

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

**IN THE MATTER OF THE PROTEST OF
KEVIN PIERCE
DENIAL OF CLAIM FOR REFUND
OF 2001 PERSONAL INCOME TAX**

No. 03-01

DECISION AND ORDER

A formal hearing on the above-referenced protest was held January 6, 2003, before Margaret B. Alcock, Hearing Officer. Kevin Pierce ("Taxpayer") represented himself. The Taxation and Revenue Department ("Department") was represented by Bridget Jacober, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. From 1980 until August 2000, the Taxpayer was a resident of Texas and worked for the El Paso Police Department ("EPPD").
2. In August 2000, the Taxpayer became eligible to retire from EPPD.
3. In August 2000, the Taxpayer left Texas and became a resident of New Mexico after accepting a job with San Juan College in Farmington, New Mexico.
4. The Taxpayer had a substantial amount of accrued vacation and sick leave from his employment with EPPD and used this leave to remain on the EPPD payroll between August 2000 and December 30, 2000, his official retirement date.
5. In February 2001, EPPD sent the Taxpayer a check for \$24,293.83, representing payment for the balance of the Taxpayer's accrued leave as of the date of his retirement.
6. For tax year 2001, the City of El Paso sent the Taxpayer a "Form W-2 Wage and Tax Statement" reporting the \$24,293.83 payment as "wages, tips, other compensation."

7. After receiving payment for his accrued leave from EPPD in February 2001, the Taxpayer asked the Department for a written ruling as to whether this payment was subject to New Mexico income tax.

8. On September 21, 2001, the Department issued Ruling No. 200-01-3, advising the Taxpayer that all compensation the Taxpayer received while he was a full-year resident of New Mexico, including the compensation he received from EPPD for accrued leave, was subject to New Mexico income tax.

9. The Taxpayer reported the payment from EPPD as income on his 2001 federal and New Mexico income tax returns.

10. The Taxpayer reported his 2001 income using the cash basis method of accounting.

11. On March 27, 2002, the Taxpayer filed a claim for refund with the Department, stating that he believed the Department's ruling concerning his liability for tax on the \$24,293.83 payment he received from EPPD in 2001 was in error and asking that the tax he had paid on this amount be refunded.

12. The Taxpayer did not request a refund or dispute his liability for New Mexico income tax on the pension payments he received from his EPPD retirement plan during 2001 or on the income he received from his employment with San Juan College in Farmington, New Mexico.

13. On May 18, 2002 the Department denied the Taxpayer's claim for refund.

14. On May 30, 2002, the Department's protest office received the Taxpayer's written protest to the denial of his claim for refund.

DISCUSSION

The issue presented is whether New Mexico has the right to impose personal income tax on the \$24,293.83 cash payment the Taxpayer received in February 2001 as compensation for vacation

and sick leave the Taxpayer accrued during the 20 years he worked for EPPD. The Taxpayer argues that the taxability of this payment should be determined as of the date the benefit or right to payment accrued, rather than the date the payment was received. It is the Department's position that cash basis taxpayers are liable for tax on income actually received during the taxable year, and that New Mexico has the right to tax all compensation received by full-year residents, regardless of the source of that payment or the date that the right to payment accrued.

New Mexico imposes income tax on the "net income of every resident individual...." NMSA 1978, § 7-2-3. New Mexico is among the majority of states that use the federal income tax system as the basis for calculating state income tax. *See*, NMSA 1978, § 7-2-2(A), (B) and (N). *See also, Holt v. New Mexico Department of Taxation and Revenue*, 2002-NMSC-034 ¶¶ 8, 9, 59 P.3d 491. The starting point for calculating New Mexico income tax is a taxpayer's federal adjusted gross income, which is defined in Section 62 of the Internal Revenue Code ("I.R.C.") as gross income minus certain specified deductions. I.R.C. § 61(a) defines gross income to include "all income from whatever source derived, including (but not limited to)...[c]ompensation for services, including fees, commissions, fringe benefits, and similar items...." The term "compensation" is defined in New Mexico's Income Tax Act as "wages, salaries, commissions and any other form of remuneration paid to employees for personal services." NMSA 1978, § 7-2-2(C).

