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

IN THE MATTER OF THE PROTEST OF
CHILES CONSULTING COMPANY No. 00-15
ID NO. 02-348340-00 7
ASSESSMENT NO. 2180303

DECISION AND ORDER

A formal hearing on the above-referenced protest was held May 25, 2000, before Margaret B. Alcock, Hearing Officer. The Taxpayer, J. Hunter Chiles, III, d/b/a Chiles Consulting Company, represented himself. The Taxation and Revenue Department was represented by Bruce J. Fort, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer became a resident of New Mexico in July 1993, when he moved to the state to begin employment as president of Southwest Energy Ventures, Inc. (SEV).

2. SEV, which was owned by the Taxpayer and three other shareholders, was formed to determine the best location for new power plants in the Southwestern United States.

3. The Taxpayer was paid a salary for his work as an employee of the company and was also reimbursed for travel and other expenses.

4. In October 1994, SEV ran out of money and stopped paying the Taxpayer.

5. Beginning in October, the Taxpayer contracted to perform services for other companies as an independent contractor. The Taxpayer was paid an hourly fee, plus expenses.

6. During 1994, the Taxpayer also performed work for a family trust, for which he was paid an hourly fee, plus expenses.

7. The Taxpayer invoiced his independent contractor fees and expenses under the name "Chiles Consulting Company."

8. For tax year 1994, the Taxpayer received a Form W-2 from SEV reflecting wages of $56,645.55. The W-2 did not include any of the reimbursed expenses paid to the Taxpayer.

9. The Taxpayer's 1994 federal income tax return, Form 1040, listed wages of $56,646 on Line 7, a business income loss of $6,586 on Line 12, and a $3,000 capital loss on Line 13.

10. The business loss claimed by the Taxpayer was based on Schedule C to the 1994 Form 1040, which reported $14,958 of business income from the Taxpayer's services as a consultant and $21,544 of business expenses, for a net loss of $6,586.

11. The Taxpayer never questioned the certified public accountant who prepared the return concerning the business income and expenses reported on Schedule C.

12. As a result of the business loss claimed on Form 1040, the Taxpayer had no federal taxable income and no federal income tax liability for 1994. The Taxpayer's New Mexico income tax return, which he prepared based on the federal return, also showed a zero tax liability.

13. The Taxpayer did not register with the Department for payment of gross receipts tax and did not report or pay gross receipts tax on the business income shown on Schedule C to his 1994 federal income tax return.

14. In July 1997, the Department sent the Taxpayer a letter asking him to explain why the business income reported on his 1994 federal income tax return was not reported to the Department for gross receipts tax purposes.

15. In September 1997, the Taxpayer responded in writing (Dept. Ex. 4), stating: "I cannot explain why my accountant showed a figure of $14,958 on the Schedule C, although it is probably a combination of adding certain expense reimbursements, and balancing them out with the

actual expenses." The Taxpayer maintained that his business income for 1994 should have been $6,680.

16. The Department did not accept the Taxpayer's explanation. On October 4, 1997, Assessment No. 2180303 was issued to the Taxpayer in the total amount of $1,208.69, representing gross receipts tax, interest and penalty for the period January-December 1994.

17. On October 8, 1997, the Taxpayer filed a written protest to the assessment.

18. During the course of the protest, the Taxpayer provided additional information to the Department's protest auditor, stating in a June 30, 1998 letter (Dept. Ex. 5): "I think the only way for you and I to get to the bottom of this is to ignore what was done for Federal tax purposes, and look only at the invoices for Chiles Consulting, as these constitute the best record of the REAL Gross Receipts."

19. Using his personal computer records, the Taxpayer prepared a reconciliation spreadsheet showing his wages, fees and reimbursed expenses for 1994 (Dept. Ex. 1). According to the spreadsheet, the Taxpayer received $56,343.60 in employee wages from SEV; $14,077.01 in reimbursed expenses incurred as an employee of SEV; $6,620.00 in independent contractor fees; and $226.26 in reimbursed expenses related to this independent contractor work.

