

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 20387
[REDACTED]	)	
	)	DECISION
Petitioners.	)	
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On April 11, 2007, the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted] (petitioners) proposing withholding tax, penalty, and interest for the taxable periods beginning January 1, 2003, through December 31, 2006, in the total amount of \$72,631. The petitioner filed a timely protest and petition for redetermination. The Tax Commission, having reviewed the file, hereby issues its decision.

**I. PROCEDURAL BACKGROUND**

On March 12, 2007, an auditor in the withholding unit of the Commission’s Tax Discovery Bureau sent the petitioners a letter requesting information relating to the petitioners’ federal Schedule C [Redacted]. Since the petitioners did not respond to the auditor’s information request, on April 11, 2007, the auditor issued a Notice of Deficiency Determination for the period of January 1, 2003, through December 31, 2006, seeking \$51,426 in tax, \$12,856 in penalty, and \$8,349 in interest, for a grand total of \$72,631.

On June 13, 2007, the Commission received the petitioners’ petition for redetermination dated May 30, 2007. The auditor acknowledged the filing of the petition in the auditor’s letter dated June 14, 2007, and informed the petitioners that the petition would be retained in the Tax Discovery Bureau in order to work with the petitioners on obtaining the previously requested information. On July 23, 2007, the petitioners were notified that the petition would be forwarded to the legal section since the petitioners had not responded to the auditor’s June 13, 2007, letter.

On August 3, 2007, the Commission informed the petitioners of their appeal rights and requested that they provide the Commission with a completed power of attorney form if they intended to have the representative that prepared the petition represent them during the appeal process. The Commission sent a second letter on January 10, 2008, seeking the same. On February 26, 2008, the Commission received a letter from the petitioners' representative in which the petitioners provided the Commission with an Idaho power of attorney form that was dated May 22, 2007, and additional evidence indicating the power of attorney form had been previously faxed to the Commission on July 24, 2007. In that same letter, the representative requested a hearing before the Commission and that an informal conference be conducted prior to a hearing to examine evidence and discuss the case. The Commission responded on March 3, 2008, and provided copies of various documents. The Commission requested that the representative contact the Commission after reviewing the documents in order to schedule the hearing. Since the Commission has not received any written response to its March 3, 2008, letter and has been unsuccessful in its attempts to schedule an informal hearing in this case, the Commission issues its decision based upon the information in the file.

## **II. ISSUES**

In the petitioners' petition for redetermination, the petitioners argue that (1) the petitioners' sole proprietorship is not an employer and assert the Commission must have agreed since the Commission did not provide the petitioners with withholding tables as required by Idaho statute, and (2) the workers at issue are not employees under the standard set forth in the regulations issued by the U.S. Treasury Department.

### III. FACTS

The petitioners are husband and wife and are Idaho residents. [Redacted]. In the petition for redetermination dated May 30, 2007, it is stated, in part, that:

[Redacted]

The auditor, in his letter dated March 12, 2007, requested information relating to the petitioners' federal Schedule C [Redacted]. The auditor requested (1) payroll records for each worker including any federal Form 1099 or W-2s, (2) check register and bank statements, (3) general ledger, (4) subcontractor contracts, and (5) Industrial Commission reports and related correspondence. Since the petitioners did not respond to the information request, on April 11, 2007, the auditor issued an Notice of Deficiency Determination with the following explanation:

Since we did not receive a response to our audit appointment letter, we have determined that the labor shown on your Schedule C's were employees subject to Idaho income tax withholding.

In 2003 and 2005, the Schedule C's showed Cost of Labor as \$275,700 and 227,822, respectively. In 2004, there were 2 Schedule C's filed with your Idaho return. It appears that the income and expenses were somewhat split [Redacted]. There was no Cost of Labor shown on either Schedule C. However, total expenses shown on both Schedule C's were in excess of the listed expense amounts by \$125,810. We have determined that the excess constituted labor for a total amount of \$251,620.

