JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2011-08-30-05 / NON-PRECEDENTIAL**
ID: **P-10-1643-K**
DATE: **AUGUST 30, 2011**
DISPOSITION: **SUSTAINED IN PART / DENIED IN PART**
TAX TYPE: **WITHHOLDING**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

A *Prehearing Conference Notice* ("*Notice*") was served on Protestant, PROTESTANT at his last known address[1]. Protestant did not respond to the *Notice* or appear at the conference. The Compliance Division of the Oklahoma Tax Commission ("Division") is represented by OTC ATTORNEY 1, First Deputy General Counsel, and OTC ATTORNEY 2, Assistant General Counsel, General Counsel's Office, Oklahoma Tax Commission.

STATEMENT OF THE CASE

Office audits of the available withholding tax records of the corporations, COMPANY 1 and COMPANY 2 ("Corporation" or "Corporations") were performed by the Division. As a result of the audit, the Division by letters dated August 13, 2010, issued proposed withholding tax assessments against Protestant, as President of the Corporations and as an individual, for the period inclusive of the months of January, 2008 through June, 2010. Protestant timely protested the proposed assessments. A hearing was not requested in the protest letters.

On December 1, 2010, the Division referred the protests to this Office for further proceedings consistent with the Uniform Tax Procedure Code[2] and the *Rules of Practice and Procedure Before the Office of the Administrative Law Judges*[3]. The protests were docketed as Case No. P-10-1643-K and assigned to ALJ, Administrative Law Judge.[4]

A pre-hearing conference was scheduled for January 18, 2011, by the *Notice* issued January 6, 2011.[5] Protestant neither appeared at the conference nor responded to the *Notice*. By *Prehearing Conference Order* ("*Order*") issued January 19, 2011, the Division was directed to file a verified response to protest no later than March 7, 2011 and Protestant was advised that a reply to the response could be filed on or before April 7, 2011. The *Order* further directed that if an oral hearing was not requested, the record would be closed and the protest submitted for decision upon completion of the procedural schedule[6]. Protestant did not respond to the *Order*.

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1 68 O.S. Supp. 2009, § 208.

2 68 O.S. 2001, § 201 et seq., as amended.

3 *OAC*, 710:1-5-20 through 710:1-5-47.

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

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

6 *OAC*, 710:1-5-28(b).

The *Compliance Division's Verified Response* ("*Verified Response*") was filed March 7, 2011. Attached thereto were Exhibits A through T. Protestant did not file a reply to the *Verified Response*. On April 15, 2011, the record was closed and the protest was submitted for decision.[7]

FINDINGS OF FACT

Upon review of the file and records, including the *Verified Response* and the exhibits attached thereto, the undersigned finds:

1. On March 25, 2008, the Oklahoma Tax Commission received a Business Registration Application for COMPANY 1. The Application shows Protestant was the Chief Executive Officer ("CEO") of COMPANY 1. Exhibits A-1 and A-2.

2. Further inquiry with respect to COMPANY 1'S Application indicated the it was filed to report a name change and that Protestant was also the President of COMPANY 1. The *Certificate of Amendment by Shareholders or Members* filed with the Ohio Secretary of State was executed by Protestant on April 2, 2007, as the authorized representative of COMPANY 1. Exhibits A-3 through A-5.

3. On August 15, 2008, the Oklahoma Tax Commission received a second Business Registration Application for COMPANY 1. The Application indicates it was COMPANY 1'S initial Franchise Return. Protestant is listed as COMPANY 1'S President and CEO. The Application was executed by Protestant as COMPANY 1'S President and CEO. Exhibits B-1 through B-5.

4. On or about August 8, 2008, a Business Registration Application was filed for COMPANY 2. The Application indicates it was COMPANY 2'S initial Franchise Return. Protestant is listed as COMPANY 2'S President and CEO. The Application was executed by Protestant as COMPANY 2'S President and CEO. Exhibits C-1 through C-6.

5. Based on audit leads from the Corporate Income Tax Section, the Division reviewed the withholding tax accounts of the Corporations. Exhibits D and E. Withholding tax reports were filed and the taxes reported thereon were remitted with respect to each of the Corporations' withholding tax accounts for the period inclusive of the months of January, 2008 through September, 2008. No further withholding tax reports were filed nor remittance made on either of the Corporations' withholding tax accounts. Exhibits S and T.

6. Oklahoma Employment Security Commission ("OESC") quarterly reports of wages paid were filed with respect to each of the Corporations for the 4th quarter of 2008 and the 1st, 2nd and 3rd quarters of 2009. In regard to the selected audit period of January, 2008 through June, 2010 for each of the Corporations, the *Audit Write Up*[s] reflect:

> This company has a start date of 01/01/08 and has issued 2008 W2s as evidenced by electronically filed returns by some of their employees. Since

[7] *OAC*, 710:1-5-39.

