

MICHAEL T. EGAN, Employee, v. SHANNON'S PLUMBING & HEATING and CNA COM. INS., Employer-Insurer/Appellants.

WORKERS' COMPENSATION COURT OF APPEALS
SEPTEMBER 14, 2001

No. [REDACTED SSN]

HEADNOTES

TEMPORARY PARTIAL DISABILITY - SELF-EMPLOYMENT. A self-employed person's earning capacity is equivalent to what the owner of the business would have to pay another, in an arm's-length negotiation, to perform the work performed by the employee in self-employment. This wage is subject to the enterprise's ability to pay. In determining net income available to pay the wage, all sources of revenue are included and all expenses, including depreciation, are allowed.

Affirmed in part, reversed in part and remanded.

Determined by Wheeler, C.J., Rykken, J., and Johnson, J
Compensation Judge: Gregory A. Bonovetz

OPINION

STEVEN D. WHEELER, Judge

The employer and insurer appeal from the compensation judge's determination of the employee's earning capacity during calendar year 1999. We affirm in part, reverse in part and remand.

BACKGROUND

The employee, Michael T. Egan, sustained an admitted low back injury while working for Shannon's Plumbing and Heating, the employer, as a pipefitter on July 28, 1992. At the time of the injury the employee was 38 years of age and had a weekly wage of \$779.60. The employer and its insurer, CNA Commercial Insurance, initially denied liability because the employee had not reported the injury until sometime after he had been laid off from work. On September 29, 1992, the employee filed a claim petition, seeking payment of temporary total disability from July 28, 1992.

In the fall of 1992, the employee, who had a four-year bachelor of science degree in business from St. Cloud State University, decided to open a sporting goods store in Hibbing, Minnesota, with a friend, Keith Balinger. The business was incorporated with the employee and Mr. Balinger as equal shareholders. Mr. Balinger apparently continued in his regular occupation as a pipefitter and the employee was the principal operator of the business. (T. 37.)

In 1993, the parties reached a settlement of the employee's claims through September 30, 1993, with a lump sum payment of \$14,910.00, subject to withholding for attorney fees. The stipulation, signed in November 1993, provided as follows with respect to the employee's future entitlement to temporary partial disability benefits:

That the parties agree that the Employee has a minimum earning capacity of \$400.00 per week, and that therefore, after September 30, 1993 future temporary partial disability benefits shall be calculated based on either his actual average weekly earnings as based on his tax records, or \$400.00 per week, whichever is more. The Employee agrees to provide his tax returns, initially on an annual basis, and if he begins preparing tax returns on a quarterly basis, then he will provide those records to the Employer and Insurer. These records will be used to calculate Employee's average weekly earnings and temporary partial disability benefits should be paid based on those records. Since no updated records are presently available, Employee's temporary partial disability benefits will be paid initially based on a \$400.00 per week earnings and shall be recalculated when tax records are received for the 1993 calendar year. Once the tax records are received, the Employee's temporary partial disability benefits for 1993 should be recalculated and adjusted with the overpayment/underpayment paid or withheld pursuant to statute.

(Stipulation for Settlement, p. 5.) The stipulation further provided that the employer and insurer admitted that the employee suffered a personal injury to his low back on July 28, 1992, and agreed to continue to pay medical expenses in the future. No other rights or benefits were settled by the stipulation.

The employee testified his duties at the sporting goods business included retail sales and calling on schools to sell uniforms on a wholesale basis. In 1994 the employee and Mr. Balinger formed a corporation, B & E Properties, Inc., of which they were equal shareholders, which purchased a building in which the sporting goods store would be located. Following the purchase, the sporting goods store business paid rent for its space to B & E Properties, Inc. In addition to his responsibility to manage the sporting goods store, the employee was also required to manage the rental of living units located above the store. The employee estimated that he spent approximately one hour per week engaged in managing the B & E property. (T. 37-39.) The employee testified that initially he worked in the store 50 to 60 hours per week but later reduced his hours to 40 to 45 hours per week. (T. 40.) In 1996, the employee bought Mr. Balinger's interests in the retail sporting goods operation and he became the sole shareholder of the sporting goods corporation. The employee testified that from 1992 through calendar year 1998, while he was engaged full time in the sporting goods business, his earnings never exceeded \$400.00 per week and he was paid temporary partial disability benefits by the insurer based on an earning capacity of \$400.00 per week, pursuant to the 1993 stipulation for settlement.

On November 19, 1999, the insurer filed a notice of intention to discontinue benefits to the employee because the employee had failed to provide tax information for calendar years 1997 and 1998. The notice of benefit payments portion of the NOID indicated that from October 1, 1993 through November 18, 1999, the insurer had paid 320 weeks of temporary partial disability benefits to the employee in the amount of \$81,324.70. The matter of the discontinuance of benefits came before a settlement judge who determined that the employee was attempting to provide the tax returns and that discontinuance of benefits was not the appropriate remedy for his failure to provide them to that point. Apparently the employee ultimately provided his tax returns for 1997 and 1998.

The employee testified that in early 1999, B & E Properties sold the property in which the retail sporting goods store had been operating. As a result of that sale, the employee received \$8,179.00 as his equal share of the gain on the sale of the property. The retail sporting goods store continued to operate from the same premises, apparently paying rent to the new owner. The employee further testified that during the first three months of 1999, in addition to his wages and profits from the retail sales operation, he performed officiating duties at local high school sports competitions for which he was paid approximately \$690.00. In the spring of 1999, a corporation, Wannabee's Inc., was formed by the employee and wife, as equal shareholders. The corporation acquired a building in which was located a bar and some rental units above the bar. The building and bar fixtures were acquired on the basis of a contract for deed. The employee testified that his profit from the sale of B & E Properties and funds provided by his wife were used to acquire the purchase. The bar business started, under the business name of Wannabee's, on May 1, 1999, and operated through the end of 1999. The employee's retail sporting goods store continued to operate through 1999 but ceased business at the end of the year. The employee testified that during 1999 he was a full time employee of the retail sporting goods store and only worked part-time at Wannabee's.

The employee provided several tax returns to the employer and insurer for 1999, including his joint tax return with his wife and the returns for the retail sports and bar businesses. The tax return for B & E Properties was not offered into evidence and it is not known if it was provided to the employer and insurer. On September 12, 2000, the employer and insurer filed a notice of intention to discontinue temporary partial disability benefits, contending that the 1999 tax returns showed that the employee had received earnings in 1999 which exceeded his pre-injury wage of \$779.60.

The matter came on for an administrative conference before a settlement judge who determined that the employee's post-injury earning capacity during 1999 was \$533.29 per week. The employee objected to this finding and the matter was referred to a compensation judge at the Office of Administrative Hearings. Following a hearing, the compensation judge issued a decision in which he determined that for the first four months of 1999 the employee's earning capacity was \$396.33 per week, which represented the average of the total wages and profits received from the operation of the sporting goods store during 1999. The judge determined that the \$690.00 of income received for officiating at high school games need not be counted toward the employee's earning capacity because it had not been reported on the employee's tax returns. With respect to the period following May 1, 1999, however, the compensation judge determined that only a small

portion of the profits of the bar business, \$75.00 per week, were attributable to the employee and his earning capacity was \$471.33. He ordered that the employee's temporary partial disability benefits for that period be adjusted based on these findings. The employer and insurer appeal.

STANDARD OF REVIEW

In reviewing cases on appeal, the Workers' Compensation Court of Appeals must determine whether "the findings of fact and order [are] clearly erroneous and unsupported by substantial evidence in view of the entire record as submitted." Minn. Stat. § 176.421, subd. 1 (1992). Substantial evidence supports the findings if, in the context of the entire record, "they are supported by evidence that a reasonable mind might accept as adequate." Hengemuhle v. Long Prairie Jaycees, 358 N.W.2d 54, 59, 37 W.C.D. 235, 239 (Minn. 1984). Where evidence conflicts or more than one inference may reasonably be drawn from the evidence, the findings are to be affirmed. Id. at 60, 37 W.C.D. at 240. Similarly, "[f]actfindings are clearly erroneous only if the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed." Northern States Power Co. v. Lyon Food Prods., Inc., 304 Minn. 196, 201, 229 N.W.2d 521, 524 (1975). Findings of fact should not be disturbed, even though the reviewing court might disagree with them, "unless they are clearly erroneous in the sense that they are manifestly contrary to the weight of the evidence or not reasonably supported by the evidence as a whole." Id.

DECISION

On appeal, the employer and insurer argue that the compensation judge has erred in not including in the employee's earning capacity for 1999 the following earnings: (1) \$690.00 for officiating at various athletic competitions; (2) a portion of the gain from the sale of the building owned by B & E Properties; and (3) half of the profits earned by Wannabee's as reflected in the corporation's tax return, plus half of any depreciation deducted by the corporation.

Fees for Officiating

The compensation judge made the following finding with respect to the fees obtained by the employee for officiating:

Although at the hearing of January 24, 2001 the employee specifically agreed and testified to the fact that in the first three months of 1999 he had earned a total of \$690.00 officiating at various athletic competitions, as testified to this \$690.00 is not included within the tax return for calendar year 1999. As such, based on the parties['] specific agreement under the terms of the earlier Stipulation for Settlement, the Court cannot and does not take into account that \$690.00 earning for the 12 week period.

(Finding 3.)

We reverse the compensation judge's determination. Although the stipulation for settlement does indicate that the employee's earning capacity during each calendar year would be based on his tax records, the stipulation must be interpreted to presume that the employee's tax records, upon which the parties were to rely, would be accurate. The court would not enforce a settlement which would condone intentional or negligent violation of the tax laws. The employee cannot profit by the filing of a false or erroneous tax return or by keeping false or erroneous records. As the \$690.00 should have been included in the employee's tax records and returns, the compensation judge should have included these payments in his calculation of the employee's earning capacity. The employee's earning capacity for the first three months of 1999 should be revised to reflect these earnings. On remand, the compensation judge shall include these payments when recalculating the employee's earning capacity for the first three months of 1999.

Capital Gain, Bar Income and Depreciation

The employer and insurer argue that some portion of the capital gain on the sale of the building owned by B & E Properties should be included in the employee's 1999 earning capacity. They contend that the employee's efforts added value to the property during the five years that the property was owned by B & E Properties. The employer and insurer suggest that the employee's contribution to the increase in value be determined by dividing the employee's gain, \$8,179.00, by the number of weeks that the property was owned, two hundred sixty (260), and then allocating that sum, \$31.46, to each of the weeks that the property was owned during 1999.

With respect to the income from Wannabee's, Inc., which operated the bar and rented living quarters, the employer and insurer contend that the corporation had a net profit of \$16,929.00 for the eight months of operation. It argues that, since the employee was a fifty percent shareholder of the corporation, one-half of the profits, \$8,465.00, should be allocated to the employee, representing an additional weekly earning capacity of \$244.16. In addition, it claims that the depreciation expense claimed by Wannabee's of \$8,411.00 does not represent a real cash expense and as a result, for workers' compensation purposes, the corporation's income should be increased by that amount. It contends that the employee's share of that increase is \$4,205.00 or \$121.31 per week during the eight-month period Wannabee's was in operation. As a result of each of these adjustments, the employer and insurer contend that the employee's weekly wage during the last eight months of 1999 exceeded his stipulated weekly wage at the time of his injury.¹

¹ The compensation judge determined that the employee's weekly wage during the last eight months of 1999 was \$471.33, based on an earning capacity of \$396.33 from the operation of the sporting goods store, an imputed wage of \$60.00 per week from the employee's work at Wannabee's Bar for 12 hours per week at \$5.00 per hour and \$15.00 per week from the payment of \$1,050.00 to the officers of the Wannabee's corporation. The compensation judge's findings with respect to the sporting goods store, the part-time bartending and the officer's earnings were not appealed. When the allocations for the capital gain (\$31.46), the bar and rental profits (\$244.16) and depreciation (\$121.31) are added to the compensation judge's determination, the total weekly earnings advocated by the employer and insurer is \$868.26. We note that this calculation fails to take into account the fact that if the employee had actually been paid \$60.00

In his decision, the compensation judge rejected the employer and insurer's arguments. He determined that the employee's share of the proceeds from the sale of B & E Properties was a capital gain and was therefore not related to his labor. He found that the profit of \$16,929.00 by Wannabee's should not be attributed to the employee because the company had shown the profit only because it received \$25,100.00 of revenue which had been earned by the corporation as a result of renting space in the building, which was a return on investment and not the result of the employee's efforts.² The compensation judge did not specifically rule on the employer and insurer's position with respect to depreciation, but we assume, based on his determination of the employee's earning capacity, that he rejected their argument.

We reverse the compensation judge's method of determining the employee's post injury earning capacity. We believe that the principles set forth in the supreme court's decision in Backaus v. Murphy Motor Freight, 442 N.W.2d 326, 42 W.C.D. 24 (Minn. 1989), are controlling in this case. In Backaus the employee was the owner and driver of a truck which was leased to Murphy Motor Freight with contracts with shippers to haul freight. The total payment received by the owner of the truck for the operation of the truck (lease of truck with a driver) was a percentage of the payments paid to the trucking company by the shipper. The employee, who was attempting to establish his pre-injury weekly wage, argued that almost all of this payment should be used to establish his weekly wage at the time he was injured while working as a truck driver for Murphy Motor Freight. The employer and insurer contended that a large portion of the payment represented a return on the employee/owner's capital investment in the truck.

In agreeing with the employer and insurer, the supreme court set forth several principles for establishing an employee's pre-injury weekly wage in a self-employment setting. These principles can also be applied to the determination of an employee's post-injury earning capacity. The court stated that "wages are compensation for labor and services and reflect the worker's ability to earn. Wages include neither the income from capital equipment nor the increment in the value of a business interest arising out of the worker's contributions of capital." In Backaus, the court discussed how to separate the value of the employee's services as a truck driver from the return on his capital investment in the truck. The court determined that the employee's weekly wage was to be based on the amount that the owner of a truck would have had to pay if he had hired another person to drive his truck. The court stated that the employee's services as a truck driver were limited to the wage rate established by the collective bargaining agreement between the Teamsters union and the trucking company. The court emphasized that the contract wage rate was the appropriate valuation of the employee's services because it had been arrived at by an arm's-length negotiation.

per week by the bar that the wage expense for the company would have increased and the profit would have been reduced by an equivalent amount.

² In addition to revenue from sales of liquor and food, the Wannabee's corporation received revenue from the rental of living quarters above the bar (\$6,750.00), from the rental of space to the VFW to use for the sale of pull tabs to bar patrons (\$6,400.00) and from a percentage of sales from use of video games, dart games and pool tables owned and maintained by a third party on the bar premises (\$11,950.00).

This same principle can be applied to a small business self-employment situation, as exists in this case. In a self-employment situation, a compensation judge should determine what it would cost the owner of the business in question, in an arm's-length negotiation, to hire someone to do the work performed by the employee. That amount would constitute the employee's earnings in the self-employment. This general principle presumes, as was the case with the employee's retail sporting goods store, that the business had sufficient net income to pay the determined wage to the employee.³ As a result, after the wage has been determined the compensation judge must take the second step of considering whether the business had sufficient net income to pay the wage. If it did, then that wage would constitute the employee's earning capacity for determining his entitlement to temporary partial disability. If the enterprise's earnings were insufficient to pay the determined wage the employee's wage will equal the enterprise's earnings. In making the second step determination the compensation judge should include revenues from all sources, including rental and interest income to the company and allow deduction for all lawful business expenses permitted by the tax laws. The general rule should be that depreciation permitted by the federal tax laws on personal or business tax returns involving the self-employment should be allowed as a business expense for determining if funds are available to pay the employee's wage. Hamilton v. GMW Trucking, 42 W.C.D. 257 (W.C.C.A. 1989); Gillespie v. Wesli/Johnson Screens, slip op. (W.C.C.A. June 13, 1996).

Under the circumstances of this case, we remand the matter to the compensation judge for a review of the employee's activities to determine what the owner of a business like B & E would have had to pay in total compensation, after an arm's-length negotiation, for the performance of all of the services provided to that corporation by the employee during 1999.^{4, 5}

³ We note that this method apparently was used by the parties in 1993 when they stipulated that the employee would be deemed to have a post injury earning capacity of at least \$400.00 per week. The employee testified that his QRC determined that \$400.00 per week would be the minimum a retail store manager could expect to receive. (T. 41.)

⁴ By requiring an arm's-length negotiation, the supreme court in Backaus obviously hoped to eliminate the problem caused by attempts by the parties to a dispute to allocate or shift funds between wages and expenses and return on investment depending on whether the employee was trying to establish a high pre-injury wage or the employer was trying to show a high post-injury earning capacity. See Wallak v. Ace Plumbing & Heating, 42 W.C.D. 772 (W.C.C.A. 1990).

⁵ We do not ignore the language in the stipulation concerning the importance of the employee's tax records in determining his post-injury earning capacity. We interpret the stipulation as intending that the employee's earning capacity be determined in accordance with the intent of the workers' compensation act and decisions of the supreme court interpreting the act. It was not the intent of the parties to adopt a standard inconsistent with the law. As a result, we interpret the stipulation to simply place an emphasis on the importance of having the employee produce his tax records to assist in the earning capacity determination. Tax records include all tax forms and business records used to complete the tax forms.

We note that the compensation judge has already determined that the employee should be considered to have a \$60.00 weekly wage for his work as a bartender at Wannabee's. This finding was not appealed. This finding was based on the employee's testimony that the only work he did at Wannabee's was to take inventory, fill in as a bartender and "just oversee what was going on." He testified that the bar operation was his wife's business and he operated the sports store. He stated that she made all the bar business decisions, ordered inventory, made all personnel decisions, kept the books and records, worked with the tax consultant on the tax returns and ran the day-to-day operation. (T. 51-58, 70, 78.) The compensation judge accepted this testimony as credible since he determined that the employee's work at Wannabee's was only worth \$60.00 per week based on \$5.00 per hour for twelve hours work per week. The compensation judge selected a wage rate of \$5.00 per hour, one obviously based on arm's-length negotiation with other part-time employees who were paid the same rate. (Findings 8, 9, 10, 14.) We find the compensation judge's unappealed decision satisfies the standard established in Backaus and there is no need for the issue of the employee's earnings from the bar to be revisited on remand. On remand the compensation judge need not consider whether Wannabee's had sufficient funds to pay the \$75.00 per week the compensation judge has attributed to the employee. Based on the tax returns submitted, the business had sufficient funds to pay this wage. As indicated above, in making this determination, we reject the employee's theory that the bar business need not include the income derived from the rental of living quarters and space to the VFW or concession fees paid by the video game owners. All of this income should be considered a part of the bar business. We reject the employer and insurer's argument that the depreciation should not be allowed as a business expense.