20. The Taxpayer never consulted with an accountant or made any effort to amend his 1994 federal and state income tax returns to correct the amount of business income and expenses reported on those returns.

DISCUSSION

At issue is whether the Taxpayer is liable for gross receipts tax on the $14,958 of business receipts reported on Schedule C to his 1994 Form 1040. The Taxpayer maintains his accountant incorrectly included employee expense reimbursements the Taxpayer received from Southwest

Energy Ventures, Inc. as business income on Schedule C. Based on his personal computer records, the Taxpayer asserts that his total receipts from doing business as an independent contractor during 1994 were $6,846.26 and this is the only amount that should be subject to New Mexico gross receipts tax.

Section 7-1-17(C) NMSA 1978 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. *See also*, *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). Accordingly, the Taxpayer has the burden of producing evidence to establish that the Department's assessment of gross receipts tax, penalty and interest on his 1994 income is incorrect.

At the hearing, the Taxpayer presented information from his personal computer records indicating that he had $6,846.26 of taxable gross receipts during 1994. Unfortunately, there is no way to reconcile his current figures with the figures reported on his 1994 federal income tax return. According to the Taxpayer's records, he received $56,343.60 in employee wages from SEV; $14,077.01 in reimbursed expenses incurred as an employee of SEV; $6,620.00 in independent contractor fees; and $226.26 in reimbursed expenses related to this independent contractor work. If the Taxpayer's accountant had simply included all employee reimbursements as business income and offset those reimbursements with the underlying expenses, the Schedule C would show business income of $20,923.27 ($14,077.01 of employee reimbursements plus $6,846.26 of independent contractor fees and expenses) and offsetting business expenses of $14,303.27 ($14,077.01 of employee expenses plus $226.26 of independent contractor expenses), resulting in net business income of $6,620.00. Instead, the Schedule C shows $14,958.00 of business income and $21,544.00 of business expenses, resulting in a net *loss* of $6,586.00

The Taxpayer cannot explain how his accountant came up with the figures reported on the 1994 Schedule C.. It must be assumed, however, that the Taxpayer's certified public accountant did not simply make up the numbers shown on the return, but relied on information provided to him by the Taxpayer. There is simply no basis for determining which figures are accurate—those used by the accountant to prepare the original return or those presented by the Taxpayer at the hearing. Having accepted the benefit of the business loss reported on his 1994 federal income tax return, the Taxpayer cannot now claim that the figures shown on the return are incorrect and should be ignored for purposes of determining his gross receipts tax liability for the same period. New Mexico law holds that a taxpayer must treat transactions uniformly for all purposes within the tax laws. A taxpayer may not report business income (with offsetting expenses) on his income tax returns and then recharacterize the income as nontaxable employee reimbursements for purposes of the gross receipts tax.

The first case to address the requirement of consistency in state tax reporting was *Co-Con, Inc. v. Bureau of Revenue*, 87 N.M. 118, 529 P.2d 1239 (Ct App., 1974), *cert. denied*, 87 N.M. 111, 529 P.2d 1232 (1974). Co-Con, Inc. was a wholly owned subsidiary of Universal Constructors, Inc. During the audit period, construction equipment was used in common by both companies. Each corporation attributed a value to the other corporation's use of the equipment and reflected that value as "gross rentals" for federal income tax purposes. The Department treated the rental income reported on the federal returns as receipts from leasing property in New Mexico and assessed gross receipts tax on this amount. The corporations maintained the federal returns were incorrect and tried to recharacterize the income reported on those returns. The court of appeals upheld the assessments, finding that the corporations' treatment of the transactions as rentals for federal income tax purposes was binding for state tax purposes. As the court stated:

> Taxpayers must treat transactions uniformly for all purposes within the tax scheme and not attempt to show, first, a lease for federal

> purposes and second, a non-taxable event for state tax purposes. We find ample evidence in the record to indicate that taxpayers engaged in leasing, both by intent and within the scope of the statutory definition.

Id., 87 N.M. at 121-122.