> there is evidence that the company has been in operation in 2008 with no evidence that the company has closed the audit period is 01/01/08 through 06/30/10.

Exhibits S and T. The *Audit Write Up* for COMPANY 1 indicates: "[t]his company does have an Oklahoma Withholding & an OESC account with a start date of 07/01/07 on the OTC account and an effective date of 08/01/07 on the OESC with a start date of 09/01/07 with no stop date on either account." Exhibit S. The *Audit Write Up* for COMPANY 2 indicates: "[t]his company does have an Oklahoma Withholding & an OESC account with a start date of 01/01/08 on the OTC account and an effective date of 01/01/08 on the OESC with a start date of 03/01/08 with no stop date on either account." Exhibit T.

7. Each Corporation's audited withholding tax liability for the period inclusive of the months of October, 2008 through September, 2009 was calculated by multiplying the gross wages reported on the OESC quarterly reports by five percent (5%) and dividing that amount by three (3). Each Corporation's audited withholding tax liability for the period inclusive of the months of October, 2009 through December, 2009 was supposedly calculated by increasing the gross wages reported on the 2009 3rd quarter OESC report by $1,000.00, multiplying that amount by five percent (5%) and dividing by three (3). Each Corporation's audited withholding tax liability for the period inclusive of the months of January, 2010 through June, 2010 was calculated by increasing the gross wages from the pervious quarter by $1,000.00, multiplying that amount by five percent (5%) and dividing by three (3). Exhibits S and T.

8. The audited withholding tax liability of COMPANY 1 is $183,425.59 calculated as follows:

2008

OESC 4th Otr = $355,502.49 X 5% = $17,775.13 / 3 = 2@ $5,925.04 & 1@ $5,925.03

2009

OESC 1st Qtr = $514,224.01 X 5% = $25,711.21 / 3 = 1@ $8,570.41 & 2@ $8,570.40
OESC2ndQtr= $593,738.07 X 5% = $29,686.91 / 3 = 2@ $9,895.64 & 1@ $9,895.63
OESC3rdQtr = $531,046.89 X 5% = $26,552.35 / 3 = 2@ $8,850.78 & 1@ $8,850.79
Est.OESC4thQtr =$557,000.00 X 5% =$27,850.00 / 3=1@ $9,283.34 & 2@ $9,283.33

2010

Est.OESC1stQtr =$558,000.00 X 5% =$27,900.00 / 3=3@ $9,300.00
Est.OESC2ndQtr=$559,000.00X 5% =$27,950.00 / 3=2@ $9,316.67 & 1@ $9,316.66

Exhibit S.

9. The audited withholding tax liability of COMPANY 2 is $77,120.44 calculated as follows:

2008

OESC 4th Otr = $274,147.00 X 5% = $13,707.35 / 3 = 2@ $4,569.12 & 1@ $4,569.11

2009

OESC 1st Qtr = $227,742.13 X 5% = $11,387.11 / 3 = 1@ $3,795.71 & 2@ $3,795.70
OESC2ndQtr= $221,100.43 X 5% = $11,055.03 / 3 = 3@ $3,685.01
OESC3rdQtr = $129,419.09 X 5% = $ 6,470.95 / 3 = 2@ $2,156.98 & 1@ $2,156.99
Est.OESC4thQtr =$229,000.00 X 5% =$11,450.00 / 3= 1@ $3,816.67 & 1@ $3,816.66

2010

Est.OESC1stQtr =$230,000.00 X 5% =$11,500.00 / 3= 1@ $3,833.34 & 2@ $3,833.33
Est.OESC2ndQtr=$231,000.00X 5% =$11,550.00 / 3= 3@ $3,850.00

Exhibit T.

10. By letters dated August 13, 2010[8], the Division issued proposed assessments of withholding tax, interest and penalty against COMPANY 1 and Protestant, as President of COMPANY 1 and as an individual, in the total amount of $231,171.37, consisting of tax of $183,425.59, interest accrued through October 31, 2010 of $29,403.24 and a thirty (30) day delinquency penalty of $18,342.54.[9] Exhibits J and L.

11. By letters dated August 13, 2010[10], the Division issued proposed assessments of withholding tax, interest and penalty against COMPANY 2 and Protestant, as President of COMPANY 2 and as an individual, in the total amount of $97,934.20, consisting of tax of $77,120.44, interest accrued through October 31, 2010 of $13,101.72 and a thirty (30) day delinquent penalty of $7,712.04.[11] Exhibits K and M.

