

**STATE OF ARKANSAS
DEPARTMENT OF FINANCE & ADMINISTRATION
OFFICE OF HEARINGS & APPEALS**

ADMINISTRATIVE DECISION

IN THE MATTER OF

(ACCT. NO.: [REDACTED])

DOCKET NO.: 19-350

**WITHHOLDING
TAX ASSESSMENT**

**01/01/13 – 06/30/18¹
(\$ [REDACTED])²**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated December 24, 2018, signed by [REDACTED], doing business as [REDACTED], the Taxpayer. The Taxpayer protested the assessment of Withholding Tax resulting from an audit conducted by Kriscinda Young and Eleanor Austin, Tax Auditors – Northeast Audit District of the Office of Field Audit (“Tax Auditor Young” and “Tax Auditor Austin”, individually), for the Department of Finance and Administration (“Department”). The Audit Number is [REDACTED].

A telephone hearing was held on May 2, 2019, at 12:00 p.m., in Little Rock, Arkansas. The Department was represented by Brad Young, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). The Tax Auditors and Adam Hillis, Audit Supervisor, appeared at the hearing, via

¹ At the start of the hearing, the Department’s Representative stated that the beginning of the audit period would be changed to 01/01/17 for purposes of this assessment.

² The reflected amount has not been adjusted to reflect the change discussed in Footnote 1.

telephone, for the Department. The Taxpayer appeared at the hearing, via telephone, and represented himself.

ISSUE

Whether the assessment made by the Department should be sustained?

Yes, in part.³

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Taxpayer operates a plumbing business in Arkansas. The Taxpayer's workers performed various plumbing services. The Department's Answers to Information Request provided, in pertinent part, as follows:

Taxpayer is the owner of a plumbing business called [REDACTED]. Taxpayer has been in business over [REDACTED] years. The audit period is January 1, 2013 through June 30, 2018. During the audit period, Taxpayer had not registered with the Department for a withholding wage tax account.

Beginning on or about July 30, 2018, the Department conducted an audit of Taxpayer's records in relation to withholding wage tax. The Department's auditors met with the Taxpayer to learn about the Taxpayer's business and to review documents. The auditors reviewed copies of IRS Form 1099 that Taxpayer had issued to workers, bank statements from Taxpayer's payroll account, and Taxpayer's monthly financial statements.

Taxpayer asserted that its workers were subcontractors. Upon review, the auditors determined that the workers were employees. Among other factors that led to this determination, Taxpayer set the hours of his workers. He provided tools and supplies for their work. There were no written contracts between the Taxpayer and the workers.

Once the auditors had determined that the workers were employees for whom the Taxpayer should have remitted withholding wage tax, their next task was to determine the amount of withholding tax due. First, the auditors compiled a list of the employees paid by Taxpayer during the audit period. That list included the name, social security number (if available), and monthly amounts paid to each employee during the audit period. Next, the auditors

³ See Footnotes 1 and 2.

consulted the Department's records to verify whether the employees had reported the income from the payments they received from the Taxpayer. After eliminating those individuals who did report their income, the auditors compiled a list of Taxpayer's employees during the audit period who did not report income. See Schedule E,⁴ Payroll Amounts from Financial Statements, attached as **Exhibit 1**.

The auditors used the listing in Schedule E to estimate the amount of withholding tax that Taxpayer should have remitted. Because no further information about the employees was available, the auditors calculated the monthly amount of withholding for each employee as if the employee had filed his income tax as single with one exemption. The Taxpayer was able to provide monthly financial statements for January 2013-November 2016 and January 2018-June 2018. The auditors used the amounts listed in those statements to calculate the tax for those periods. Because the Taxpayer did not provide financial statements for December 2016, the auditors estimated the amounts for that month based on the information available from Taxpayer's financial statements for January 2016-November 2016. Because only the 1099 forms were available for 2017, the auditors estimated the average income for those employees based on the forms. Using these amounts, the auditors prepared schedules of the withholding tax that the Taxpayer should have remitted for each affected employee. See Schedules A-D, attached as **Exhibit 2**. [Footnote 1 was changed to Footnote 4, P. 2].