In this case, the \$24,293.83 payment the Taxpayer received in February 2001 represented the cash value of leave the Taxpayer accrued during his 20 years of employment with EPPD. This payment comes within the definition of "compensation" in the I.R.C. and the New Mexico Income Tax Act and is subject to New Mexico personal income tax. The fact that the payment was attributable to work performed outside New Mexico is irrelevant. When a taxpayer has income that is taxable both within and without New Mexico, NMSA 1978, § 7-2-11 allows the taxpayer to allocate

and apportion certain categories of income between New Mexico and non-New Mexico sources. There are some categories of income, however, that must be allocated 100 percent to New Mexico, regardless of the source of the income. Subsection A(3) of § 7-2-11 specifically requires compensation of full-year residents to be allocated to New Mexico. Regulation 3.3.11.11 NMAC states that “all compensation received while a resident of New Mexico shall be allocated to this state whether or not such compensation is earned from employment in this state.”¹

The right of a state to impose tax on all income received by its residents, including income attributable to activities in other states, is one of long-standing. More than 70 years ago, the United States Supreme Court recognized the rights of the several states “to exercise the widest liberty with respect to the imposition of internal taxes” noting that “states have full power to tax their own people....” *Shaffer v. Carter*, 252 U.S. 37, 51 (1919). In *Lawrence v. State Tax Commission of Mississippi*, 286 U.S. 276 (1932), the Court confirmed that this power includes the right to tax residents on income earned outside the state, holding that Mississippi had the right to tax a Mississippi resident on income earned from services performed on a construction project in the state of Tennessee. As stated by the Court:

The obligation of one domiciled within a state to pay taxes there, arises from the unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits. Hence, domicile in itself establishes a basis for taxation.

286 U.S. at 279. *See also*, 4 U.S.C. § 114 (an individual’s state of residence is the only state allowed to tax that individual’s retirement income, even when the income is attributable to work performed in another state); Department Regulation 3.3.11.13(B) NMAC (New Mexico residents are required

¹ It should be noted that NMSA 1978, § 7-2-13 provides a tax credit to New Mexico residents required to pay tax to both New Mexico and another state on the same income. Because Texas does not impose a state income tax, this provision is not applicable in this case.

to allocate all retirement income to New Mexico, “regardless of the source of the retirement income, where it is paid from or whether the resident was a resident of New Mexico at the time of the employment which gave rise to the income....”).

The Taxpayer does not dispute New Mexico’s right to tax his retirement income from EPPD, but maintains that the payment he received for his vacation and sick leave should not be subject to tax because his right to payment accrued before he became a full-year resident of New Mexico. The Taxpayer argues that because EPPD *could* have processed his leave check more promptly, in which case he would have received the check during the 2000 tax year instead of the 2001 tax year, he is entitled to treat that payment as having been received in 2000. The Taxpayer acknowledges, however, that he did not report his accrued leave as income on his federal income tax return until the 2001 tax year, the year he received payment from EPPD. The Taxpayer reported his income using the cash basis method of accounting, which is defined as:

That system of accounting which treats as income only that which is actually received and as expense only that which is actually paid out, in contrast to accrual basis which records income when due though not received and expense when incurred though not yet paid.

Black's Law Dictionary 196 (5th ed. 1979). Once a taxpayer has chosen an accounting method, I.R.C. § 446 requires the taxpayer to obtain IRS approval before changing to another accounting method. NMSA 1978, § 7-2-21.1 requires taxpayers to “use the same accounting methods for reporting income for New Mexico income tax purposes as are used in reporting income for federal income tax purposes.” Accordingly, the \$24,293.83 payment the Taxpayer received from EPPD in February 2001 had to be recognized and reported as income on the Taxpayer’s 2001 New Mexico income tax return, and there is no legal basis for refunding the tax paid on that income.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to the Department's denial of his claim for refund of 2001 personal income tax, and jurisdiction lies over the parties and the subject matter of this protest.

2. As a full-year New Mexico resident, the Taxpayer was required to allocate all of his compensation to New Mexico when calculating his New Mexico personal income tax.

3. Because the Taxpayer filed his federal taxes on the cash basis, and included the payment he received from EPPD as income on his 2001 federal income tax return, the Taxpayer was required to include that payment as income on his 2001 New Mexico income tax return.

For the foregoing reasons, the Taxpayer's protest is DENIED.

DATED January 13, 2003.