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

IN THE MATTER OF THE PROTEST OF
TERRY R. AND LINDA A. WOLFF **No. 04-04**
ID NO. 02-440607-00-4
ASSESSMENT NOS. 3936272 & 3936273

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on March 18, 2004, before Margaret B. Alcock, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Jeffrey W. Loubet, Special Assistant Attorney General. Terry R. Wolff ("Taxpayer") represented himself. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer was a resident of New Mexico during the 1999 tax year.

2. The Taxpayer is a craftsman whose primary business involves the sale of woodcarvings and woodworking supplies, performing repair and restoration work, and teaching classes on woodcarving at the University of New Mexico. During 1999, Mr. Wolff also performed services designing web sites, repairing knives, and selling books on a commission basis.

3. When the Taxpayer filed his 1999 federal income tax return, he reported gross receipts of $25,994.00 on Schedule C (Profit or Loss from Business) of his return.

4. The Taxpayer was not aware that his business receipts were subject to New Mexico's gross receipts tax and he did not report or pay gross receipts tax to the state.

5. As part of an information-sharing program with the Internal Revenue Service, the Department was notified of the business income reported on the Taxpayer's 1999 federal income tax return.

6. On June 4, 2002, the Department sent the Taxpayer a Notice of Limited Scope Audit asking him to explain why the business income reported on his 1999 federal income tax return was not reported to New Mexico for gross receipts tax purposes.

7. The Department's notice also advised the Taxpayer that he must be in possession of all nontaxable transaction certificates ("NTTCs") required to support his deductions within 60 days or those deductions would be disallowed.

8. In response to the Department's notice, the Taxpayer provided the Department with evidence that $6,978.89 of his sales were out-of-state sales that were not subject to New Mexico gross receipts tax, and the Department reduced the amount of business income subject to tax by that amount.

9. The Taxpayer maintained that the balance of $19,015.11 included receipts from sales of tangible personal property for resale, as well as $11,832.00 from sales of stock that were mistakenly reported on Schedule C of his federal return.

10. The Taxpayer did not provide the Department with any proof of the stock sales or any of the nontaxable transaction certificates required to support his deduction of sales for resale.

11. On September 19, 2002, the Department issued assessments in the total amount of $1,736.58, representing gross receipts tax, penalty, and interest on $19,015.11 of the business income reported on the Taxpayer's 1999 federal return.

12. On October 8, 2002, the Department received the Taxpayer's written protest to the Department's assessments.

13. On April 9, 2003, the Department's protest auditor wrote the Taxpayer a letter outlining the documents that the Department would need in order to adjust the assessments. The documents the auditor requested from the Taxpayer included a receipt for the sale of stock, NTTCs to support his claim of sales for resale, purchase orders from UNM, and "any other documentation that you deem necessary to prove why a transaction should not be taxed."

14. The Department's auditor followed up her letter with telephone calls during which the Taxpayer said he would provide the documentation requested.

15. When the Taxpayer failed to provide the requested documents, the Department's attorney wrote the Taxpayer a letter on December 4, 2003, explaining that the Department could not make any adjustments to the assessments without some evidence to support the Taxpayer's claims.

16. No documents were forthcoming from the Taxpayer, and an administrative hearing on the Taxpayer's protest was subsequently scheduled for March 18, 2004.

17. At the March 18, 2004 hearing, the Taxpayer produced a Form 1099-B evidencing 1999 stock sales in the amount of $11,832.00. Based on this form, the Department's attorney stipulated that the Department would abate the amount of gross receipts tax attributable to the $11,832.00 of capital gain.

18. The Taxpayer also produced an NTTC from John Neglia, which had been issued to the Taxpayer on October 4, 1998; two schedules the Taxpayer had prepared setting out the different categories of income he received during 1999; and a 1999 Form 1040 the Taxpayer had prepared—but never filed with the Internal Revenue Service—to correct the mistakes he claims to have made on his original return.

DISCUSSION

The Taxpayer maintains that the Department erroneously assessed gross receipts tax on his receipts from wholesale sales and from sales to the University of New Mexico ("UNM"). Although not raised in his protest letter, the Taxpayer also claims that tax was erroneously assessed on monetary gifts he received from family members as wedding and birthday gifts. The Department responds that the Taxpayer failed to provide the documentation required to support his claimed deductions.

Presumptions and Burden of Proof. NMSA 1978, § 7-1-17(C) provides that any assessment of tax by the Department is presumed to be correct, and it is the taxpayer's burden to overcome this presumption. *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972); *Wing Pawn Shop*, 111 N.M. 735, 741, 809 P.2d 649, 655 (Ct. App. 1991). In addition, "it is presumed that all receipts of a person engaging in business are subject to the gross receipts tax." NMSA 1978, § 7-9-5. Where 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*, 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991).

