

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 23703
)
)
Petitioner.) DECISION
)
_____)

PROCEDURAL BACKGROUND

On August 6, 2010, an auditor of the Idaho State Tax Commission (Auditor) issued a Notice of Deficiency Determination (NODD) to [Redacted] (Petitioner) proposing withholding tax, penalty, and interest for taxable years ended December 31, 2007, 2008, and 2009. The Petitioner filed a timely request for redetermination (Protest) on October 8, 2010.

The Protest was written by an attorney on behalf of the Petitioner. The attorney was sent an Idaho Power of Attorney Form to complete, sign, and return the form to the Tax Commission to allow the Tax Commission to discuss the Petitioner and the disputed issues with him.

ISSUE

1. Was the auditor correct in disallowing the classification of the management and workers [Redacted] as employees, therefore requiring payroll taxes to be withheld, remitted, and reported to the state of Idaho?

DISCUSSION

The Petitioner was incorporated in Idaho on May 10, 1968. They are located in [Redacted], Idaho, and operate on weekends from April through October. The Petitioner opened an Idaho withholding account effective April 1, 1986. They began filing withholding reports showing no employees and no Idaho income tax withheld since 1997.

[Redacted] is the president [Redacted]. [Redacted] works for and receives compensation [Redacted] Based on Internal Revenue Code (IRC) section 3401(a), an officer of the corporation is defined as an employee. [Redacted] cannot be considered an independent contractor. The Petitioner denies that there is oversight or control over all the other workers in the [Redacted] family. The Petitioner stated that each member of the [Redacted] family agreed to be treated as an independent contractor.

[Redacted] only worked [Redacted]. [Redacted] lists his principle business as “[Redacted].” The Petitioner claimed that [Redacted] has full creative license and control. He performs his duties without any supervision, direction, or control. [Redacted] showed no other source of income on his personal income tax returns. [Redacted] expenses (as reported on Schedule C, Form 1040) are 5 percent or less for each year of the audit.

[Redacted] only worked [Redacted]. [Redacted] lists his principle business as “[Redacted].” [Redacted] showed no other source of income on his personal income tax returns. [Redacted] expenses (as reported on Schedule C, Form 1040) are 5 percent or less for each year of the audit.

[Redacted] is the [Redacted] for the Petitioner. [Redacted] sells the advertising and sponsorships [Redacted]. [Redacted] only worked [Redacted] and reported no other income on his personal income tax returns. The auditor found that the Petitioner pays [Redacted] quarterly taxes and adds that amount to his income¹. [Redacted] also oversees and manages employee groups [Redacted].

The auditor used the salaries and wages as reported on the federal corporate income tax returns. The corporation files their income tax returns on a fiscal year end of March 31. The

¹ See affidavit [Redacted] from divorce proceedings in audit file.

auditor used the fiscal year wages as estimates for the wages of the calendar years. The dollar amounts that were used in the audit report are not disputed.

<u>Tax Year Ended</u>	<u>March 2006</u>	<u>March 2007</u>	<u>March 2008</u>
[Redacted]	40,000	40,000	40,800
[Redacted]	35,240	37,156	38,838
[Redacted]	37,435	40,311	40,796
[Redacted]	32,000	33,000	34,000
Event Workers	25,505	24,402	24,771
Outside Labor	<u>8,264</u>	<u>6,269</u>	<u>7,500</u>
Total	<u>\$178,444</u>	<u>\$181,138</u>	<u>\$186,705</u>

The Petitioner concedes that some of the “Event Workers” should have been treated as employees. They maintain that the “Outside Labor” category was correctly characterized as payments to independent contractors. No additional information was provided to support that claim.

LAW AND ANALYSIS

Idaho Code section 63-3035(a) states, in pertinent part, that “Every employer who is required under the provisions of the IRC 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.” Idaho Code section 63-3018 defines the term employee to mean an employee as defined in the IRC.

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 IRC.

