JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2010-05-04-04 / NON-PRECEDENTIAL**
ID: **P-09-123-K**
DATE: **MAY 4, 2010**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestants, HUSBAND AND WIFE, are represented by ACCOUNTANT, Certified Public Accountant. The Compliance Division ("Division") is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

Protestants timely filed an amended Oklahoma income tax return for tax year 2005 reporting certain Internal Revenue Service examination changes. The Division audited the amended return, disallowed the out-of-state income deduction which had been claimed on the original 2005 Oklahoma return and by letter dated June 10, 2009, proposed the assessment of additional income tax due of $3,343.00. By letter dated July 6, 2009, Protestants timely protested the proposed adjustment and assessment. A hearing was not requested.

On July 24, 2009, the Division's file was referred to the Office of the Administrative Law Judges for further proceedings consistent with the Uniform Tax Procedure Code ("Code")[1], the Oklahoma Income Tax Act ("Act")[2] and the Rules of Practice and Procedure before the Office of the Administrative Law Judges[3]. The case was docketed as Case Nos. P-09-123-K and assigned to ALJ, Administrative Law Judge.[4]

A pre-hearing conference was scheduled for August 27, 2009, by *Prehearing Conference Notice* issued August 4, 2009.[5] Pursuant to the rescheduled conference held August 18, 2009, the parties were directed to file a status report on or before October 6, 2009. By *Status Report and Request for Scheduling Order* filed October 6, 2009, the parties advised of their agreement to submit the protest for decision upon the filing of a joint stipulation of facts and separate position statements.[6] Pursuant to the parties' agreement and request, a *Scheduling Order and Notice of Alternative Hearing* was issued October 9, 2009, setting forth the procedure by which this matter would be submitted for decision.[7]

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[1] 68 O.S. 2001, § 201 et seq., as amended.

[2] 68 O.S. 2001, § 2351 et seq., as amended.

[3] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code* ("*OAC*").

[4] *OAC*, 710:1-5-22(b).

[5] *OAC*, 710:1-5-28.

[6] See, *OAC*, 710:1-5-38(a).

[7] *OAC*, 710:1-5-28(b) and 710:1-5-38.

A *Stipulation of Facts and Statement of Issue* was filed November 18, 2009, with Exhibits 1 through 33 attached. Protestant's position statement was filed December 3, 2009. The *Compliance Division's Memorandum Brief* was filed December 17, 2009. A reply brief to the Division's brief was not filed by Protestants. On January 6, 2010, the record was closed and the protest was submitted for decision.[8]

FINDINGS OF FACTS

Upon review of the file and records, including the *Stipulation of Facts and Statement of Issue*, the exhibits and the pleadings of the parties, the undersigned finds:

A. The parties stipulate to the following:

1. During the 2005 tax year, Protestants HUSBAND AND WIFE were full time residents of Oklahoma.

2. During 2005, Protestant HUSBAND ("Protestant") was a forensic investigator who traveled to other states to teach investigative techniques in a classroom setting to law enforcement agencies. Protestant also taught such classes in Oklahoma during that year.

3. On or about July 22, 2008, in response to a change in Federal adjusted gross income, Protestants HUSBAND AND WIFE filed an amended Oklahoma individual income tax return for 2005. As on the original return for that year,[9] Protestants subtracted from Federal adjusted gross income (to arrive at Oklahoma adjusted [sic] gross income) $67,130.00 as out of state income.

4. The subtraction was made as a result of Protestants' apportionment of said income to states other than Oklahoma as calculated on Protestants' tax preparers' worksheets, and mathematically agrees with the Schedule C Profit or Loss From Business attached to Protestants' 2005 Federal return, and with the Oklahoma Form 511 "Statement 1 – Out of State Income."

5. The out of state law enforcement agencies to which Protestant taught issued 1099's for 2005 to Protestant (and/or to Protestant's disregarded entities "LLC" and COMPANY.") reporting the income sought to be subtracted as apportioned to those states.

