

**BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO**

IN THE MATTER OF THE PROTEST OF
DON R. HETTER,
PROTEST TO ASSESSMENT NOS. 398465 AND 398466

NO. 01-24

DECISION AND ORDER

This matter came on for formal hearing on January 13, 2000 before Gerald B. Richardson, Hearing Officer. Don Hetter, hereinafter, "Taxpayer", represented himself at the hearing. The Taxation and Revenue Department, hereinafter, "Department", was represented by Mónica M. Ontiveros, Special Assistant Attorney General. At the close of the hearing, the record was left open for an additional 30 days, or until February 14, 2000, for the Taxpayer to submit additional documentation in support of his case and some additional information was submitted. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer was the owner of a construction company, Storm Construction Company, which was audited by the Department in 1995, resulting in the issuance of assessments for underreporting of gross receipts taxes.
2. The Taxpayer protested those assessments and those protests were resolved after a formal hearing and the issuance of Decision and Order No. 99-12.
3. In 1999, the Department audited the Taxpayer for personal income taxes, using information about the Taxpayer's gross receipts from his construction business obtained during the 1995 audit.

4. The 1995 audit was based upon the bank records of the Taxpayer for his business and personal accounts.

5. As a result of the Department's audits, on June 2, 1999, the Department issued Assessment No. 398465, assessing \$568 in personal income tax, \$56.80 in penalty and \$184.60 in interest for the 1996 tax year and Assessment No. 398466, assessing \$5,148.60 in personal income tax, \$514.86 in penalty and \$2,445.58 in interest for the 1995 tax year.

6. On June 26, 1999, the Taxpayer filed written protests to Assessment Nos. 398465 and 398466.

7. As a result of information provided the Department by the Taxpayer at the formal hearing and afterwards, the Department has abated Assessment No. 398465, eliminating the liability for personal income tax, penalty and interest for the 1996 tax year.

8. The 1995 personal income tax assessment was based upon the Department's determination that the Taxpayer had underreported \$84,412.62 in gross receipts as reflected in bank deposits made into the Taxpayer's construction business account during that year, thus affecting the amount of income the Taxpayer reported on Schedule C of his federal income tax return and the Taxpayer's federal adjusted gross income, upon which the Taxpayer's New Mexico income taxes are based.

9. On November 7, 1995 the Taxpayer deposited \$42,273.97 in his bank account. This amount represents the Taxpayer's net proceeds from the sale of property in a subdivision on Miller Road, on which the Taxpayer had moved and affixed a mobile home. The Taxpayer did not provide a breakdown of the amount as to what portion of the amount represented the recovery of the cost of the real property and what portion of the amount represented the value of the improvements and the mobile home that the Taxpayer had affixed to the property. The

Taxpayer, however, established that he had reported the income made from the sale of the property on Schedule D of his 1995 federal personal income tax return, reporting \$5,843.26 as long-term capital gain income. The capital gain income was reported on line 13 of the Taxpayer's 1995 form 1040 and was taken into consideration in determining the Taxpayer's federal adjusted gross income for 1995.

10. On March 6, 1995 and July 11, 1995, the Taxpayer deposited payments received from Debra Gray in the amounts of \$1,250 and \$500, respectively. These were payments made under a real estate contract for real property the Taxpayer sold to Ms. Gray.

11. On March 20, 1995, the Taxpayer deposited \$10,212.89 into his account. This amount was directly deposited in the Taxpayer's account as loan proceeds. The Taxpayer had borrowed \$18,000 from Western Bank. The \$10,212.89 represented the proceeds from that loan after \$7,500 in principal and \$287.11 in interest was applied from the loan to pay off an earlier loan the Taxpayer had received from Western Bank.

12. On October 25, 1995, the Taxpayer deposited \$7,500 into his account. The Taxpayer provided testimony and corroborating loan documents establishing that this amount represented loan proceeds from a loan from Western Bank.

13. On February 27, 1995 and July 5, 1995 the Taxpayer deposited \$50 and \$100, respectively, into his account. These amounts represented refunds from Molzen & Corbin, an architectural and engineering firm, of deposits which had been made to borrow copies of plans of projects upon which the Taxpayer desired to make bids.

14. On October 4, 1995 the Taxpayer deposited \$18,410.32 into his account from the Village of Columbus, New Mexico. This amount represented a draw from a construction project the Taxpayer was performing for the Village of Columbus.