Subtitle C of the IRC governs payment of employment taxes. More specifically, Chapter 24, Subchapter A, sections 3401 through 3406 govern withholding from wages. IRC 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. IRC 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. section 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 (IRS) 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 IRS 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.²

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. 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, T.C. 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 Appeals 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)) (9th Cir. 1987); see also United States v. Webb, Inc., 397 U.S. 179, 192 (1970) (control is

² 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> .

the most important factor in 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.”)

The Commission analyzes these factors as follows:

1. Degree of control.

It is difficult to determine the degree of control. [Redacted] is the sole owner, President, and administrator [Redacted]. The right of control would rest with him. The Petitioner claims that the other workers have no oversight. At the very least, [Redacted] has the right of control over the other workers. This factor is indicative of an employer - employee relationship.

2. Investment in the facilities used in the work.

The individuals did not claim to have any investment in the facilities used in the work. Only minimal expenses were claimed on their personal income tax returns. No other income was reported by the individuals. When their independent status was challenged by the Tax Commission, none of the individuals offered any explanation that would have justified their classification as independent contractors. This factor is indicative of an employer - employee relationship.

3. Opportunity for profit or loss.

The fact that the individuals were paid a salary did not create a situation wherein they could have suffered a loss other than the loss of employment nor share in profits if there were extraordinary revenues. This is very indicative of an employer-employee relationship.

4. Whether the work performed is an integral part of the principal's business.

[Redacted] made up the primary workforce [Redacted]. There are no other employees. There was a much smaller amount, ranging between 13 – 14 percent of the amount labeled as salaries and wages on the federal Form 1120, was identified as “event workers.” It is clear that members of the [Redacted] family provided the vast majority of the operation [Redacted]. This factor is indicative of an employer - employee relationship.

5. The right of discharge.

[Redacted] is the sole owner, President, and administrator [Redacted] The right of discharge would rest with him. The petitioner claims that the other workers have no oversight. At the very least [Redacted] has the right of discharge over the other workers. This factor is indicative of an employer, employee - relationship.

6. The permanency of the relationship between the parties.

The agreements are open ended and indefinite, more dispositive of an employer - employee relationship.

7. The relationship the parties to a working relationship believe they are creating.

The Petitioner claimed that there were agreements for these individuals to be treated as independent contractors. None were provided to the auditor. It is important to note that the state of Idaho is not necessarily bound by an agreement that they are not a party to. Also, an agreement to break the law or avoid legal obligations is not valid.

The auditor did request and receive a copy of an affidavit [Redacted] that was given in the course of his child support proceedings. In that affidavit, he described his relationship [Redacted] as that of an employee. He also described the payments received as “salary.” When asked none of the individuals provided any evidence or explanation that would indicate their being independent contractors.

The corporation did not file the requisite 1099s to correctly treat them as contractors. That adds to the appearance that the corporation is simply not accepting their responsibilities as an employer.

8. Employee benefits.

All of the individuals were reimbursed for mileage and other costs including quarterly estimated income taxes. Such payments are a benefit and are indicative of an employer - employee relationship.

The information provided, by the auditor and the petitioner, indicates that there are several more elements of an employer-employee relationship than that of independent contractor status.

Penalties:

The Auditor added penalty to the Petitioner’s Idaho tax liability. The Tax Commission reviewed the penalties and found them appropriate. *See* Idaho Code section 63-3046(a) and 63-046(c)(2).

THEREFORE, the Notice of Deficiency Determination dated June 11, 2009, and directed to the Petitioner is hereby AFFIRMED by this decision.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/07	\$9,023	\$2,256	\$2,669	\$13,948
12/31/08	9,236	1,940	2,083	13,259
03/31/09	2,334	350	377	<u>3,061</u>
			TOTAL	<u>\$30,268</u>

Interest and Penalties are calculated through November 30, 2012, and will continue to accrue at the rate set forth in Idaho Code section 63-3045 and 63-3046.

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

As set forth in the enclosed explanation, the Petitioner must deposit with the Tax Commission 20 percent of the total amount due in order to appeal this decision.

DATED this _____ day of _____ 2012.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2012, 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]

Receipt No.