12. Protestant timely protested the proposed assessments. An oral hearing was not requested in the protest letters. Exhibit N.

ISSUE AND CONTENTIONS

Two issues are presented for decision. The first issue is whether Protestant sustained his burden of proving that he was not a principal officer of the Corporations during the audit period? The second issue is whether Protestant sustained his burden of proving he was not a responsible person for the amounts assessed?

Protestant admits that he was President and CEO of the Corporations for one (1) year period from December, 2007 to December, 2008. Protestant asserts that he was demoted to Vice-President of Sales in December 2008 and he resigned from the company in June 2009.

Protestant contends that despite his job titles, his job functions never changed from that of sales and a sales manager. He argues that the job titles were in name only "the theory was that I would be able to open more doors and sell to the executive level easier with [the job] title[s]."

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8 The letters were mailed to the last known addresses of COMPANY 1 and Protestant, respectively. See note 1.

9 Included in the penalty and interest amounts assessed are penalties and interest of $634.47 and $517.48 for the months of December, 2007 and April, 2008; respectively, due to late payments. Exhibit S.

10 See note 8.

11 Included in the penalty and interest amounts assessed are penalties and interest of $180.08 for the month of January, 2008 due to a late payment. Exhibit T.

Protestant further argues that he has an 11th grade education, he has never been anything other than a salesman and he has no training or experience in being president of a company.

Protestant further contends that when he was promoted to President, the owner of the company moved all accounting, files and control to STATE. Protestant argues that the owner of the company was in total control of all finances and accounting. Protestant further argues that he never had authority or control, nor did he operate the company.

The Division contends that Protestant has failed to sustain his burden of proving that he was not a principal officer of the Corporations during any portion of the specified time period. The Division argues "[s]ince there is no evidence that [Protestant] was not an officer responsible for the liabilities for a specified period of time, the rebuttable presumption is that he was a principal officer during the entire audit period and therefore, no adjustment can be made to the assessment which ultimately makes him responsible."

The Division further contends that under § 253 of the Uniform Tax Procedure Code, the status one holds as a principal officer by definition makes the officer liable. The Division argues that Protestant has not come forward with any "credible hard documentary evidence" to show he was not a responsible person and that simply stating he is not responsible and had no control is not sufficient to sustain the burden of proof.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned concludes:

1. Jurisdiction of the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. 2001, § 221(D).

2. "Every employer[12] who fails to withhold or pay to the Tax Commission any sums * * * required to be withheld or paid shall be personally and individually liable therefor to the State of Oklahoma." 68 O.S. 2001, § 2385.3(D). See *OAC*, 710:90-5-3(a). "The term 'employer' * * * includes an officer or employee of a corporation, * * * who as an officer or employee of a corporation, * * * is under a duty to act for [the] corporation, * * * to withhold and remit withholding taxes." *Id.* See *OAC*, 710:90-5-3(b).

3. "Any sum or sums withheld * * * shall be deemed to be held in trust for the State of Oklahoma, and, as trustee, the employer shall have a fiduciary duty to the State of Oklahoma in regard to such sums and shall be subject to the trust laws of this state." 68 O.S. 2001, § 2385.3(D). "Any employer who fails to pay to the Tax Commission any sums required to be withheld by such employer, after such sums have been withheld from the wages of employees, and appropriates the

[12] Defined to mean "any person (including any individual, fiduciary, estate, trust, partnership, limited liability company or corporation) transacting business in or deriving any income from sources within the State of Oklahoma for whom an individual performs or performed any service, of whatever nature, as the employee of such person". The employer is the person having control of the payment of the wages for such services. 68 O.S. 2001, § 2385.1(b).

tax held in trust to the employer's own use, or to the use of any person not entitled thereto, without authority of law shall be guilty of embezzlement." *Id.*

4. The Tax Commission is required to file proposed assessments against the principal officers of a corporation who are personally liable for the tax when the Tax Commission files a proposed assessment against a corporation for unpaid withheld income taxes. 68 O.S. 2001, § 253. The liability of the corporation and any principal officers for withheld income tax is joint and several. *Id.*

5. The principal officers of any corporation are personally liable for the payment of any tax "if such officers were officers of the corporation during the period of time for which the assessment was made". 68 O.S. 2001, § 253. A principal officer of a corporation is identified as: (A) President, (B) Vice-President, (C) Secretary, (D) Treasurer, or (E) Secretary/Treasurer. *OAC*, 710:65-7-3(1). The liability of a principal officer for withheld income tax is determined in accordance with the standards for determining liability for payment of federal withholding tax pursuant to the Internal Revenue Code. *Id.*

6. The courts have developed a two prong test for imposition of the penalty under the Internal Revenue Code. ***In Re Bernard***, 130 B.R. 740, 745 (Bkrtcy.W.D.La. 1991). See, ***Cooke v. United States***, 796 F. Supp. 1298 (N.D. Cal. 1992) and ***Feist v. United States***, 607 F.2d 954 (Ct. Cl. 1979). The first prong requires a finding that the person assessed is a "responsible person". The second prong requires the finding of a willful failure to collect, or truthfully account for, or pay over the tax. The burden of proof on each issue is borne by the taxpayer. *Id.*

7. The determination of liability under § 253 is limited to the standards for determining who is a "responsible person". Oklahoma Tax Commission Order No. 96-12-17-037 (Prec.).

