechanics", as more fully set out herein, the Protestants have failed to meet their burden of proof.

When the Protestants originally set up the business, CPA provided a form IC Contract, executed by MECHANIC 2 and MECHANIC 1 upon being hired, which sets out the parties' intent as to their relationship. The only IC Contracts introduced into evidence were for MECHANIC 2 and MECHANIC 1.

No other contracts were produced for the remaining "mechanics" hired during the Audit Period. The IC Contracts, which were supplemented by extensive witness testimony, are the cornerstone of the Protestants' position that all mechanics hired during the Audit Period were "Independent Contractors" and not "Employees" as maintained by the Division. Without the IC Contracts, the Protestants' position is speculative at best, because none of the remaining "mechanics" testified at hearing.

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION, based upon the facts and circumstances of this case, that the protest to the proposed assessments of withholding tax should be sustained in part and denied in part.

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[38] OKLA. ADMIN. CODE § 710:90-1-7 (f) (June 11, 1998).

[39] OKLA. ADMIN. CODE § 710:1-5-47 (June 25, 1999):

> In all administrative proceedings, unless otherwise provided by law, the burden of proof shall be upon the protestant to show in what respect the action or proposed action of the Tax Commission is incorrect. If, upon hearing, the protestant fails to prove a prima facie case, the Administrative Law Judge may recommend that the Commission deny the protest solely upon the grounds of failure to prove sufficient facts which would entitle the protestant to the requested relief.

OKLA. ADMIN. CODE § 710:1-5-77(b) (June 25, 1999), provides in pertinent part:

> . . . "preponderance of the evidence" means the evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; evidence which as a whole shows that the fact sought to be proved is more probable than not.

[40] *See Enterprise Management Consultants, Inc. v. State ex re.l Oklahoma Tax Com'n*, 1988 OK 91, 768 P.2d 359.

It is the ORDER of the OKLAHOMA TAX COMMISSION, based upon the facts and circumstances of this case, that the protest to the proposed assessments of withholding tax against the Protestants for MECHANIC 2 and MECHANIC 1 (the "Mechanics") should be sustained.

It is the ORDER of the OKLAHOMA TAX COMMISSION, based upon the facts and circumstances of this case, that the protest to the proposed assessments of withholding tax against the Protestants for MECHANIC 3, MECHANIC 4, MECHANIC 5, MECHANIC 6, and MECHANIC 7 (the "mechanics") should be denied.

It is further ORDERED that the proposed withholding tax assessments should be revised to remove the penalty and interest attributable to MECHANIC 2 and MECHANIC 1 and the resultant amount of withholding taxes and penalties be fixed as the deficiency due and owing, including interest, accrued and accruing.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are 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.