6. Protestants filed 2005 state income tax returns in those states in which out of state teaching was done, where those states impose an income tax.[10]

7. The Division examined and adjusted Protestants' 2005 amended Oklahoma return, and by letter dated June 10, 2009, the Division proposed to assess additional taxes against Protestants in the amount of $3,343.00, excluding interest and penalty. The adjustment and

[8] *OAC*, 710:1-5-39(a).

[9] The original 2005 Oklahoma return was filed March 28, 2006. Footnote original to *Stipulation*.

[10] Protestants did not claim a credit for any taxes paid to these other states, either on the 2005 original or amended Oklahoma returns. Footnote original to *Stipulation*.

assessment were made because of the Division's disallowance of the subtraction of $67,130.00 as out of state income. The reason for the denial was the Division's categorization of the income as professional or personal services income, taxable in Oklahoma.

8. On July 6, 2009, the Division received Protestants' letter of protest with copies of legal authorities attached, wherein the assessed amount was placed in controversy. Protestants' position in that letter is that the subtracted income is out of state unitary business income apportionable to the other states.

ISSUE AND CONTENTIONS

The stipulated issue is "whether Protestant's income from teaching forensic investigation techniques in states other than Oklahoma is unitary business income subject to either allocation or apportionment to other states, or rather is professional or personal services income allocable to Protestants' domiciliary state of Oklahoma."

Protestants contend that because the forensic investigative training is conducted in group classroom settings, HUSBAND by definition is not performing a personal service, but rather is engaged in a business activity. In support of this contention, Protestants assert that the Internal Revenue Code defines "personal services" and such definition is required to be recognized by the Division for state income tax purposes.

The Division contends that the art of teaching others is a personal service. In support of this contention, the Division argues that teaching is not an activity in which capital, time, attention, labor, and intelligence are invested for gain and profit for private benefit, purposes and use.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned concludes as a matter of law:

1. Jurisdiction of the parties and the subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. Supp. 2002, § 221(D).

2. "Taxation is an exclusively legislative function that can be exercised only under statutory authority and in the manner specified by statute." ***State, ex rel. Oklahoma Tax Commission v. Texaco Exploration & Production, Inc.,*** 2005 OK 52, ¶ 7, 131 P.3d 705, 707. Accordingly, the basis for assessing income tax must be found in the Act.

3. An income tax is imposed upon the "Oklahoma taxable income" of every resident individual. 68 O.S. 2001, § 2355(A). "Oklahoma taxable income" is defined to mean "'taxable income' as reported (or as would have been reported by the taxpayer had a return been filed) to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided." 68 O.S. 2001, § 2353(12).

4. The general three (3) year limitation period for tax assessments is tolled and extended for the assessment of income taxes until the amount of taxable income for any year of a taxpayer under the Internal Revenue Code ("IRC") is finally determined under applicable federal law. 68 O.S. Supp. 2007, § 2375(H)(1). If the amount of taxable income for any year of a taxpayer under the IRC is changed or corrected from the amounts reported and the change or correction affects Oklahoma taxable income, the taxpayer within one (1) year shall file an Oklahoma amended return reporting the corrected Oklahoma taxable income, and the Tax Commission within two (2) years is required to make an assessment or a refund. 68 O.S. Supp. 2007, § 2375(H)(2). Under the provisions of § 2375(H), the Tax Commission is granted the authority to audit each and every item of income, deduction, credit or any other matter related to the return where such items or matters relate to allocation or apportionment even if such items or matters were not affected by the changes or corrections made to the federal return of the taxpayer. 68 O.S. Supp. 2007, § 2375(H)(4) See, *OAC*, 710:50-5-13(b) and (c).

5. The provisions of § 2358 of the Act; in general, specify the adjustments to the taxable income of any taxpayer to arrive at the Oklahoma adjusted gross income for individual taxpayers. 68 O.S. 2001, § 2358(A). None of the adjustments permit the deduction or subtraction of wages or salary earned by an individual for services performed either partly or wholly outside the state from taxable income to arrive at Oklahoma adjusted gross income. However, § 2358(A)(4)(c) provides: "[n]et 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[11] shall be separately allocated to the state in which such activity is conducted".