Your 2006 Idaho return has not been filed at the time of this Notice of Deficiency. We have included 2006 in this Notice of Deficiency. 2006 wages were determined by increasing 2005 wages by 20%.

The auditor next determined that for the period of January 1, 2003, through December 31, 2006, 5 percent of the wages was the amount of income tax that should have been withheld from employees. The auditor imposed the Idaho Code section 63-3046(c)(1) failure to

file penalty for each of the years at issue and calculated interest through June 13, 2007, resulting in the aforementioned total amount due of \$72,631.

#### **IV. LAW AND ANALYSIS**

##### A. Idaho Law

Idaho Code section 63-3035(a) states, in pertinent part, that “Every employer who is required under the provisions of the Internal Revenue Code to withhold, collect and pay income tax on wages or salaries paid by such employer to any employee (other than employees specified in Internal Revenue Code section 3401(a)(2)) shall, at the time of such payment of wages, salary, bonus, or other emolument to such employee, deduct and retain therefrom an amount substantially equivalent to the tax reasonably calculated by the state tax commission to be due from the employee under this chapter. The state tax commission shall prepare tables showing amounts to be withheld, and shall supply same to each employer subject to this section.” Idaho Code section 63-3018 defines the term employee to mean an employee as defined in the Internal Revenue Code.

Idaho Income Tax Administrative Rule 871.01 states that for employers other than farmers;

01. An employer is required to withhold from all salaries, wages, tips, bonuses, or other compensation paid to an employee for services performed in Idaho if:
  - a. The employer is required to withhold for federal purposes; and
  - b. The employee is an Idaho resident; or the employee is a nonresident and compensation of one thousand dollars (\$1,000) or more will be paid during a calendar year to the nonresident employee for services performed in Idaho.

For the purpose of Idaho withholdings on wages, Idaho law looks to the filing requirement for federal withholding found in the Internal Revenue Code.

## B. Federal Law

Subtitle C of the Internal Revenue Code governs payment of employment taxes. More specifically, Chapter 24, Subchapter A, sections 3401 through 3406 govern withholding from wages. Internal Revenue Code section 3401(d) treats any person as an employer for whom an individual performs or performed any service, of whatever nature, as the employee of such person except in a couple of instances not pertinent to the case at hand. Internal Revenue Code section 3401(c) identifies several types of individuals as an employee including an officer of a corporation, but does not actually define the term employee.

Under Treas. Reg. sec. 31.3401(c)-1(a), the term employee includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. Thus federal law employs the common law analysis in determining the legal relationship of an employer and employee.

The Internal Revenue Service generally applies common law factors in determining whether an employee/employer relationship exists. *Professional & Executive Leasing v. Commissioner*, 89 TC 225, 231 & N. 10 (1987), aff'd, 862 F.2d 751 (9th Cir.1988). In making the determination, the Internal Revenue Service has previously relied upon a "20 factor test" found in Rev. Rul. 87-41, 1987-1 C.B. 296 or beginning in 1997 focused on behavioral control, financial control, and type of relationship to determine the degree of control and independence.<sup>1</sup>

Although the determination of an employer-employee relationship involves a mixed question of law and fact, the decision is predominantly one of fact. *Profl. & Executive Leasing, Inc. v. Commissioner*, 862 F.2d 751, 753 (9th Cir.1988). The Courts are guided by various factors; however, no single factor is dispositive. *Ewens & Miller, Inc. v. Commissioner*, 117 T.C.

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<sup>1</sup> A December 2007 news release and additional links discussing the IRS's approach to the independent contractor versus employee status question can be found at <http://www.irs.gov/newsroom/article/0,,id=177092,00.html>.