8. The courts have also developed standards to be utilized in determining whether each prong of the test has been satisfied. The factors considered by the courts under the first prong include the individual's status as an officer or director, the individual's duties as outlined in the corporate bylaws, the individual's ownership of shares or possession of an entrepreneurial stake in the company, the individual's role in the day-to-day management of the company, the individual's ability to hire and fire employees, the individual's authority to sign checks of the corporation and the individual's control over the financial affairs of the corporation. See, ***Rizzuto v. United States***, 889 F.Supp. 698 (S.D.N.Y. 1995); ***United States v. Carrigan***, 31 F.2d 130 (C.A. 3rd 1994); ***Hochstein v. United States***, 900 F.2d 543 (C.A. 2nd 1990).

9. The responsible person is frequently defined as the person who has the final word as to what bills or creditors should or should not be paid and when. ***White v. U.S.***, 372 F.2d 513, 178 Ct. Cl. 765 (1967). In ***Koegel v. U.S.***, 437 F.Supp. 176 (D.C. N.Y. 1977), the court held that the responsible person is the one who is so connected with the business as to be in the position to exercise full authority over the financial affairs, and therefore to be ultimately responsible for the decision as to the payment of the tax. The responsible person is a person who has or shares the final word as to what bills should or should not be paid. ***Cellura v. U.S.***, 245 F.Supp. 379 (D.C. Ohio 1965).

10. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. *OAC*, 710:1-5-47. *See*, ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359.

11. In administrative proceedings, the burden of proof standard is "preponderance of evidence." 2 Am.Jur.2d *Administrative Law* § 357. *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." Black's Law Dictionary 1064 (5th ed. 1979*)*. It is also defined to mean "evidence which is more credible and convincing to the mind ... [T]hat which best accords with reason and probability." *Id.*

12. An order of the Tax Commission must be supported by substantial evidence. ***Dugger v. State ex rel. Oklahoma Tax Commission***, 1992 OK 105, 834 P.2d 964. Likewise, the audit upon which a portion of the record is formed and order issued, must be supported by substantial evidence. Oklahoma Tax Commission Order No. 2003-07-22-09, 2003 WL 2347117.

An audit is supported by substantial evidence when an evidentiary foundation for the audit has been established. In a majority of cases, the evidentiary foundation will be established by the records reviewed by the auditor. In those cases where an evidentiary foundation for the audit has been established, the taxpayer has the burden of proving in what respect the action of the Tax Commission in assessing the tax is incorrect. *OAC*, 710:1-5-47; ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359. However, where an evidentiary foundation has not been laid or the records upon which the audit is based do not establish a basis for assessing a tax, the audit and assessment in the initial instance cannot be sustained as being supported by substantial evidence. ***Dugger***, supra.

13. Protestant failed to come forward with any evidence to show he was not a principal officer of the Corporations during the audit periods. Protestant also failed to sustain his burden of proving he was not a responsible person for the withholding taxes of the Corporations. However, it appears that the auditor inflated the estimated 4th quarter 2009 gross wages of both of the Corporations beyond the "customary" $1,000.00 increase without any justification. Accordingly, the audits and resulting assessments should be revised to properly reflect the customary $1,000.00 increase over the 2009 OESC 3rd quarter gross wages. This adjustment will correspondingly affect the remaining periods of the audits.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of Protestant, PROTESTANT, be sustained in part and denied in part. It is further ORDERED that the proposed assessments be revised as directed, and that the resultant amounts, inclusive of penalty and interest, accrued and accruing be fixed as the deficiencies due and owing.

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.

NOTE: The distinction between a Commission Order designated as "Precedential" or "Non-Precedential" has been blurred because all OTC Orders resulting from cases heard by the Office of Administrative Law Judges are now published, not just "Precedential" Orders. *See* OKLA. STAT. ANN. tit.68, § 221(G) (West Supp. 2009) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002). *See also* OTC Orders 2009-06-23-02 and 2009-06-23-03 (June 23, 2009), which also conclude the language of the Statute is "clear and unambiguous."