

Letter of Findings: 03-20170773
Withholding Tax
For the Years 2013, 2014, and 2015

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HOLDING

Indiana Company failed to provide sufficient, documentary evidence to establish that the Department's decision reclassifying certain of its workers as "employees" rather than "independent contractors" was incorrect; as a result, Indiana Company owed additional withholding tax.

ISSUE

I. Withholding Tax - Employees and Independent Contractors.

Authority: IC § 6-3-4-8; IC § 6-3-4-8(g); IC § 6-8.1-5-1; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Longmire v. Indiana Dep't of State Revenue, 638 N.E.2d 894 (Ind. Tax Ct. 1994); I.R.C. § 530; IRS Publication 15-A (2011); 41 Am. Jur. 2d Independent Contractors §1 (2009); Income Tax Information Bulletin 52 (August 2008); Black's Law Dictionary (8th ed. 2004).

Taxpayer argues that the Department erred when it determined that people who worked for Taxpayer were "employees" and not "independent contractors."

STATEMENT OF FACTS

Taxpayer is an Indiana company which sells and installs agricultural equipment. In addition, Taxpayer sells farm equipment repair parts. Taxpayer also provides services to farmers such as on-location equipment repair services and "custom liquid manure hauling" services.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's withholding returns and business records. The audit found that 13 of the workers who performed services for - or on behalf of Taxpayer - were not "independent contractors" but were Taxpayer's own employees. That finding resulted in an assessment of additional withholding tax.

Taxpayer disagreed with the assessment and filed a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Withholding Tax - Employees and Independent Contractors.

DISCUSSION

Taxpayer was assessed additional withholding tax because the Department's audit reclassified 13 of its workers as "employees" rather than "independent contractors." Therefore, the issue is whether all of the 13 people who worked for - or provided services on behalf of - Taxpayer were "employees" or "independent contractors." If all of the 13 were "employees," then the assessment of additional withholding tax was correct.

A. Department's Audit Examination.

The audit concluded that all of the 13 persons were "employees" for the following reasons. Copies of "purchase

invoices" provided by Taxpayer were actually employee "time sheets." These documents listed the employees' names, listed the date on which each employee worked, and listed the amount of time each employee worked.

The audit found that Taxpayer provided uniforms for the people who worked for it. Those uniforms displayed the name of the individual worker along with the name of Taxpayer's business.

One of the workers was originally classified by Taxpayer as an "independent contractor," was reclassified by Taxpayer for three months as an "employee," but was later reclassified as an "independent contractor."

According to the Department's audit, Taxpayer's documentation indicates that Taxpayer "controls the worker, what is to be done and how." In addition, Taxpayer provides each worker "job training to control how things are to be completed." Each worker is expected to report to Taxpayer "the progress of the job being completed"

After the audit reviewed Taxpayer's sales invoices, the audit found that the workers' tools were "listed as the [T]axpayer's capital assets" and that these assets were "depreciated on the [T]axpayer's tax returns." The audit rejected Taxpayer's argument that "the workers use[d] their own tools" because "[n]o documentation supporting this [argument] was found." Instead, Taxpayer's tax returns listed "large expenses for the purchase of tools"

The audit report stated that Taxpayer's general ledger establishes that the workers were paid on a consistent, weekly, or bi-weekly basis for work completed and that Taxpayer's timesheets "list[ed] the amount of hours worked and the hourly wage for each day" According to the audit report, the general ledger established that the workers were reimbursed for expenses and that "an independent contractor [would] have no reimbursed expenses incurred." The audit report also noted that the general ledger indicates that the workers were given "year-end bonuses."

The audit rejected Taxpayer's contention that if the customer failed to pay for any services rendered by the workers that the "workers do not get paid." Instead the audit found that "[T]axpayer is paid consistently, as are the workers." The audit report noted that Taxpayer had "claimed no bad debts during the audit period."

The audit report notes that Taxpayer "ha[d] a continuous relationship with the workers through the audit period" but that "[T]axpayer or the worker can terminate the relationship at any time."

The audit also rejected Taxpayer's argument that it was entitled to rely on the "safe harbor" provision under Section 530 of the Revenue Act of 1996, Pub.L. No. 104-188.

B. Taxpayer's Response to Audit Adjustments.

Taxpayer argues that the Department incorrectly concluded that all of its staff members are its employees. As explained by Taxpayer:

[Taxpayer] employs two general classes of workers, the one being more independent than the other. While the auditor may have been correct for some, they are completely inaccurate regarding the second class of [five] workers.

Taxpayer concludes that this "second class" of five workers are more accurately classified as "independent contractors" rather than "employees" for the following reasons.

Taxpayer maintains that its five workers are only paid for work when the customer first pays Taxpayer, that its workers establish their own work schedule, and that Taxpayer does not provide worker's compensation insurance for its staff.

Taxpayer further argues that it provides no "time off benefits" for its staff, that any "bonuses" paid to staff members are better classified as "profit sharing," and that individual workers are not required to attend meetings.

Taxpayer states that its individual staff members incur "unreimbursed business expenses for fuel, repairs, supplies, meals, and telephone," and that the five workers only realize a profit or loss determined by the number of jobs he chooses to do, how he chooses to charge his customers, and by what unreimbursed expenses he chooses to incur.

In addition, Taxpayer states it has no contract agreement with any of the five workers that its workers are free to seek out "other business opportunities through advertising, and that its staff members are free to "hire substitutes

for helpers without [Taxpayer's] approval."

Taxpayer summarizes the reasons that the five workers are independent contractors as follows:

Firm ["Taxpayer"] believes that each of the [five workers] is an independent contractor because evidence indicates that firm does not have sufficient behavior control, financial control, and only limited relationship type factors to determine the relation of the parties [in] an employer-employee relationship:

- Firm does not instruct worker about when and where to do the work.
- Firm does not instruct worker about what tools or equipment to use.
- Firm does not instruct worker about what workers to hire or to assist with the work.
- Firm does not instruct worker about where to purchase supplies and services.
- Firm does not instruct worker about what must be performed by a specific individual.
- Firm does not instruct worker about what order or sequence to follow.
- Firm provided none of the training to the worker.

. . .

- No written contract exists describing the relationship the parties intended to create.
- Firm does not provide worker with employee-type benefits . . .
- Relationship of the firm with worker has been ongoing for a number of years.
- Services performed by the worker are a key aspect of the regular business of the firm . . .

Taxpayer points out that it underwent a 2009 Internal Revenue Service ("IRS") audit during which it was asked to provide copies of all of the 1099s ("Miscellaneous Income"), that "[n]o employment tax returns were ever filed with IRS for the audit period," that the IRS audit resulted in "no change," and that - as a result - Taxpayer "believed it was reasonable not to reclassify its workers from independent contractors to employees."

Finally, Taxpayer argues that it is now entitled to seek relief under the "safe harbor" provisions of Section 530 of the Revenue Act of 1996, which, according to Taxpayer - provides "relief from retroactively reclassifying 'independent contractors' as 'employees.'"

C. Statement of Law.

Because the Department assessed additional tax, it is Taxpayer's responsibility to establish that tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

IC § 6-3-4-8(a) states:

Except as provided in subsection (d), **every employer making payments of wages subject to tax under this article**, regardless of the place where such payment is made, **who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department.** The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under [IC 6-3.5](#), and on the total amount of exclusions the taxpayer is entitled to under [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#). However, the withholding instructions on the adjusted gross income of a nonresident alien (as defined in Section 7701 of the Internal Revenue

Code) are to be based on applying not more than one (1) withholding exclusion, regardless of the total number of exclusions that [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#) permit the taxpayer to apply on the taxpayer's final return for the taxable year. Such employer making payments of any wages:

- (1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and
- (2) shall make return of and payment to the department monthly of the amount of tax which under this article and [IC 6-3.5](#) the employer is required to withhold. (**Emphasis added**).

IC § 6-3-4-8(g) also provides:

The provisions of [IC 6-8.1](#) relating to additions to tax in case of delinquency and penalties shall apply to employers subject to the provisions of this section, and for these purposes any amount deducted or required to be deducted and remitted to the department under this section shall be considered to be the tax of the employer, and with respect to such amount the employer shall be considered the taxpayer. In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest.

Accordingly, an employer is also required to withhold Indiana state and county income taxes pursuant to the above mentioned statute, which piggybacks the requirement to withhold for federal tax purposes. That is, when an employer is required to withhold federal income tax for an individual because that individual is an employee of the employer - defined either by common law or by statute - the employer is also required to withhold Indiana state and county income taxes for that individual as well (provided that the wages are subject to Indiana income tax). The following discussion focuses on whether Taxpayer's workers were employees or independent contractors as defined by common law.

"Employer" is defined as "[a] person who controls and directs a worker under an express or implied contract of hire and who pays the worker's salary or wages." Black's Law Dictionary 565 (8th ed. 2004).

"Employee" is defined as "[a] person who works in the service of another person (the employer) under an express or implied contract of hire, under which the employer has the right to control the details of work performance." Id. at 564.

"Independent contractor" is defined as "[o]ne who is entrusted to undertake a specific project but who is left free to do the assigned work and to choose the method for accomplishing it." Id. at 785. According to the American Jurisprudence, an "independent contractor is one who, in exercising an independent employment, contracts to do certain work according to his or her own methods, without being subject to the control of the employer, except as to the product or result of the work." 41 Am. Jur. 2d Independent Contractors §1 (2009).

Behavioral and financial controls are the crucial factors in determining whether an employer-employee relationship exists. An employer-employee relationship "exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." Longmire v. Indiana Dep't of State Revenue, 638 N.E.2d 894, 897 (Ind. Tax Ct. 1994).

The IRS, in its Publication 15-A, in relevant part, states:

To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides **evidence of the degree of control and the degree of independence** must be considered. (**Emphasis added**).

The IRS publication illustrates that "facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties." The IRS further provides factors to be considered, in relevant part, as follows:

Behavioral control. Facts that show whether the business has a right to direct and control how the worker does the task for which worker is hired include the type and degree of:

Instructions that the business gives to the worker. An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training that the business gives to the worker. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Financial Control. Facts that show whether the business has a right to control the business aspects of the worker's job include:

The extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their employer.

The extent of the worker's investment. An independent contractor often has a significant investment in the facilities or tools he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.

The extent to which the worker makes his or her services available to the relevant market. An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

How the business pays the worker. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is often paid a flat fee or on a time and materials basis for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

The extent to which the worker can realize a profit or loss. An independent contractor can make a profit or loss.

Type of relationship of the parties. Facts that show the parties' type of relationship include:

- **Written contracts describing the relationship the parties intended to create.**
- **Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.**
- **The permanency of the relationship.** If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that you intend was to create an employer-employee relationship.
- **The extent to which services performed by the worker are a key aspect of the regular business of the company.** If a worker provides services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship. **(Emphasis in original).**

The above factors may not all apply to a particular situation; nonetheless, factors are applied when relevant.

D. Conclusion.

As noted previously, Taxpayer does not disagree entirely with the audit's determination that its workers are better and more accurately classified as "employees" rather than as "independent contractors." Instead, Taxpayer maintains that its "second class" of 5 employees should retain their original classification as "independent contractors."

In this case, the Department is unable to agree that Taxpayer has provided sufficient tangible, documentary evidence to establish that Taxpayer does not have "the right to control and direct the individual[s] who perform[] the services." Taxpayer offers to its customers. Longmire, 638 N.E.2d at 897. The audit clearly defined certain aspects of the relationship between Taxpayer and its workers which would lead one to reasonably conclude that Taxpayer "controls and directs [its workers] under an express or implied contract of hire and who pays the worker's wages." Black's Law Dictionary, at 565. As noted in the audit report, the Department found that Taxpayer: (1) instructed the workers on what tasks were to be done; (2) how the work was to be completed; (3) provided on-the-job training; (4) provided the workers with the tools needed to perform the work; (5) paid its workers on a regular basis with no evidence that payment was withheld when the customer failed to pay for the work; (6) reimburses the employees' expenses; (7) and that Taxpayer has a continuous, on-going relationship with the employees.

In arriving at this decision, the Department does not dismiss out-of-hand the narrative description Taxpayer has provided because - as described in the audit report and Taxpayer's written protest - there are aspects of Taxpayer's employee/employer relationship with the five specific workers which are ambiguous or ill-defined. However Taxpayer did not provide - and is apparently unable to do so - tangible evidence, such as written job descriptions or written agreements, which help Taxpayer meet its burden of conclusively establishing that the audit's decision was "incorrect" as required under Indiana law. IC § 6-8.1-5-1(c).

In addition, the Department does not agree that Taxpayer can rely on the "safe harbor" provision provided for under Section 530 of the Revenue Act of 1996, Pub.L. No. 104-188. While the Department agrees that Section 530 is designed to provide relief for employers who have misclassified one or more employees as independent contractors and, accordingly, have failed to pay federal employment taxes for such employees, the Department does not agree that Section 530 is either relevant to or binding on the Department because there is no indication Section 530 has been incorporated into Indiana law. In addition, an IRS decision granting relief under Section 530 does not necessarily bear on a state's decision to grant or deny similar relief.

FINDING

Taxpayer's protest is respectfully denied.

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