6. "Deductions [and credits against tax] are a matter of legislative grace rather than judicial intervention." ***Flint Resources Company v. Oklahoma Tax Commission***, 1989 OK 9, 780 P.2d 665, 673. In order to be allowed, authority for the deduction sought must be clearly expressed. ***Home-State Royalty Corporation v. Weems***, 1935 OK 1043, 175 Okla. 340, 52 P.2d 806 (1935). None may be allowed in absence of a statutory provision therefor. *Id. See*, ***New Colonial Ice Co. v. Helvering***, 292 U.S. 435, 440, 54 S.Ct. 788, 78 L.Ed. 1348 (1934).

7. Income received by a resident of Oklahoma for services performed wholly without the state is subject to Oklahoma income tax. ***Colchensky v. Oklahoma Tax Commission***, 1938 OK 612, 184 Okla. 207, 86 P.2d 329. *See*, ***Oklahoma Tax Commission v. Benham***, 1947 OK 104, 198 Okla. 384, 179 P.2d 123. In ***Colchensky***, the Oklahoma Supreme Court cited the holding of the U.S. Supreme Court in ***Lawrence et al. v. State Tax Commission of Mississippi***[12], wherein it held: "[a] state has constitutional power to tax its own citizens on their net incomes though derived wholly from activities carried on by them outside of the State. Domicile in itself establishes a basis for taxation" and said "[e]njoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government."

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[11] A business is unitary in character when the "business * * * operates in more than one state * * * [the] operations conducted in one state benefit and are benefited by operations in one or more other states * * * [and] the various aspects are so interdependent and of such mutual benefit that they are considered to form one integral business." ***Griffin Television, Inc. v. Oklahoma Tax Commission***, 1994 OK 35, 877 P.2d 588, 592, citing *In re Income Tax Protest of Ashland Exploration, Inc.*, 1988 OK 23, 751 P.2d 1070, 1072.

[12] 286 U.S. 276, 52 S.Ct. 556, 76 L.Ed. 1102, 87 A.L.R. 374.

8. In ***Benham***, supra., the Oklahoma Supreme Court held at 386:

> We think the terms 'business' and 'profession' are best defined by the New York court in *Iselin et al. v. Flynn*, 90 Misc. 164, 154 N.Y.S. 133, 136, wherein it is said: '* * * 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 Court in ***Benham*** found that even though taxpayer was an engineer by profession, the duties and responsibilities required of him under the construction contract, including hiring employees, fixing their salaries and discharging them at will; paying bills from his own funds; carrying workmen's compensation insurance; supervising final construction; analyzing construction materials; and preparing cost estimates and invitations for bids, placed taxpayer in the category of transaction a business rather than performing a personal service. Id., at 386.

9. Other states have addressed the issue of what constitutes "personal services" for income tax purposes. In ***Wiik v. Wisconsin Department of Taxation***, 249 Wis. 325, 331, 24 N.W.2d 685 (1946) citing *State ex rel. Lerner v. Wisconsin Tax Commission*[13], the court held that to define income derived from personal services comprehensively and exactly would be difficult, however to the Court it seemed "fairly clear" that such income resulted from the performance of services or labor without the material aid of capital. In ***Ness v. Commissioner of Taxation***, 270 N.W.2d 258 (1978), the Supreme Court of Minnesota held at 263:

> * * * two conditions must be met before a taxpayer's income can be deemed personal-or-professional-service income. First, the income-producing activity itself must be the rendition of personal or professional services; and, second, the taxpayer must personally render such services; it is not enough to employ others to render them.

In ***Benda v. Girard***, 585 N.W.2d 422, the Court of Appeals of Minnesota held at 424 that the "definition of 'personal or professional services' [is limited] to businesses that provide services typically performed for the benefit of an individual, identifiable client" and under such definition "a direct relationship must exist between a client and the services performed by the taxpayer." Finally, in ***Czubaj v. City of Tallmadge***, 2003 WL 22339267 (Ohio App. 9 Dist.) the Court of Appeals of Ohio citing *Emery Industries, Inc. v. Limbach*, 43 Ohio St.3d 3 (1989), held at ¶ 16 that "'personal service' is 'any intellectual or manual *act* involving a recognized skill performed by a person who is specifically engaged * * * to perform the act'", (emphasis original").

