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

IN THE MATTER OF THE PROTEST OF
KEVIN ST. JOHN **No. 13-19**
TO ASSESSMENTS ISSUED UNDER LETTER
ID NO. L0252924490

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on July 2, 2013 before Brian VanDenzen, Esq., Tax Hearing Officer, in Santa Fe. Mr. Kevin St. John ("Taxpayer") appeared *pro se*. Staff Attorney Peter Breen appeared representing the Taxation and Revenue Department of the State of New Mexico ("Department"). Protest Auditor Mary Griego appeared as a witness for the Department. Taxpayer Exhibits #1-4 and Department Exhibits A-D were admitted into the record. All exhibits are more thoroughly described in the Administrative Exhibit Log. The undersigned Hearing Officer also reviewed and printed out IRS Form 1040 (2006), IRS Form 1040, Schedule C (2006), and IRS 2006 Instructions for Schedule C (2006), which are included in the administrative record for reference. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On November 30, 2010, the Department assessed Taxpayer $497.64 in gross receipts tax principal, $99.52 in penalty, and $156.89 in interest for a total assessment of $754.05 for the reporting period ending December 31, 2006. **[Letter id. no. L0252924480]**.

2. On December 3, 2010, Taxpayer filed a written protest of the assessment.

3. On January 18, 2011, the Department acknowledged receipt of Taxpayer's protest.

4. On May 21, 2013, the Department requested a hearing in this matter.

5. On May 22, 2013, the Hearing Bureau issued Notice of Administrative Hearing, scheduling this matter for July 2, 2013.

6. In 2006, Taxpayer worked both as an employee in the film and ski industries, and as an independent contractor in the film industry. [**Taxpayer Ex. 1**; **Taxpayer Ex. 3**; **07-02-13 CD 06:00-07:32; 07-02-13 CD 23:57-24:22]**.

7. The assessment in this matter originated from the Department's Tape Match program with the IRS. Under that program, the Department detected a mismatch between Taxpayer's reported 2006 IRS Schedule C business income of $23,630.00 and Taxpayer's reported New Mexico gross receipts tax liability of $0.00. **[Department Ex. B; 07-02-13 CD 25:20-49]**.

8. The Department sent Taxpayer "Notice of Limited Scope Audit Commencement-Schedule C Gross Receipts" on January 13, 2010. This Notice informed Taxpayer of the $23,630.00 discrepancy between his Schedule C and State gross receipts tax information**.** **[Department Ex. B; 07-02-13 CD 39:20-39:58]**.

9. In response to the Notice of Limited Scope Audit, Taxpayer provided the Department three 2006 1099-MISCs, five 2006 W-2s, and two nontaxable transaction certificates ("NTTCs of NTTC"). [**07-02-13 CD 25:49-26:02].**

10. Taxpayer provided the following 2006 1099-MISCs totaling $18,206.41 to the Department:

a. Creative Services, Inc., for $3,645.63. **[Taxpayer Ex. 1.1]**.

b. Southwest Productions, Inc., for $12,960.78. **[Taxpayer Ex. 1.2]**.

c. Mills/James Productions, for $1,600.00. **[Taxpayer Ex. 1.3]**.

11. Taxpayer proved the following NTTCs to the Department:

a. Type 16 NTTC executed by Southwest Productions, Inc. on October 1, 1999. **[Taxpayer Ex. 2.1]**.

b. Type 16 NTTC executed by Creative Services, Inc. on April 1, 1997. **[Taxpayer Ex. 2.2]**.

12. In light of Taxpayer's presentation of timely executed NTTCs, the Department accepted that Taxpayer's receipts from Southwest Productions, Inc. and Creative Services, Inc. were nontaxable. Therefore, the assessed gross receipts tax did not include the $16,607 in total receipts from those two companies and only imposed gross receipts tax on the remaining $7,023.00 in business income that Taxpayer listed on his IRS Schedule C. **[Department Ex. C; 07-02-13 CD 25:40-26:37; 07-02-13 CD 39:49-40:22]**.

13. Taxpayer provided the Department five 2006 W-2s totaling $17,499.75 as follows:

a. Talent Services Int'l Corp., for $1000.00. **[Taxpayer Ex. 3.1]**.

b. Santa Fe Ski Company for $2,904.75. **[Taxpayer Ex. 3.2]**.

c. FPS Payroll Services, Inc., for $4,705.00. **[Taxpayer Ex. 3.3]**.

d. Talent Paymaster, Inc., for $7,180.00. **[Taxpayer Ex. 3.4]**.

e. PDEI, Inc., for $1,710.00. **[Taxpayer Ex. 3.5]**.