In *Stohr v. New Mexico Bureau of Revenue*, 90 N.M. 43, 559 P.2d 420(Ct. App. 1976), *cert. denied*, 90 N.M. 254, 561 P.2d 1347 (1977), the court of appeals upheld an assessment of gross receipts tax against Mr. Stohr's compensation from performing carpentry work for various individuals. Mr. Stohr argued that these amounts were wages exempt from gross receipts tax. In responding to these arguments, the court noted that during the audit period Mr. Stohr filed self-employment tax returns for social security purposes and filed federal Schedule C's reporting his compensation as business income. In determining Mr. Stohr liable for gross receipts tax, the court first examined the indicia of employment found in the Department's regulations, and then stated:

> The ***controlling*** factor, however, is that the taxpayer must treat transactions uniformly for all purposes within the tax laws. The taxpayer must not attempt to show one scheme for federal tax purposes and a nontaxable event for purposes of state gross receipts taxes. (citations omitted, emphasis added).

Thus, the court found that the manner in which Mr. Stohr reported his compensation for federal purposes controlled the determination of whether that compensation could be considered wages exempt from gross receipts taxes.

The most recent case to address the need for consistency in filing state and federal returns is *Sutin, Thayer & Browne v. Revenue Division of the Taxation and Revenue Department,* 104 N.M. 633, 725 P.2d 833 (Ct. App. 1985), *cert. denied,* 102 N.M. 293, 694 P.2d 1358 (1986). The issue in that case was whether the Sutin firm could claim a wage deduction on its state corporate income tax return that exceeded the wage deduction claimed on its federal return. Under the Tax Reduction and Simplification Act of 1977, a corporation could either claim a federal tax deduction or elect a jobs

credit for wages paid to certain new employees. The Sutin firm elected to claim the jobs credit on its federal return. Because New Mexico did not have a similar jobs credit, the Sutin firm deducted all of the wages paid to new employees on its New Mexico return. The Department disallowed the deduction, arguing that a taxpayer cannot claim the jobs credit on its federal return and then add back the wage deduction it forfeited on its federal return when calculating state taxable income. The court upheld the Department's position, noting that "a taxpayer who makes an election for federal purposes is bound by that election in calculating the amount of its state taxes." *Id*., 104 N.M. at 636.

The foregoing cases establish that a taxpayer may not treat a taxable transaction one way for federal tax purposes and a different way for state tax purposes. In this case, the Taxpayer asserts that his 1994 federal income tax return is incorrect and does not accurately reflect his business income and expenses for that year. The Taxpayer failed, however, to take any action to correct the return. At the hearing, the Taxpayer maintained he was unable to amend his return because the three-year statute of limitations had expired by the time he discovered the error. The Internal Revenue Code requires taxpayers to file claims for refund of overpaid tax within three years from the date the return is filed. 26 U.S.C. § 6511. The Taxpayer has not provided any authority to show that a taxpayer who has *underreported* tax has only three years to file an amended return to correct the error. Even if such a provision existed, the Taxpayer had ample time after discovering the error in his 1994 return to file an amended return. Based on the documents submitted at the May 25, 2000 hearing, the Taxpayer's 1994 federal income tax return was not filed until January 1996. This means the three-year statute of limitations set out in 26 U.S.C. § 6511 did not expire until January 1999, eighteen months after the Taxpayer received the Department's inquiry letter in July 1997.

Had the Taxpayer amended his 1994 Schedule C to match the figures shown on his spreadsheet, the business loss of $6,586 reported on Line 12 of his federal Form 1040 would have changed to positive income of $6,620. This, in turn, would have increased his federal taxable income from zero to $9,528 and his federal tax liability from zero to approximately $1,400 (using a 15% tax rate). The Taxpayer's income tax liability to New Mexico would have increased as well. Having reaped the benefit of the business loss shown on his original returns, the Taxpayer may not now recharacterize his business income to avoid payment of gross receipts tax.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2180303, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer failed to meet his burden of proving that the business income reported on his 1994 Schedule C was incorrect.

3. Having claimed the benefit of the business income and expenses reported on his 1994 Schedule C, the Taxpayer may not take an inconsistent position concerning that income for purposes of calculating New Mexico gross receipts tax.

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

DATED June 6, 2000.