15. On August 29, 1995, the Taxpayer deposited \$2,000 into his account. This amount represents a voice transfer of monies from the Taxpayer's payroll account to his general business account.

16. On October 24, 1995, the Taxpayer deposited \$3,700 into his account.

DISCUSSION

The issues in this protest essentially came down to whether the Taxpayer met his burden of proof with respect to the items the Department considered to be gross receipts of the Taxpayer's business for purposes of calculating the Taxpayer's income from his business which would be included in the Taxpayer's personal income for tax year 1995. Section 7-1-17(C) NMSA 1978 provides that there is a presumption of correctness which attaches to an assessment of tax issued by the Department. This means that the burden is on a taxpayer contesting the assessment to present evidence or arguments to overcome the presumption of correctness. *Archuleta v. O'Cheskey*, 84 N.M. 428, 504 P.2d 638 (Ct. App. 1972).

The Department's auditor used the Taxpayer's bank deposits in order to try to reconstruct the Taxpayer's gross receipts from his construction business, because the Taxpayer did not have books of account which could be audited. The bank deposits were then compared to the gross receipts from a business or profession as reported on the Taxpayer's Schedule C of his Federal personal income tax return. The discrepancy was treated as unreported gross receipts and the Taxpayer's federal adjusted gross income was recalculated and used as a basis to determine the amount of personal income tax which the Department assessed for tax years 1995 and 1996.

The individual transactions which were treated as gross receipts will now be discussed. The largest item in dispute is \$42,273.97, which the Taxpayer testified represented his proceeds from the sale of property upon which the Taxpayer had moved and affixed a mobile home.

Section 7-9-53 NMSA 1978 provides a deduction from gross receipts for receipts from the sale or lease of real property. The statute provides an exception from the deduction, however, for the portion of the receipts from the sale of real property which is attributable to improvements constructed on the real property by the seller in the ordinary course of his construction business. Because the Taxpayer is in the construction business, the Department took the position that it would allow a deduction for the value of the real property involved in the transaction, but it argued that since the Taxpayer did not provide such documentation, that the full amount of the deposit must be included in the Taxpayer's gross receipts used to calculate his income from his business for personal income tax purposes.

The Taxpayer demonstrated that he had reported the income from this transaction as a long term capital gain on Schedule D of his 1995 federal personal income tax return, and that the capital gain was included in his calculation of his federal adjusted gross income for that year. This evidence points out the fundamental flaw in the Department's approach to assessing personal income tax based upon a discrepancy in the gross receipts as reported on a taxpayer's federal Schedule C and gross receipts as reported to the Department under the Gross Receipts and Compensating Tax Act. Although I can imagine many instances in which a taxpayer's "gross receipts" as reported for federal income tax purposes on a federal Schedule C would be equivalent to taxable gross receipts under the Gross Receipts and Compensating Tax Act, I can also imagine many instances in which they would not correlate. The gross receipts of a business operating in multiple states would be quite different than the gross receipts of that same business for purposes of calculating gross receipts for New Mexico tax purposes. Indeed, given the number of exemptions and deductions which are contained in the Gross Receipts and Compensating Tax Act which have been enacted by the legislature and are subject to

amendment, repeal or modification in any given legislative session, it would appear highly unlikely that the two can be always be sufficiently correlated to ensure that New Mexico personal income taxes are assessed correctly based upon federal Schedule C gross receipts. In this case, the Department assumed that because of the discrepancy in the Taxpayer's gross receipts as reported to the Department and the Taxpayer's gross receipts as reported on Schedule C, that the income had not been included in the calculation of the Taxpayer's federal adjusted gross income, which is the starting point for calculating New Mexico personal income taxes.¹ Obviously, that assumption was not correct in this case. The Taxpayer has met his burden of proving that the \$42,273.97 cannot be used to adjust the Taxpayer's income as reported on federal Schedule C or for modifying the Taxpayer's federal adjusted gross income for purposes of assessing New Mexico personal income tax.

Next, we have the two deposits, in the total amount of \$1,750 which the Taxpayer testified represented payments he had received on a real estate contract from Debra Gray. While I find the Taxpayer's testimony as to the source of these payments to be credible and the Department's audit procedure, using Schedule C gross receipts for purposes of assessing personal income tax to be conceptually flawed, nonetheless, the Taxpayer has failed to demonstrate where any of the income² he received from his real estate transaction with Ms. Gray was reported on his 1995 federal income tax return. In the absence of such evidence the amount will not be excluded for purposes of calculating the Taxpayer's personal income tax liability for 1995.