14. At the hearing, Taxpayer presented a spreadsheet of this 2006 income that included reference to a 2006 W-2 from Park Group for $600.00, though that W-2 was not provided at hearing. Adding the Park Group W-2 to the other W-2s discussed in **FOF #12**, Taxpayer had $18,099.75 in W-2 wage income in 2006. **[Taxpayer Ex. 4]**.

15. On line 7 of his 2006 IRS Form 1040 Individual Income Tax Return, Taxpayer only reported $17,500 in wages and salaries from his W-2s identified in **FOF #12** rather than reporting $18,099.75, which is the total wage income with the Park Group W-2. **[Department Ex. D].**

16. On line 12 of his 2006 IRS Form 1040 Individual Income Tax Return, Taxpayer reported $13,960 in business income from his Schedule C. **[Department Ex. D].**

17. Although Taxpayer's 2006 1099-MISCs totaled only $18,206.41, Taxpayer reported $23,630.00 in business income on his 2006 IRS Schedule C. **[Department Ex. B]**.

18. In 2006, in accord with his long standing practice and based partially on his consultations with H&R Block over the years, Taxpayer included some unspecified income from his W-2s on his IRS Schedule C in order to deduct more business expenses from his taxable income. [**07-02-13 CD 19:04-21:38].**

19. In addition to Taxpayer's $18,206.41 1099-MISC income, there is no possible combination of any specific W-2 or series of W-2s that would total the $23,630.00 amount that Taxpayer listed on his IRS 2006 Schedule C. Therefore, it is impossible to determine which W-2 or series of W-2s Taxpayer included in his Schedule C.

20. The Department encouraged Taxpayer to amend his 2006 federal 1040 income tax return to remove his W-2 income from his Schedule C. Taxpayer did not amend his 2006 federal 1040 income tax return. [**07-02-13 CD 28:04-29:55].**

21. Taxpayer did not demonstrate which of his wage income from W-2s was included in his Schedule C total of $23,630.00. Without either an amended Schedule C total corresponding with the $18,207 in 1099-MISCs that Taxpayer provided or without other proof of which W-2s were erroneously included in his original 2006 IRS Schedule C, the Department had

no factual basis to further abate gross receipts tax because it could not determine which W-2s had been included in the Schedule C. [**07-02-13 CD 28:54-29:55; 07-02-13 CD 40:39-41:06; 07-02-13 CD 46:06-47:17].**

22. As of the date of hearing, Taxpayer owed $497.64 in gross receipts tax, $99.53 in penalty, and $198.86 in interest for a total outstanding liability of $796.03. Interest continues to accrue at $0.04 per day. **[Department Ex. A; 07-02-13 CD 29:59-30:27]**.

DISCUSSION

This case originates from the Department's detection of a discrepancy between the $23,630.00 in business income Taxpayer reported on his 2006 Schedule C to the IRS and the $0.00 Taxpayer reported in 2006 New Mexico gross receipts tax. After conducting a limited scope audit, where Taxpayer was given credit for $16,607 in deductible receipts supported by timely executed NTTCs, the Department assessed Taxpayer gross receipts tax, penalty, and interest on the remaining $7,023.00 in Taxpayer's self-reported Schedule C business income. Taxpayer protested, arguing that with the exception of $1,600.00 in his Mill James Production receipts where he was not provided with a NTTC, all of his remaining 2006 income and receipts was not subject to New Mexico gross receipts tax.

Under NMSA 1978, Section 7-1-17(C) (2007), the assessment issued in this case is presumed correct. Consequently, the Taxpayer has the burden to overcome the assessment and establish that he was entitled to the claimed deduction. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428, 431. Moreover, "[w]here an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer." *Wing Pawn Shop v. Taxation and Revenue Department*, 1991-NMCA-

024, ¶16, 111 N.M. 735, 740 (internal citation omitted); *See also TPL, Inc. v. N.M. Taxation & Revenue Dep't*, 2003-NMSC-7, ¶9, 133 N.M. 447, 451. When a taxpayer rebuts the presumption of correctness, the burden shifts to the Department to show the correctness of the assessed tax. *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 2003-NMCA-21, ¶13, 133 N.M. 217, 220.

For the privilege of engaging in business, New Mexico imposes a gross receipts tax on the receipts of any person engaged in business. *See* NMSA 1978, § 7-9-4 (2002). "Engaging in business" is defined as "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." NMSA 1978, § 7-9-3.3 (2003). Under the Gross Receipts and Compensating Tax Act, there is a statutory presumption that all receipts of a person engaged in business are taxable. *See* NMSA 1978, § 7-9-5 (2002). However, under NMSA 1978, Section 7-9-17, "[e]xempted from gross receipts tax are the receipts of employees from wages…"

In 2006, the evidence established that Taxpayer worked as both an independent contractor in the film industry and as an employee in the film and ski industries. Taxpayer, as an independent contractor, was engaged in business and therefore his receipts were presumed subject to gross receipts tax under Section 7-9-5. While Taxpayer's receipts as an employee would not be subject to gross receipts tax under Section 7-9-17, the problem in this matter is factual: because Taxpayer included some of his employee wages as business income on his Schedule C filing with the IRS, and there are discrepancies between his reported Schedule C income, his IRS 1040 tax return, and the records he provided to the Department, there is no way to delineate which portion of his Schedule C income is attributable to wages.