263, 270, 2001 WL 1575671 (2001). These factors are: (1) The degree of control exercised by the principal over the details of the work, (2) the taxpayer's investment in the facilities used in the work, (3) the taxpayer's opportunity for profit or loss, (4) whether the work performed is an integral part of the principal's business, (5) the principal's right of discharge, (6) the permanency of the relationship between the parties to a working relationship, (7) what relationship the parties to a working relationship believe they are creating, and (8) the provision of employee benefits. See *Moore v. Commissioner*, TC Memo 2007-13; *Professional & Executive Leasing v. Commissioner*, 89 TC 225, at 232 (citing, *United States v. Silk*, 331 U.S 704, 716 (1947)).

The Ninth Circuit Court of Appeal has declared that, in distinguishing employees from independent contractors, “employer control over the manner in which the work is performed, ‘either actual or the right to it, is the basic test.’” *General Inv. Corp.*, 823 F.2d, 337, 341 (quoting *Air Terminal Cab, Inc. v. United States*, 478 F.2d 575, 578 (8th Cir.), cert. denied, 414 U.S. 909 (1973)) (9<sup>th</sup> Cir. 1987); see also *United States v. Webb, Inc.*, 397 U.S. 179, 192 (1970) (control is the most important factor in the employment test). Idaho courts have also placed substantial weight on control, for example, see *Merrill v. Duffy Reed Construction Co.*, 82 Idaho 410, 415, 353 P.2d 657 (1960). (“The authorities have suggested various tests for determining the relationship. No one test standing alone, except perhaps the right to control in the employer-employee relationship, and the lack of such right in that of principal and independent contractor, is wholly decisive.”)

### C. Issue 1 – Idaho Withholding Tables.

The petitioner points to Idaho Code section 63-3035(a) language that states “[t]he state tax commission shall prepare tables showing amounts to be withheld, and shall supply same to each employer subject to this section” as evidence that the Commission obviously believes the

petitioners were not an employer since the Commission failed to send to the petitioners the withholding tables. The Commission does not believe that the inclusion of that language by the Idaho Legislature was intended to be used in the manner the petitioners suggest. If that were true, an employer transacting business in Idaho and wishing to avoid the Idaho withholding requirement could simply not register with Idaho as an employer as required by Idaho law and then claim that the Commission must not have viewed the employer as an employer under the Idaho statute because the Commission did not send the employer the withholding tables.<sup>2</sup> As for the case before the Commission, until such time as an employer or non-employer determination is made, the Commission would not have knowledge of the petitioners' employer status nor of the Commission's obligation to send the withholding tables. Accordingly, the Commission finds no merit in the petitioners' first argument.

#### D. Issue 2 - Independent Contractor versus Employee

In the petitioners' petition for redetermination, the petitioners' representative addresses each of the 20 factors used by the Internal Revenue Service and makes arguments as to why the factor analysis supports a non-employee finding. However, the petitioners have not provided any documentation supporting the 20 factor analysis nor have they provided any evidence from the workers themselves supporting the petitioners' position that the workers are independent contractors. While the Commission certainly recognizes the arguments set out by the petitioners' representative during this protest, arguments are not evidence. Accordingly, the Commission finds that the record contains very little evidence supporting the petitioners' non-employee finding.

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<sup>2</sup> Idaho Code section 63-3035(a)(3) requires every employer to "register with the state tax commission, in the manner prescribed by it, to establish an employer's withholding account number. The account number will be used to report all amounts withheld, for the annual reconciliation required in this section, and for such other purposes relating to withholding as the state tax commission may require."

WHEREFORE, the Notice of Deficiency Determination dated April 11, 2007, is hereby is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2003	\$13,785	\$3,446	\$4,732	\$21,963
2004	12,581	3,145	3,650	19,376
2005	11,391	2,848	2,623	16,862
2006	13,669	3,417	2,327	<u>19,413</u>
			TOTAL DUE	<u>\$77,614</u>

Interest is calculated through October 31, 2008, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2008.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2008, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]  
[REDACTED]

Certified Mail No.  
\_\_\_\_\_