Monetary Gifts and Capital Gains. At the administrative hearing, the Taxpayer argued that $13,384.00 of monetary gifts he received from his family during 1999 are not subject to New Mexico gross receipts tax. This is a correct statement of the law. There is no evidence, however, to substantiate the Taxpayer's claim that gross receipts tax was assessed on these amounts. Because gifts are not subject to federal income tax, they would not normally appear on a taxpayer's federal return. There is certainly no reason for gifts to be reported as business income on Schedule C.

Although the Taxpayer maintained that he included the gifts on Schedule C in order to inflate his business income for purposes of obtaining a bank loan, the two income schedules the Taxpayer prepared and introduced at the hearing call this testimony into question. Those schedules show income from sales of tangible personal property and services totaling $22,224.07, which is close to the $25,994.00 of business income reported on the Taxpayer's 1999 Schedule C. Based on the Taxpayer's own exhibits, there is no way that the amount reported on Schedule C also could have included the $13,384.00 of monetary gifts the Taxpayer received from his family.[1]

The same problem exists with regard to the Taxpayer's $11,832.00 of capital gain on his sale of stock. Unfortunately, neither the Taxpayer nor the Department's attorney seemed to fully understand the basis for the Department's assessment. This is evidenced by the December 4, 2003 letter that Mr. Loubet sent to the Taxpayer. In that letter, Mr. Loubet listed the documents sought by the Department "that would enable us to reduce your assessment without a hearing." The list included "[r]eceipt for the sale of your stock (I would also accept a copy of your 1999 Federal Schedule D showing the stock sale)." This makes no sense. The assessment of tax was limited to income reported on Schedule C. If the Taxpayer reported his sale of stock on Schedule D, this would be prima facie evidence that the gain from the sale was *not* erroneously included on Schedule C—as represented by the Taxpayer—and was not part of the income on which tax was assessed. Accordingly, there would be no basis for reducing the assessment.

In any event, the Taxpayer never produced a copy of Schedule C or D to his 1999 federal return. And, while I do not believe that the Taxpayer met his burden of proving that the proceeds of his stock sale were included in the income reported on Schedule C, I also believe that the

[1] The Taxpayer testified that he erroneously reported his income on an accrual basis. It is difficult to understand how he could have done so, however, when his own schedules show that calculating his business

Department is bound by Mr. Loubet's stipulation that the Department would accept the Taxpayer's testimony on this issue and abate the amount of gross receipts tax that corresponds to the $11,832.00 of capital gain.[2] The Taxpayer is not, however, entitled to an additional adjustment on the $13,384.00 of monetary gifts he received during 1999.

Sales for Resale. The Taxpayer argues that the Department should have allowed him to deduct his wholesale sales of woodcarvings and other tangible personal property. The Gross Receipts and Compensating Tax Act provides several deductions from gross receipts for taxpayers who meet the statutory requirements set by the legislature. With regard to the sale of tangible personal property for resale, NMSA 1978, § 7-9-47 states as follows:

> Receipts from selling tangible personal property or licenses may be deducted from gross receipts...if the sale is made to a person who delivers a nontaxable transaction certificate to the seller....

Based on this language, the fact that some of the Taxpayer's sales were made for resale is not sufficient to support a deduction under Section 7-9-47. The requirements of the statute are very specific. The buyer must deliver an NTTC to the seller before the seller is entitled to claim a deduction from gross receipts. The requirements for obtaining NTTCs are set out in NMSA 1978, § 7-9-43, which provides, in pertinent part:

> All nontaxable transaction certificates...should be in the possession of the seller or lessor for nontaxable transactions at the time the return is due for receipts from the transactions. If the seller or lessor is not in possession of the required nontaxable transaction certificates within sixty days from the date that the notice requiring possession of these nontaxable transaction certificates is given the seller or lessor by the department, deductions

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income on a cash basis results in a figure very close to that actually reported. Had the accrual method been used, the gross sales reported on Schedule C would have been substantially higher.

[2] The Department's stipulation would not be binding if the amount at issue exceeded $10,000, since the Tax Administration Act requires the Department to obtain the prior written approval of the New Mexico Attorney General before abating taxes amounting to $10,000 or more. NMSA 1978, § 7-1-28. In this case, the amount of tax conceded by the Department was under $1,000.

> claimed by the seller or lessor that require delivery of these nontaxable transaction certificates shall be disallowed.

While taxpayers "should" have possession of required NTTCs at the time of the transaction at issue, the statute gives taxpayers audited by the Department a second chance to obtain these NTTCs. Taxpayers who rely on this provision must recognize, however, that they run the risk of having their deductions disallowed if they are unable to meet the 60-day deadline set by the legislature. The reason why a taxpayer cannot obtain an NTTC is irrelevant. The language of the statute is mandatory: if a seller is not in possession of required NTTCs within 60 days from the date of the Department's notice, "deductions claimed by the seller...that require delivery of these nontaxable transaction certificates *shall be disallowed."* (emphasis added).