At hearing, Taxpayer initially seemed to present compelling evidence based on his spreadsheet of 2006 income, **Taxpayer Ex. 4**, that he was entitled to further deductions. However, in accord with the Department's Mary Griego credible testimony at hearing and upon more careful

mathematical review after hearing, the numbers contained on **Taxpayer Ex. 4** remain at odds with his 2006 IRS Schedule C and his 1040 tax return. On **Taxpayer Ex. 4**, Taxpayer listed $18,206.41 in 1099-MISC income and $18,099.75 in W-2 income, for a total 2006 income of $36,397.53. Taxpayer reported $23,600 in business income on his 2006 IRS Schedule C, which is more than the 1099-MISC income total shown on **Taxpayer Ex. 4**. While Taxpayer testified that he included some of his W-2 income as business income, no combination of Taxpayer's $18,206.41 total 1099-MISC business income with any particular W-2 or series of W-2s shown on **Taxpayer Ex. 4** equals the $23,630.00 in business income reported on his Schedule C. Moreover, while Taxpayer only reported $17,500 in wage income on his 1040 tax return, at hearing Taxpayer demonstrated that he in fact had $18,099.75 in 2006 wage income. While Taxpayer genuinely believed that **Taxpayer Ex. 4** contained all of his 2006 income, given the discrepancy in the numbers and the age of the case, it is possible either that Taxpayer had some other income that year that he can no longer recall, or his self-reported IRS Schedule C business income was inaccurate. Considering the presumption of correctness and the presumption that all receipts of a person engaged in business are subject to gross receipts tax until Taxpayer clearly establishes that the receipts are exempt, neither scenario supports further exemption of taxes, especially because of the incongruence of the numbers.

Further, Taxpayer incorrectly reported some of his employee wage income from his W-2s on his 2006 IRS Schedule C. Wage income listed on Taxpayer's W-2s is employment income to be reported specifically as wages on Line 7 of IRS Form 1040, U.S. Individual Income Tax Return (2006). *See* **Department Ex. D**. Taxpayer's independent contractor income contained on his 1099-MISCs is business income that must be reported on the Schedule C, the total of which must be listed on Line 12 of IRS Form 1040, U.S. Individual Income Tax Return (2006). *See* **Department Ex. D**. In the 2006 Instructions for Schedule C, the IRS instructs taxpayers that they cannot combine self-

employment income with statutory employee income on a single Schedule C. *See* IRS Form 1040 sched. C, C3 (2006).

In conducting this audit, the Department reasonably relied on Taxpayer's self-reported 2006 IRS Schedule C business income as the starting basis for determining Taxpayer's potential gross receipts tax liability. Ultimately, Taxpayer had a duty to report his Schedule C income to the IRS properly. Because Taxpayer erroneously included W-2 wage income as business income on his Schedule C leading to the discrepancy in numbers in this matter, Taxpayer needed to amend his 2006 federal 1040 return and Schedule C. Absent amendment, the Department is entitled to rely on the information that Taxpayer self-reported to the IRS on his Schedule C, and assess gross receipts taxes accordingly. *See e.g. Holt v. N.M. Dep't of Taxation & Revenue*, 2002- NMSC-34, ¶23, 133 N.M. 11, 19 (N.M. 2002) (under a self-assessment system where taxpayers' have a duty to report, the Department may assess additional tax above the reported federal gross income amount when W-2s demonstrated that a taxpayer made reporting errors on their federal income tax return).

Absent either an amended federal return (which the Department encouraged Taxpayer to file) or some other clear evidence showing an accounting of Taxpayer's 2006 Schedule C, the Department has insufficient information to allow additional exemptions, deductions, or otherwise abate the assessment. Taxpayer has not amended his 2006 IRS Schedule C to remove his employee wages or in any other manner demonstrated what specific employee wage income from his W-2s he included in his Schedule C business income. The information Taxpayer brought to hearing was insufficient because the total W-2s wage income and the total business income are inconsistent with what he reported to the IRS in 2006 on his 1040 tax return and Schedule C. Since all receipts of a person engaged in business are presumed subject to gross receipts tax and since Taxpayer carries the burden to clearly establish he is entitled to an exemption from tax under *Wing Pawn Shop*, ¶16,740,

Taxpayer's failure to either amend his Schedule C or otherwise demonstrate which specific employee wages he included in his business income is fatal to his protest because he cannot show what amount of the reported $23,600.00 business income he derived from his employee wages. Factually, Taxpayer did not overcome the presumption of correctness that attached to the Department's assessment and did not establish he was entitled to exemption of gross receipts tax under Section 7-9-17.