Tax Auditor Young presented testimony consistent with the contentions in the Department's Answers to Information Request and also testified that: (1) she performed a withholding wage tax audit of the Taxpayer's business; (2) the Taxpayer claimed that his workers were independent contractors; (3) the Taxpayer did not produce any Form I-9's; (4) she reviewed financial statements and time cards; (5) she determined that the Taxpayer employed workers over multiple tax periods without withholding taxes for any of the workers (See Department Exhibit 1); (6) if she could determine that a worker filed an Arkansas tax return, that worker's name is not included on Department Exhibit 1; (7)

⁴ Footnote 1 of the Department's Answers to Information provided that, "Schedule E [**Ex. 1**] only includes those employees who did not report income to the Department."

Department Exhibit 2 reflects the calculation of the withholding tax due; and (8) the factors which led her to determine that the workers were employees included: (i) the workers used time cards and were paid by the hour; (ii) she was informed that the Taxpayer supplied trucks and tools for the workers; (iii) the Taxpayer controlled the details of the work; (iv) the workers were engaged in the same occupation as the Taxpayer; (v) some of the workers had a continuing relationship with the Taxpayer over the years of the audit period; (vi) the workers rendered services directly to the Taxpayer under his direct supervision and without any employment contracts; and (vii) the Taxpayer could fire the workers (or the workers could quit) at any time.

The Taxpayer's Protest Form stated that he believed "an error has been made in classifying contract laborers as employees. [P. 1]." The Taxpayer testified that: (1) 98% of Tax Auditor Young's testimony was correct but he only supplied big items for the workers such as a backhoe with a truck and trailer to pull it (and large treading equipment); (2) the workers supplied their own hand tools and power tools; (3) the workers do work for other people and do provide their own trucks from time-to-time; and (4) he does have control over whether to fire the workers if they can't do quality work "or any other viable reason for discharging an employee."

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313(c) (Supp. 2017) provides, in pertinent part, as follows:

The burden of proof applied to matters of fact and evidence, whether placed on the taxpayer or the state in controversies regarding the application of a state tax law shall be by preponderance of the evidence.

A preponderance of the evidence means the greater weight of the evidence.

Chandler v. Baker, 16 Ark. App. 253, 700 S.W.2d 378 (1985). In Edmisten v. Bull Shoals Landing, 2014 Ark. 89, at 12-13, 432 S.W.3d 25, 33, the Arkansas Supreme

Court explained:

A preponderance of the evidence is “not necessarily established by the greater number of witnesses testifying to a fact but by evidence that has the most convincing force; superior evidentiary weight that, though not sufficient to free the mind wholly from all reasonable doubt, is still sufficient to incline a fair and impartial mind to one side of the issue rather than the other.

The Department bears the burden of proving that the tax law applies to an item or service sought to be taxed, and a taxpayer bears the burden of proving entitlement to a tax exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(d) (Supp. 2017). Statutes imposing a tax or providing a tax exemption, deduction, or credit must be reasonably and strictly construed in limitation of their application, giving the words their plain and ordinary meaning. Ark. Code Ann. § 26-18-313(a), (b), and (e) (Supp. 2017). If a well-founded doubt exists with respect to the application of a statute imposing a tax or providing a tax exemption, deduction, or credit, the doubt must be resolved against the application of the tax, exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(f)(2) (Supp. 2017).

Withholding Tax Assessment

The Arkansas Income Tax Withholding Act of 1965, Ark. Code Ann. § 26-51-901 et seq. (Repl. 2012), contains the following relevant provisions of law:

26-51-902. Definitions.

As used in this subchapter:

...

(5) 'Employee' means any individual subject to the Income Tax Act of 1929, § 26-51-101 et seq., who performs or performed services for an employer and receives wages for the services;

(6) 'Employer' means a person doing business in or deriving income from sources within this state who has control of the payment of wages to an individual for services performed, or a person who is the officer or agent of the person having control of the payment of wages;

...

(13) 'Wages' means remuneration in cash or other form for services performed by an employee for an employer, . . .

26-51-905. Withholding of tax.