At the administrative hearing, the Taxpayer produced a Type 2 NTTC issued by John Neglia on October 4, 1998. The Department's attorney argued that the NTTC could not be accepted because it had not been delivered to the Department within the 60-day period provided in § 7-9-43. The Department is misreading the statute. Section 7-9-43 does not require the Taxpayer to deliver his NTTCs to the Department within the 60-day period, it simply requires the Taxpayer to have possession of the NTTCs within that time frame. As stated in Department Regulation 3.2.201.8(A)(3):

> (3) a NTTC *acquired* by the taxpayer after the 60 days following notice have expired will not be honored by the department for the period covered by the audit. (emphasis added)

In this case, the face of the NTTC indicates that it was acquired by the Taxpayer in October 1998. There is no evidence that the NTTC has been altered or backdated. Accordingly, it meets the time limitations set out in § 7-9-43.

The problem with the Taxpayer's NTTC is not one of timeliness, but one of relevance. The name John Neglia does not appear on the Taxpayer's list of customers. Although the Taxpayer testified that the NTTC was issued by the owner of Import Warehouse in Taos, he did not provide any invoices

or other records to substantiate this claim. Department Regulation 3.2.201.10 NMAC provides that receipts may be deducted "only if documentation justifying the deduction is maintained so it can be verified upon audit." Example 3 of the regulation states:

> Example 3: M, a motor parts store, deducts receipts for sales made over the counter to cash customers who have delivered proper NTTCs. A sales ticket is prepared by M indicating the date, the amount and the items purchased. "CASH" is written in the space provided for the customer's name. If M is audited, the deduction would be disallowed; the transaction could not be related to a specific NTTC.

In this case, there is no documentation to link the Taxpayer's transactions with Import Warehouse to the NTTC issued by John Neglia. For this reason, the Taxpayer has not met his burden of proving that he is entitled to a deduction. In addition, most of the Taxpayer's sales to Import Warehouse were sales of services and not sales of tangibles. The Taxpayer's list of sales for 1999 (Taxpayer Exhibit 4) includes 15 invoices for Import Warehouse. With the exception of two invoices for the sale of "penetrating wood finish," all of these invoices were for restoration or repair services. Because a Type 2 NTTC does not cover the sale of services, a deduction could not be allowed for these transactions even if the Taxpayer had been able to establish that John Neglia and Import Warehouse were the same entity.

The NTTC from John Neglia was the only NTTC produced by the Taxpayer. The Taxpayer testified that he either did not obtain or lost the NTTCs from his other wholesale customers. He explained that some of these customers had gone out of business or changed ownership, making it impossible for him to replace the missing NTTCs within the 60-day period. While this is unfortunate, it cannot override the statutory directive that deductions for which a taxpayer does not have a timely NTTC "shall be disallowed." § 7-1-43(B). Based on this language, the Department has no choice but to deny the Taxpayer's deductions.

Sales to UNM. Receipts from sales of tangible personal property to the State of New Mexico or "any governmental unit or subdivision, agency, department or instrumentality thereof" may be deducted from gross receipts without the requirement of obtaining an NTTC. NMSA 1978, § 7-9-54. The Taxpayer argues that the Department erroneously assessed tax on his sales of tangible personal property to UNM. Once again, the issue is one of proof. Department Regulation 3.2.212.19 NMAC states that:

> A seller must be able to prove that payment for tangible personal property was made from the state of New Mexico, or any political subdivision thereof,...or the deduction will not be allowed.

Acceptable proof includes:

> documents related to the transaction showing the governmental entity's name, such as purchase orders, copies of warrants issued in payment and contracts covering the items purchased.

In this case, the Department gave the Taxpayer ample opportunity to substantiate his deduction of receipts from UNM. In April 2003, the Department's protest auditor sent the Taxpayer a letter asking him to provide the purchase orders for his sales to UNM. She followed up her letter with two telephone calls, during which the Taxpayer stated that he would send the requested documents. No documents were received, however, prompting another letter to the Taxpayer, this time from the Department's attorney. Still no purchase orders, invoices, warrants or other evidence of the Taxpayer's sales to UNM were produced. In the absence of such evidence, the Taxpayer has not met his burden of proving his right to the deduction claimed.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment Nos. 3936272 & 3936273, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Department is bound by its stipulation that it will abate gross receipts tax on the Taxpayer's 1999 capital gain from his sale of stock.

3. The Taxpayer did not meet his burden of proving that he is entitled to any additional exemption or deduction of the income reported on Schedule C to his 1999 federal return.

For the foregoing reasons, the Taxpayer's protest IS GRANTED IN PART AND DENIED IN PART. The Department is ordered to abate gross receipts tax, penalty, and interest on the $11,832.00 of capital gain the Taxpayer realized during 1999. The Taxpayer is liable for the balance of tax, penalty, and interest remaining after this adjustment is made.

DATED March 25, 2004.