Interest.

When a taxpayer fails to make timely payment of taxes due to the state, "interest *shall* be paid to the state on that amount from the first day following the day on which the tax becomes due...until it is paid." NMSA 1978, § 7-1-67 (2007) (italics for emphasis). Under the statute, the Department has no discretion in the imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24, 32 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary). The language of the statute also makes it clear that interest begins to run from the original due date of the tax and continues until the tax principal is paid in full. The Department has no discretion under Section 7-1-67 and must assess interest against Taxpayer from the time the tax was due but not paid until the tax is paid.

Penalty.

When a taxpayer fails to pay taxes due to the State because of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, NMSA 1978 Section 7-1-69 (2007) requires that

> there *shall* be added to the amount assessed a penalty in an amount equal to the greater of: (1) two percent per month or any fraction of a month

> from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed twenty percent of the tax due but not paid.

(*italics* added for emphasis).

As discussed above, the statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meets the legal definition of "negligence" even if a taxpayer's actions or inactions were unintentional.

Regulation 3.1.11.10 NMAC defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required"; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." Inadvertent error meets the legal definition of "negligence" under the penalty statute. *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶10, 108 N.M. 795, 799. Here, Taxpayer's erroneous calculation of his Schedule C business income, even if inadvertent, constitutes civil negligence under *El Centro Villa Nursing Center* and Regulation 3.1.11.10 NMAC.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, NMSA 1978 Section 7-1-69 (B) (2003) provides a limited exception: "No penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." Further, under Regulation 3.1.11.11 NMAC, there are several situations where a taxpayer can show nonnegligence. In such nonnegligent situations, the Department either may choose not to assess civil penalty or may abate civil penalty. Potentially relevant in this case is Regulation 3.1.11.11 (D) NMAC, which allows for abatement of penalty when a taxpayer "proves that the failure to

pay tax or to file a return was caused by reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts…"

In this protest, Taxpayer testified that it became his practice over 30-years to include W-2 employee wage income in his Schedule C partially because he believed that was what H&R Block advised him to do. However, there is no evidence that Taxpayer ever discussed the potential gross receipts tax consequences of such an action with H&R Block or any other qualified tax professional. Without such a discussion, it cannot be said that H&R Block's advice came after full disclosure of all relevant facts or that Taxpayer relied on that information on reasonable grounds. Therefore, neither Section 7-1-69(B) nor Regulation 3.1.11.11 (D) NMAC provides a basis to abate penalty in this case.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the assessment. Jurisdiction lies over the parties and the subject matter of this protest.

B. Taxpayer's was a person engaged in business in 2006, and therefore all of Taxpayer's receipts in that year are presumed subject to gross receipts tax under NMSA 1978, Section 7-9-5 (2002). Because Taxpayer did not establish factually which portion of his receipts was attributable to employee wage income, Taxpayer did not clearly establish he was entitled to the exemption from gross receipts tax under NMSA 1978, Section 7-9-17. *See Wing Pawn Shop v. Taxation and Revenue Department*, 1991-NMCA-024, ¶16, 111 N.M. 735, 740 (internal citation omitted) (a taxpayer must clearly establish the right to an exemption from taxation).

C. Because of discrepancies between Taxpayer's federally reported business income on his Schedule C (which Taxpayer choose not to amend), his 2006 IRS 1040 tax return, and the total income listed on the documentation presented to the Department and at hearing, Taxpayer did not

overcome the presumption of correctness under NMSA 1978, Section 7-1-17 that attached to the Department's assessment.

D. Under NMSA 1978, Section 7-1-67 (2007), Taxpayer is liable for accrued interest under the assessment. Interest continues to accrue until the tax principal is satisfied.

E. Under Regulation 3.1.11.10 (C) NMAC, Taxpayer's erroneous belief that he could report wage income on a single Schedule C was negligent and thus Taxpayer is liable for civil penalty pursuant to NMSA 1978, Section 7-1-69 (2007). *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶10, 108 N.M. 795, 799.

For the foregoing reasons, Taxpayer's protest **IS DENIED.** Taxpayer owes $497.64 in gross receipts tax, $99.53 in penalty, and $198.86 in interest (as of the date of hearing) for a total outstanding liability of $796.03. Interest continues to accrue at $0.04 per day.

DATED: July 31, 2013.

Brian VanDenzen, Esq.
Tax Hearing Officer
Taxation & Revenue Department
Post Office Box 630
Santa Fe, NM 87504-0630