10. Protestants have the burden of proof to show the action or proposed action of the Division is incorrect, and in what respect. *OAC*, 710:1-5-47. *See*, ***Enterprise Management***

[13] 213 Wis. 267, 251 N.W. 456

Consultants, Inc. v. Oklahoma Tax Commission, 1988 OK 91, 768 P.2d 359. The burden of proof standard is "preponderance of evidence." 2 Am.Jur.2d *Administrative Law* § 357. "Preponderance of evidence" means "[e]vidence which is of greater weight or more convincing than the evidence offered in opposition to it; that is, evidence which as a whole shows the fact sought to be proved is more probable than not * * * evidence which is more credible and convincing to the mind * * * that which best accords with reason and probability." Black's Law Dictionary 1064 (5th ed. 1979). Each element of the claim must be supported by reliable, probative, and substantial evidence of sufficient quality and quantity as to show the existence of the facts supporting the claim are more probable than their nonexistence. 2 Am.Jur.2d *Administrative Law* § 357. If the taxpayer fails to prove a prima facie case, the protest may be denied solely on the grounds of failure to prove sufficient facts which would entitle the taxpayer to the requested relief. *OAC*, 710:1-5-47; ***Continental Oil Company v. Oklahoma Tax Commission***, 1976 OK 23, 570 P.2d 315.

11. Here, the evidence shows the income at issue was earned through the performance of personal or professional services. HUSBAND was hired by federal, state and local law enforcement agencies to teach forensic investigate training techniques in group classroom settings. In each instance, HUSBAND taught the classes for an individual, identifiable client – the agency sponsoring the sessions, a direct relationship existed between the agencies and the instructions provided by HUSBAND and HUSBAND was specifically engaged to teach the classes. Further, Protestants admit that HUSBAND was provided "an office, telephone and fax facilities, audio and visual equipment" at the classroom locations which indicates the services were provided without the material aid of capital.

12. Protestants' protest to the Division's adjustment to their 2005 amended Oklahoma income tax return should be denied. However, the proposed assessment should be revised to allow a credit for the taxes paid to other states on the personal service income.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of Protestants, HUSBAND AND WIFE, be denied. It is further ORDERED that the proposed assessment be revised to allow a credit for the taxes paid to the other states on the personal service income, and that the resultant amount of the revised assessment, inclusive of any accrued interest, be fixed as the deficiency due and owing.

ADDENDUM TO FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

The above styled and numbered cause, comes on for consideration of a recommendation as to the amount of the deficiency which should be confirmed by an order of the Tax Commission.

The Division, as directed by the *Findings, Conclusions and Recommendations*, revised the proposed income assessment and provided notice of the revision to Protestants. Protestants have not challenged the revisions proposed by the Division.

Upon consideration of the *Findings, Conclusions and Recommendations* and the revision to the assessment, the undersigned finds that the following findings should be added to and incorporated in the *Findings, Conclusions and Recommendations*:

1. That notice of the revision to the assessment was filed of record in this cause on February 19, 2010.

2. That the Division revised the income tax assessment to an amount of $1,115.00, consisting of a tax refund in the amount of $616.00 and adjusted interest in the amount of $1,731.00.

3. That the revision complies with the recommendation set forth in the *Findings, Conclusions and Recommendations*.

5. That Protestants were provided notice of the revision.

6. That Protestants did not file a response to the revision.

The undersigned further finds that the following should be added to and incorporated in the *Findings, Conclusions and Recommendations*:

> It is further ORDERED that the amount in controversy, as revised, inclusive of any additional accrued and accruing interest, be fixed as the deficiency due and owing.

THEREFORE, the *Findings, Conclusions and Recommendations* issued on February 19, 2010, is amended to include and incorporate the above and foregoing findings of fact and ORDER.

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.