(a)(1) Every employer making payments of wages to employees shall deduct and withhold from the employees' wages an amount determined from withholding tables promulgated by the Director of the Department of Finance and Administration and furnished to the employer.

(2) The full amount deducted and withheld from any employee's wages during the income year shall be credited against the tax liability of the employee under the Income Tax Act of 1929, § 26-51-101 et seq., for that year.

26-51-908. Employer's return and payment of taxes withheld.

(a)(1) Every employer required to deduct and withhold from wages under this subchapter shall file a withholding return on an annual basis as prescribed by the Director of the Department of Finance and Administration and annually pay over to the director the full amount required to be deducted and withheld from the wages of the employees if the amount is less than one thousand dollars (\$1,000) per year.

(2) Every employer required to deduct and withhold from wages under this subchapter shall file a withholding return on a monthly basis as prescribed by the director and pay over on a monthly basis to the director the full amount required to be deducted and withheld from the wages of the employees if the amount is one thousand dollars (\$1,000) or more per year.

...

(e) Every employer who fails to withhold or pay to the director any sums required by this subchapter to be withheld and paid shall be personally and individually liable for the sums except as provided in § 26-51-916.

26-51-916. Employer liable for amounts required to be withheld — Exceptions.

Every employer shall be liable for amounts required to be deducted and withheld by this subchapter regardless of whether or not the amounts were in fact deducted and withheld. However, if the employer fails to deduct and withhold the required amounts and if the tax against which the required amounts would have been credited is paid, the employer shall not be liable for those amounts not deducted and withheld if the failure was due to reasonable cause.

The resolution of this case depends on a determination of whether the Department correctly concluded that the workers who performed services for the Taxpayer during the audit period were employees rather than independent contractors. The Department's Answers to Information Request contained a summary of relevant principles and factors and stated, in part:

For purposes of civil liability for an employee's activities, the Arkansas Supreme Court explained the governing principles in determining an employer-employee relationship as follows:

In Blankenship v. Overholt, 301 Ark. 476, 786 S.W.2d 814 (1990), this court set out ten factors to be considered in determining whether one is an employee or an independent contractor. The principal factor is the extent of control that the master may exercise over the details of the work. It is the right to control, not the actual control, that is determinative. Other factors include whether the one employed is engaged in a distinct occupation or business; whether the employer furnishes the tools and workplace for the job; the length of time the person is employed; and whether the work is part of the regular business of the employer. Generally, the question of employment status is a question of fact for the jury to resolve.

Madden v. Aldrich, 346 Ark. 405, 419, 58 S.W.3d 342, 353 (2001).

Similarly, the Internal Revenue Service has identified twenty factors that it analyzes in determining an employer-employee relationship exists:

1. INSTRUCTIONS. A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the RIGHT to require compliance with instructions.

2. TRAINING. Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner.

3. INTEGRATION. Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business.

...

6. CONTINUING RELATIONSHIP. A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.

7. SET HOURS OF WORK. The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control.

8. FULL TIME REQUIRED. If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor on

the other hand, is free to work when and for whom he or she chooses.

...

12. **PAYMENT BY HOUR, WEEK, MONTH.** Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on straight commission generally indicates that the worker is an independent contractor.

...

14. **FURNISHING OF TOOLS AND MATERIALS.** The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship.

15. **SIGNIFICANT INVESTMENT.** If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. Special scrutiny is required with respect to certain types of facilities, such as home offices.

16. **REALIZATION OF PROFIT OR LOSS.** A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees

and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

17. **WORKING FOR MORE THAN ONE FIRM AT A TIME.** If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

18. **MAKING SERVICE AVAILABLE TO GENERAL PUBLIC.** The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.

19. **RIGHT TO DISCHARGE.** The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications.

20. **RIGHT TO TERMINATE.** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship.

IRS Rev. Ruling 87-41.

In this case, all evidence points to the conclusion that the Taxpayer's workers were employees. The Department's witnesses will testify that the factors identified by the Arkansas Supreme Court in *Madden* were present here: the Taxpayer had the right to control the details of the work; the workers were engaged in plumbing, which was the same occupation as the Taxpayer; Taxpayer furnished the tools for the job; Taxpayer directed the workers on where to go for the work; and the work that the workers were performing was part of Taxpayer's regular business of plumbing. *See Madden*, 346 Ark. at 353, 58 S.W.3d at 419.

