

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessments of Income Tax)
Withholding, Penalties, and Interest for the Period)
September 1, 1993 through August 31, 1998)
by the Secretary of Revenue of North Carolina)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2000-137

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, upon an application for a hearing by [Taxpayer], wherein he protested the proposed assessments of withholding tax, penalties, and interest for the period September 1, 1993 through August 31, 1998. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1. At Taxpayer's request, the hearing was conducted via written communication and is based on all information presented for the record as of October 9, 2002. [Taxpayer was represented by an attorney.]

ISSUES

The issues to be decided in this matter are:

1. Was Taxpayer required to withhold North Carolina income tax from the compensation paid to individuals who worked for him?
2. Are the withholding tax assessments proposed against Taxpayer for the period September 1, 1993 through August 31, 1998, lawful and proper?

EVIDENCE

The evidence presented at the hearing by W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, consisted of the following:

1. Memorandum from E. Norris Tolson, Secretary of Revenue, to Eugene J. Cella, Assistant Secretary for Administrative Tax Hearings, dated May 16, 2001, a copy of which is designated as Exhibit PT-1.
2. Notice of Withholding Tax Assessment for the period September 1, 1993 through August 31, 1998 dated December 13, 1999, a copy of which is designated as Exhibit PT-2.

3. Field Auditor's Report for the period September 1, 1993 through August 31, 1998 dated August 5, 1999, a copy of which is designated as Exhibit PT-3.
4. Taxpayer's federal Schedule C, Profit or Loss from Business, for the tax year 1995, a copy of which is designated as Exhibit PT-4.
5. Taxpayer's federal Schedule C, Profit or Loss from Business, for the tax year 1996, a copy of which is designated as Exhibit PT-5.
6. Taxpayer's federal Schedule C, Profit or Loss from Business, for the tax year 1997, a copy of which is designated as Exhibit PT-6.
7. Title 17, subchapter 6C, section 0108 of the North Carolina Administrative Code, a copy of which is designated as Exhibit PT-7.
8. Letter from Attorney to Muriel K. Offerman, former Secretary of Revenue, dated January 11, 2000, a copy of which is designated as Exhibit PT-8.
9. Letter from Michael A. Hannah, former Assistant Secretary of Revenue, to Attorney dated March 24, 2000, a copy of which is designated as Exhibit PT-9.
10. Letter with related attachments from Attorney to Michael A. Hannah dated June 7, 2000, copies of which are collectively designated as Exhibit PT-10.
11. Letter from Michael A. Hannah to Attorney dated June 12, 2000, a copy of which is designated as Exhibit PT-11.
12. Letter with related attachments from Attorney to Michael A. Hannah dated June 12, 2000, copies of which are collectively designated as Exhibit PT-12.
13. Letter from Michael A. Hannah to Taxpayer dated June 27, 2000, a copy of which is designated as Exhibit PT-13.
14. Letter from Richard C. Stewart, Administrative Officer in Sales and Use Tax Division, to Taxpayer dated January 18, 2002, a copy of which is designated as Exhibit PT-14.
15. Letter from Eugene J. Cella to Taxpayer dated February 18, 2002, a copy of which is designated as Exhibit PT-15.
16. Letter from Taxpayer to Department of Revenue dated February 23, 2002, a copy of which is designated as Exhibit PT-16.
17. Letter from Eugene J. Cella to Taxpayer dated March 1, 2002, a copy of which is designated as Exhibit PT-17.
18. Letter from Taxpayer to Department of Revenue dated March 6, 2002, a copy of which is designated as Exhibit PT-18.
19. Letter from Eugene J. Cella to Taxpayer dated March 13, 2002, a copy of which is designated as Exhibit PT-19.

20. Letter from Eugene J. Cella to Taxpayer dated September 9, 2002, a copy of which is designated as Exhibit PT-20.
21. Letter from Eugene J. Cella to Taxpayer dated September 9, 2002, a copy of which is designated as Exhibit PT-21.