¹ Section 7-2-3 imposes income tax on the "net income" of New Mexico residents and others who derive income from property or employment in this state. "Net income" is defined as "base income" subject to certain adjustments. Section 7-2-2(N) NMSA 1978. "Base income" is defined as "adjusted gross income" as defined in Section 62 of the Internal Revenue Code, plus certain adjustments. Section 7-2-2(B) NMSA 1978.

² Arguably, that portion of the real estate contract payments which represented a return of the Taxpayer's basis in the property would not be income subject to tax. The Taxpayer failed to provide any breakdown, however, of the payments received so that the basis portion could be excluded from consideration as income.

There were two deposits which the Taxpayer testified represented loan proceeds from Western Bank. A review of the Taxpayer's checking account records, Taxpayer's exhibits 3, 4, 5, 6 and 7, reveal a number of deposits and transactions involving Western Bank, with whom the Taxpayer apparently had either a line of credit or other financing arrangements for his business. With respect to the October 25, 1995 deposit in the amount of \$7,500, the Taxpayer was able to present corroborating loan documents after the hearing and the Department agreed that the amount should be excluded from consideration for purposes of calculating the Taxpayer's 1995 personal income tax liability. Although the Taxpayer failed to provide similar corroborating loan documentation from the bank with respect to the March 20, 1995 deposit, I find that the Taxpayer sufficiently explained the entries in his checking account records with respect to that deposit to establish that the deposit represented loan proceeds as well.

The Taxpayer testified that two deposits, in the amounts of \$100, and \$50, represented a return of monies he had deposited with Molzen & Corbin, an architectural and engineering firm, when he borrowed plans needed to prepare bids on projects. I found the Taxpayer's testimony to be credible and such refunded deposits should not be considered income for purposes of calculating income taxes.

On October 4, 1995, the Taxpayer deposited \$18,410.32 into his account from the Village of Columbus, New Mexico. Although the Taxpayer testified that this amount represented a loan from the Village of Columbus, the Taxpayer failed to explain why a municipal government would be making his business a loan. The Taxpayer's testimony was further put into question by his own entries in his checking account records which reflect that that deposit, as well as two others received during October and November of 1995, were draws from "Columbus Project". This indicates that the deposit was a draw from a construction project rather than a loan. As

such, it would be treated as gross receipts under the Gross Receipts and Compensating Tax Act and presumably, would also constitute gross receipts from the Taxpayer's business for purposes of reporting business gross receipts on the Taxpayer's Schedule C. Accordingly, this amount was properly included in the calculation of the Taxpayer's business income for purposes of the assessment at issue herein.

Finally, there were two deposits which the Taxpayer testified were voice transfers of monies from the Taxpayer's payroll account to his business account. The Taxpayer's testimony was corroborated by an entry in his checking account records tendered as Exhibit 3, with respect to the August 29, 1995 deposit in the amount of \$2,000, but the Taxpayer failed to tender any checking account records to corroborate his testimony with respect to the October 24, 1995 deposit in the amount of \$3,700. Accordingly, only the \$2,000 will be excluded from the calculation of the Taxpayer's business income for purposes of the assessment at issue herein.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely written protest to Assessment Nos. 3984666 and 398465 pursuant to Section 7-1-24 NMSA 1978 and jurisdiction lies over both the parties and the subject matter of this protest.

2. The Taxpayer sufficiently established that the following deposits should not have been included in the calculation of the Taxpayer's federal adjusted gross income:

November 7, 1995	\$42,273.97
March 20, 1995	\$10,212.89
October 25, 1995	\$ 7,500.00
February 27, 1995	\$ 50.00
July 5, 1995	\$ 100.00
August 29, 1995	\$ 2,000.00

3. The Taxpayer failed to sufficiently establish that the following deposits should not have been included in the calculation of the Taxpayer's federal adjusted gross income:

March 6, 1995	\$ 1,250.00
July 11, 1995	\$ 500.00
October 4, 1995	\$18,410.32
October 24, 1995	\$ 3,700.00

For the foregoing reasons, the Taxpayer's protest IS HEREBY GRANTED IN PART
AND DENIED IN PART.

DONE, this 21st day of September, 2001.