Similarly, many of the factors identified by the IRS were present as well: the workers had to comply with Taxpayer's instructions about

when, where, and how to work; the workers received on-the-job training from Taxpayer; the workers' services were integrated into the Taxpayer's business operations; the workers rendered their services personally to the Taxpayer; Taxpayer directly hired, supervised, and paid the workers; for most of those employees included in the audit, there was a continuing relationship over multiple years; Taxpayer set the hours of work; Taxpayer directed the order or sequence of the work; Taxpayer paid the workers hourly; Taxpayer furnished the tools and materials; the workers did not personally bear economic risk as a result of their services (other than the type of profit or loss ordinarily realized by employees); the Taxpayer had the right to discharge the workers; and the workers had the right to terminate their relationship with the Taxpayer at any time without incurring contractual liability.

Taxpayer has provided no evidence of entitlement to the defense under Ark. Code Ann. § 26-51-916 (Repl. 2012) that: (1) the withholding tax has been paid; and (2) the employer's failure to withhold and pay the tax was due to reasonable cause. Because the auditors excluded amounts paid to those employees who reported and paid their income tax, the Department's assessment does not include any withholding tax that has been paid. *See Morris v. Ark. Dep't of Fin. & Admin.*, 82 Ark. 124, 131-32, 112 S.W.3d 378, 383-84 (2003) (holding employer was not entitled to credit against unpaid withholding taxes where Department's records did not show payment and employer had not shown reasonable cause for failing to withhold and remit taxes). [P. 4-8].

The Department's arguments, regarding the classification of Taxpayer's workers as employees, are persuasive. Some of the IRS factors weigh in favor of the Taxpayer (no training, no set hours of work, and no full time required) but more of the IRS factors weigh in favor of the Department (instructions, integration, payment by the hour, significant investment, continuing relationship, realization of profit or loss, and the right to discharge or terminate).⁵ Significantly, the evidence presented in this case also established that the Taxpayer exercised control over the details of the work performed by the workers. See Blankenship v. Overholt, *supra*. The greater weight of evidence

⁵ The IRS factor for "furnishing of tools and materials" weighs evenly between the parties because the Taxpayer furnished expensive equipment but the workers furnished their own hand tools.

supports a finding that the workers were employees rather than independent contractors. Consequently, the Department correctly assessed withholding tax against the Taxpayer.

Interest

Interest should be assessed upon the tax deficiency, after the stipulated adjustment, for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2012).

DECISION AND ORDER

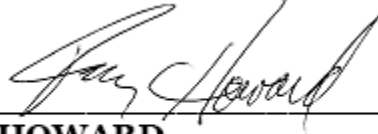
Subject to the stipulated adjustment to be made by the Department,⁶ the proposed assessment is sustained. The file is to be returned to the appropriate section of the Department for further proceedings in accordance with this Administrative Decision and applicable law. Pursuant to Ark. Code Ann. § 26-18-405 (Supp. 2017), unless the Taxpayer requests in writing within twenty (20) days of the mailing of this decision that the Commissioner of Revenues revise the decision of the Administrative Law Judge, this Administrative Decision shall be effective and become the action of the agency.

The revision request may be mailed to the Assistant Commissioner of Revenues, P.O. Box 1272, Rm. 2440, Little Rock, Arkansas 72203. A revision request may also be faxed to the Assistant Commissioner of Revenues at (501) 683-1161 or emailed to revision@dfa.arkansas.gov. The Commissioner of Revenues, within twenty (20) days of the mailing of this Administrative Decision, may revise the decision regardless of whether the Taxpayer has requested a revision.

⁶ See Footnotes 1 and 2.

Ark. Code Ann. § 26-18-406 (Supp. 2017) provides for the judicial appeal of a final decision of an Administrative Law Judge or the Commissioner of Revenues on a final assessment or refund claim denial; however, the constitutionality of that code section is uncertain.⁷

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: May 8, 2019

⁷ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.