In lieu of appearing at the hearing, Taxpayer requested that the matter be resolved via written communication. The Assistant Secretary granted the request and allowed Taxpayer until October 9, 2002, to furnish information in support of his objections to the assessment. Taxpayer submitted a letter dated October 5, 2002, summarizing his position, a copy of which is designated as Exhibit TP-1.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. Taxpayer is and at all times was a natural person, sui juris, and a citizen and a resident of North Carolina.
2. During the tax period at issue, Taxpayer operated a sole proprietorship engaged in the business of muffler repair and used auto sales. Taxpayer did not file any State withholding returns or pay any income tax withheld for the period at issue. Although requested by the auditor, Taxpayer did not provide business records pertaining to sales, income and expenses. Taxpayer claims that the business records for the period January 1, 1996 through August 28, 1997 were destroyed by fire. Taxpayer also claims that the business records for the period after the fire, August 1997 through September 1998, were lost when the truck in which the records were stored was involved in a traffic accident.
3. In conjunction with an examination of Taxpayer's individual income tax and sales and use tax, the auditor determined that Taxpayer had not withheld or paid North Carolina income tax from compensation paid to individuals determined to be his employees. On two occasions while visiting Taxpayer's business, the auditor observed uniformed individuals working on the premises. Taxpayer indicated to the auditor that the withheld taxes had been filed and paid under a corporate name but provided no records in support of this claim. Taxpayer now contends that the individuals who worked at his business were not employees, but instead were "service providers" (Exhibit TP-1).
4. Taxpayer deducted expenses for wages and labor on federal Schedule C for the business on his individual income tax returns for the taxable years 1995, 1996, and 1997. Using those expenses, the auditor estimated the amount of State income tax required to have been withheld from the compensation.
5. The auditor asserted the 25 percent penalty for failure to file the withholding tax returns and the 10 percent penalty for failure to pay the tax when due. The auditor also asserted the 25 percent negligence penalty.
6. A Notice of Tax Assessment for the income tax required to have been withheld for the period September 1, 1993 through August 31, 1998, was mailed to Taxpayer on

December 13, 1999. Taxpayer filed a timely protest to the proposed assessment and requested a hearing before the Secretary of Revenue.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. An employee is defined as an individual who performs services for wages. An employer is defined as a person for whom an individual performs services for wages. Wages are remuneration for service performed by an employee for his employer.
2. An employer is required to deduct and withhold North Carolina income tax from the wages paid to his employees; to pay over the tax withheld to the Secretary of Revenue; and, upon failure to withhold or pay the tax, the employer becomes personally and individually liable for the tax required to have been withheld. Amounts withheld are deemed to be held in trust for the Secretary of Revenue.
3. Income tax is required to be withheld if an employer-employee relationship exists. The determination of that relationship must be based on the facts and circumstances of each particular case. An individual who performs services subject to the will and control of an employer both as to what shall be done and how it shall be done is an employee. An employer-employee relationship exists when the person for whom the services are performed has the right to control and direct the individual performing the services. Whether the employer actually controls and directs the manner in which the services are performed does not matter if he has the right to do so, and it does not matter that the employee is called by some other name such as partner, agent, or independent contractor; nor whether the individual works full or part time; nor how the payments are measured, paid, or what they are called.
4. A taxpayer is required to furnish records, books of account, and any other information necessary to verify the correctness of his return when requested to do so by the Secretary of Revenue.
5. In cases where the taxpayer does not provide adequate and reliable information upon which his tax liability may be determined, an assessment may be made upon the basis of the best information available and in the absence of information to the contrary, such assessment is deemed to be correct.
6. A penalty of 5 percent of the tax per month, 25 percent maximum, is required for failure to file a withholding tax return when due.
7. A penalty of 10 percent of the tax is required for failure to pay the tax when due.
8. A negligence penalty of 25 percent of the tax is required if a taxpayer understates his tax liability by 25 percent or more.

DECISION

Taxpayer contends that the individuals who worked for him in his business were not employees. Taxpayer claimed deductions for wages and for labor on federal Schedule C for the business on his 1995, 1996, and 1997 individual income tax returns. The deduction for wage expense clearly contradicts Taxpayer's claim that he had no employees. During the audit investigation, Taxpayer stated that withholding taxes were filed and paid under a corporate name but he has provided no factual evidence to support his claim. Further, Taxpayer has furnished no information to support his claim that the individuals to which he paid wages and labor were independent contractors rather than employees. Consequently, the Assistant Secretary finds that Taxpayer was required to withhold State income tax from the compensation paid. Taxpayer has not carried his burden of proof that the workers were not employees or that the proposed assessments are otherwise in error.

Based on the foregoing findings of fact and conclusions of law, the proposed withholding tax assessment for the period September 1, 1993 through August 31, 1998, is lawful and proper and is declared to be finally determined and immediately due and collectible together with interest as allowed by law.

Made and entered this 6th day of January, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue