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3 of 18 DOCUMENTS

NAME: IN RE: * * *

NUMBER: HEARING NO. 41,098

COURT: COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS

CITE: 2003 *Tex. Tax LEXIS 99*

DATE: June 18, 2003

PANEL: [*1]

TIMOTHY MASHBURN, Administrative Law Judge

COUNSEL: ELIAS V. LORENZANA, JR., Representing Administrative Hearings Section

* * *, Representing Petitioner

OPINIONBY: MASHBURN

TAXPAYER NO.: * * *

AUDIT OFFICE: * * *

AUDIT PERIOD: 02/01/96 THROUGH 01/31/00

LIMITED SALES, EXCISE AND USE TAX/RDT

COMPTROLLER'S DECISION

PRELIMINARY COMMENTS:

This case was the subject of oral hearing on the merits on December 9, 2002. * * * and * * * appeared on behalf of Petitioner and presented the testimony of * * *. Elias V. Lorenzana, Jr., appeared on behalf of the Administrative Hearings Section (AHS) and presented the testimony of Hermie Eugenio, the Comptroller's auditor conducting the audit under review.

The Administrative Law Judge (ALJ) took official notice of all records of the Comptroller's office that pertain to the Petitioner and the issues involved in the case. Unless otherwise indicated, all Section references are to TEX. TAX CODE ANN. (Vernon 2002) and all references to Rules are to Title 34, Texas Administrative Code (2002).

AUDIT AMENDMENT AGREEMENTS:

Deletion of REC ID 2683-663, 2683-2963 and 2683-2967, and adjustment of the taxable amount of REC ID 2683-2964, in Exam 3 were agreed [*2] to by the AHS in its Position Letter. Further, in its Amended Response to Petitioner's Post-Hearing Documentation Submission filed February 28, 2003, the AHS agreed to additional credits relating to REC ID 2683-1516 in Exam 3. Such agreed deletions, adjustments and credits are supported by the evidence and are therefore appropriate and recommended for adoption.

In addition, based on documentation Petitioner was permitted by the ALJ to submit subsequent to the oral hearing, the AHS has agreed that the Texas modification factor that ultimately is the basis for the estimated liability resulting from the equipment rental transactions scheduled in Exam 2 should be adjusted to 5.41%. Such adjustment is supported by the Auditor's Revised Exam Schedule 2A attached to the Supplemental Response of the AHS filed March 7, 2003, and is appropriate and recommended for adoption.

By Reply dated March 7, 2003, Petitioner has indicated that the adjustment to the Texas modification factor satisfies Petitioner's contention concerning Exam 2 and thus no need exists to dispose of the same by this decision.

PETITIONER'S CONTENTIONS:

1. Petitioner contends that REC ID 2683-1516 of Exam 3 erroneously [*3] schedules employee wages and erroneously includes materials purchased by Petitioner on which tax was previously paid.
2. Petitioner contends that credits granted on January 9, 2002, for the involved audit period should be applied against deficiency amounts for the same periods to reduce interest assessed.

FINDINGS OF FACT:

The AHS filed Proposed Findings of Fact in this matter on February 7, 2003. The following findings constitute the ALJ's ruling thereon.

1. Petitioner is an industrial contractor providing labor and services principally to mining concerns, utilities and manufacturers with job locations in Texas, New Mexico and Arizona.
2. The services provided by Petitioner include construction, maintenance and repair of equipment and facilities, and general contracting for capital projects. Petitioner also provides staff to supplement its customers' labor forces for operating purposes when requested.
3. Petitioner was audited for Texas sales and use tax compliance for the period February 1, 1996, through January 31, 2000, as a result of which a Texas Notification of Audit Results dated February 26, 2001, was issued, reflecting a tax deficiency and an assessment of interest. [*4] Penalty was waived. In response to the Notification, Petitioner timely sought redetermination, resulting in this proceeding.
4. During the audit period, Petitioner made tax-free sales of taxable items to the extent and in the amounts reflected by Exam 1 of the Audit Report under review, which Petitioner does not challenge.
5. During the audit period, Petitioner purchased the taxable expense items reflected by Exam 4 of the Audit Report under review tax-free for the amounts shown therein, which Petitioner does not challenge.
6. During the audit period, Petitioner leased equipment from its affiliate, * * *, delivery of which was taken in Texas and which was subsequently used in Texas. Because documentation reflecting delivery and possession of the equipment was not available at the time of the audit, by agreement a "Texas modification factor" was determined based on rentals during six sample months (September 1996, August and November 1997, May and July 1998 and February 1999). The Texas modification factor was then applied to gross rentals during the audit period, resulting in Petitioner's estimated liability attributable to Texas equipment rentals. Estimation was required due to the [*5] absence of complete records required to be maintained by Petitioner.
7. Petitioner's documentation reflects delivery and first possession of the leased * * * equipment in Texas that results in an adjusted Texas modification factor of 5.41%.
8. Motor vehicles were deleted from the scheduled equipment lease transactions to the extent supported by documentation provided by Petitioner.
9. Petitioner does not challenge the audit methodology employed by the Comptroller's assigned auditor.
10. The equipment leased from Petitioner's affiliate was used by Petitioner to provide the services that Petitioner contracted to provide pursuant to master service agreements with Petitioner's customers.
11. No evidence was provided that Petitioner is in the business of rental or lease of equipment, or otherwise released to its customers the equipment leased from its affiliate, separate and apart from use by Petitioner in connection with provision of services for the customer pursuant to the master service agreements.
12. The equipment leased by Petitioner from * * * was pursuant to an Equipment Lease Agreement dated January 1, 1993, and in effect throughout the audit period, providing, inter alia [*6] , that Petitioner "shall employ and have absolute control, supervision, and responsibility over any operators or users of the property." The lease was an operating lease.
13. Petitioner provided the operator of the equipment leased from its affiliate and was continuously in control of its use and operation at the jobsite of its customer.

14. The charges assessed by Petitioner for the equipment leased from its affiliate were on an hourly basis separate and apart from charges for the operator, labor and other charges.

15. During the audit period, Petitioner purchased the taxable capital assets reflected by Exam 3 of the Audit Report under review for the amounts shown therein, which are unchallenged excepting only REC ID 2683-1516.

16. During the audit period, Petitioner provided labor and materials to * * * for real property (ranch) improvements to the extent reflected by REC ID 2683-1516 of Exam 3 of the Audit Report under review. Petitioner collected no sales tax on any labor provided, nor paid sales tax on materials purchased and incorporated in the job except as reflected by credits referred to above.

17. An agricultural exemption certificate was utilized by Petitioner in lieu of [*7] payment of sales tax on the materials for the ranch improvements. Petitioner did not present the exemption certificate and no evidence concerning the identity, nature and use of the materials was provided.

18. All adjustments and credits supported by documentation provided by Petitioner have been allowed with respect to REC ID 2683-1516.

19. Petitioner capitalized for Federal income tax purposes the amounts for labor and materials provided for the ranch improvements.

20. On January 9, 2002, Petitioner was granted refunds for the periods 96-06, 96-08, 96-09, 96-11 through 97-04 and 99-11 through 00-01, pursuant to a refund claim filed separately by Petitioner pursuant to instructions of the Comptroller's assigned auditor.

21. Petitioner has requested a refund hearing concerning its indicated separate refund claim, which is in the hearing process.

22. The period covered by Petitioner's refund claim is February 1, 1996, through January 31, 2001. The credits sought to be offset are within the instant audit period.

23. Petitioner requested such credits to obtain an offset for any deficiency found to exist for each involved period in order to minimize the interest to be assessed for any [*8] such deficiency.

CONCLUSIONS OF LAW AND DISCUSSION:

Petitioner's first contention should be granted in part and otherwise denied.

Petitioner's specific contention is that employee wages exempt under Section 151.057(1) n1 must be removed from REC ID 2683-1516 of Exam 3 and that tax has already been paid on materials scheduled as a part thereof. A lumpsum journal entry reflecting the labor, together with the materials, described as "Land Investment Expenses," capitalized for Federal income tax purposes, resulted in the scheduling of the disputed amounts by the Comptroller's assigned auditor as "building improvements." That is, the auditor scheduled the amounts involved as purchases by Petitioner. Particularly as concerns the labor, no assertion is made by the AHS that the labor amounts represent taxable services sold by Petitioner and the AHS would remove the labor from REC ID 2683-1516 upon "correction" of the capitalization thereof, an offer Petitioner has not chosen to accept.

n1 In pertinent part, Section 151.057 provides:

"The following services are not taxable under this chapter:

(1) a service performed by an employee for his employer in the regular course of business, within the scope of the employee's duties, and for which the employee is paid his regular wages or salary:"

[*9]

In its Reply to Position Letter dated November 29, 2001, Petitioner declared: "During the audit period, Petitioner constructed a building using Petitioners [sic] employees." On the other hand, the testimony of * * * is that the labor and materials amounts do not represent a capital asset of Petitioner but represent, notwithstanding their capitalization by Petitioner, labor and materials provided for various ranch projects, described by Witness * * * at the oral hearing as "stables, wells, improving the headquarters and all kinds of things out there." While the record is not conclusive, sufficient evidence exists from which it may reasonably be inferred that the ranch improved as a result of the

expenditures is that of * * *, a separate entity from Petitioner controlled by Petitioner's founder and long-time President, now retired from the business. n2

n2 The gist of the testimony is that Mr. * * *, the company's founder, operated and controlled the business for several decades until his retirement, at which time the business was turned over to his children to operate, while Mr. * * * pursued ranch and perhaps other interests.

It is apparent from the record that the amounts under [*10] review were accounted for by Petitioner in the fashion described to enable Petitioner to keep track of ranch expenditures (employee wages and materials) incurred on behalf of Bowen Enterprises at the specific direction of Petitioner's founder. In view of Witness Newby's testimony, the ALJ cannot conclude that REC ID 2683-1516 represents a building improvement of Petitioner as pled by Petitioner (and as concluded by the auditor). The employee labor was not expended for the employer in the regular course of business as required by Section 151.057(1) and thus is not exempt under such provision. The question remains, however, whether the materials and labor are otherwise taxable.

Petitioner admits that tangible personal property for the various ranch projects was purchased by Petitioner and incorporated into real property. The purchases are reflected by Petitioner's accounts. Payment of sales (or use) tax thereon was not established except to the extent of the credits agreed to by the AHS. All sales are presumed taxable and the Comptroller may proceed against Petitioner as the purchaser of the materials to obtain recovery of sales tax that the vendor failed to collect. *Bullock v. Foley* [*11] *Brothers Dry Goods Corporation*, 802 S. W. 2d 835 (Tex.App. -- Austin 1990, writ denied); Sections 151.054 and 151.515; Rule 3.282(m).

It is Petitioner's burden to establish any exemption for the materials purchased by clear and convincing evidence or that tax was paid thereon by a preponderance of the evidence. Rule 1.40(2)(A) and (B), respectively. Petitioner presented no evidence to establish any agricultural exemption under Section 3.316 and Rule 3.296, or any other exemption, that would allow tax-free purchases of the materials. No documentation has been provided to support adjustments beyond those agreed to by the AHS. Thus, Petitioner has failed to meet its burden of proof to establish that additional credits are due as concerns the materials component of REC ID 2683-1516.

In contrast to the materials, the labor amounts are troublesome because they necessarily represent services provided by Petitioner. Whereas the burden of proof with respect to tangible personal property is on the taxpayer, the burden of proof with respect to services clearly rests on the AHS to establish a prima facie case that a sale of a service that falls within those enumerated as taxable under Section [*12] 151.0101 has occurred. n3 As noted, the AHS makes no contention that the labor amounts represent the sale of taxable services by Petitioner. Thus, it has not sought to establish any component of a taxable services proof burden and has in fact conceded that the mere correction of Petitioner's treatment of the labor as a capital expenditure would result in an agreed audit amendment deleting the labor component of the lump sum journal entry. The record evidence conclusively establishes that the labor does not represent a building improvement, land investment or other capital expenditure of Petitioner as would appear from the journal entry. Correction of the entry, including for Federal income tax purposes, would certainly appear to be the proper course of action from an accounting standpoint, but the taxability of the labor does not hinge on the correction insisted on by the AHS. n4 Deletion of the labor component of REC ID 2683-1516 is required for the foregoing reasons.

n3 See e. g., Comptroller's Decisions 38,229 (2002) and 30,461 (1994).

n4 It should be noted that the holding that correction of the accounting entry is not a requirement for audit deletion is not intended to mean that the Audit Division in any way erred in scheduling the involved journal entry upon audit. That procedure, requiring taxpayers to explain such entries ultimately if necessary in the hearing process, is proper and endorsed. The short of the matter is that the hearing process here has provided an explanation, not contradicted by the AHS, and no alternative contention is made that the amounts are otherwise taxable. [*13]

Petitioner's second contention should be granted.

The instant audit was finalized and submitted for review on January 29, 2001. The Audit Report was issued on February 26, 2001. A 60-day notification was transmitted to Petitioner on April 5, 2001. Thereafter, refund items for periods clearly within the audit period were made known to the Comptroller's assigned auditor, who advised Petitioner on June 7, 2001, to file a separate refund claim for such refund items. Petitioner did so for the period February 1, 1996,

through January 31, 2001, and now seeks to have the refund items that were approved applied to the periods under audit. n5 The refund items are not those of any related entity, nor did the refund rights result from assignment.

n5 Petitioner's refund claim was denied in part and therefore Petitioner requested a refund hearing, which has been assigned Hearing No. 41,911.

The AHS objects to the offset because (i) the refund period is not identical to the instant audit period and "issues in different audit/refund periods should not be confused or convoluted"; (ii) the refund is the subject of a separate refund hearing not yet finally adjudicated; and (iii) no statutory provision [*14] authorizing interest on overpayments or credits was in effect during the period involved. n6

n6 Interest on credit items ceased on December 4, 1986, but was reenacted by the Legislature effective January 1, 2000. See Rule 3.325(c)(2); Comptroller's Decision 39,537 (2001). All of the periods involved with the approved refund items at issue here fell between December 4, 1986 and January 1, 2000, except for the period January 2000.

The refund items that Petitioner seeks to have applied have already been Comptroller-approved. They do not await the outcome of the refund hearing. Nor does it make any difference that the overall period embraced by Petitioner's refund claim is one year longer than the instant audit period. The approved refund items are directly within the instant period. Finally, credit interest is not the issue here. Certainly, the AHS is correct that no credit interest may be allowed for refunds applicable to periods between December 4, 1986, and January 1, 2000. However, what is at issue here is offset of credit items, essentially tax overpayments, for audit periods under review. Petitioner is not, of course, entitled to offsets of such credits against its tax liability [*15] and to payment of the refund amounts. However, the approved refund items for the periods reflected by Finding of Fact No. 20 should be applied against any deficiency amounts for those same periods for interest purposes.

RECOMMENDATION:

Based upon the findings of fact, conclusions of law and discussion set forth herein, the ALJ recommends that the agreed audit amendments identified hereinabove be adopted; that Petitioner's first contention be granted only to the extent of deletion of the labor amounts scheduled as a part of REC ID 2683-1516 of Exam 3; and that the deficiency be otherwise upheld in its entirety subject to offset for interest purposes of refund items approved by the Comptroller on January 9, 2002, for the periods shown by Finding of Fact 20 against deficiency amounts resulting from this audit for those same periods.

Signed June 18, 2003.

ORDER OF THE COMPTROLLER

The above decision of the Administrative Law Judge, resulting in Taxpayer's liability as set out in Attachment "A" which is incorporated by reference, is approved and adopted in all respects. This decision becomes final twenty-three (23) days from the date of this Order, and the total sum of [*16] the tax and interest amounts is due and payable within twenty (20) days thereafter. If such sum is not paid within such time, an additional penalty of ten percent of the taxes due will accrue, and interest will continue to accrue.

If a rehearing is desired, a Motion for Rehearing must be filed with the Administrative Law Judge no later than twenty-three (23) days after the date of this Order, and must state the grounds upon which the motion is based.

RENDERED and ISSUED June 18, 2003.

CAROLE KEETON STRAYHORN, Comptroller of Public Accounts of the State of Texas

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