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

IN THE MATTER OF THE PROTEST OF
MICHAEL L. FLURE, **NO. 00-24**
NM ID. NO 02-337541-00 8, PROTEST TO
ASSESSMENT NO. 2129413

DECISION AND ORDER

This matter came on for formal hearing on January 7, 2000 before Gerald B. Richardson, Hearing Officer. Mr. Michael Flure, hereinafter, "Taxpayer", was represented by Marshall Aungier, Esq. The Taxation and Revenue Department, hereinafter, "Department", was represented by Mónica M. Ontiveros, Special Assistant Attorney General. The hearing was adjourned after taking the majority of the evidence to allow the parties to investigate the consequences of the filing of an amended federal income tax return for the tax year at issue and to determine if the results of that investigation might allow the parties to arrive at a resolution of the matter in protest. After some delay, it was determined that the parties would be unable to resolve the matter. The parties were provided the opportunity to submit argument in writing and the matter was considered submitted for decision on July 25, 2000. Based upon the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer commenced working for Four Star Builders, Inc. in January, 1992 and worked for them until November of 1993. The Taxpayer was twenty years old when he began working for Four Star Builders.

2. The Taxpayer's job duties included computer aided drafting, word processing, entering data in the computer, answering phones, running errands and other duties as assigned, which could include activities such as running a backhoe, greasing machinery, laying pipe, etc.

3. The Taxpayer's job duties were assigned on a day to day basis by the two principal owners of Four Star Builders, Mr. Fred Sanchez and Mr. C.R. Freeman.

4. The Taxpayer's hours of work were set by Four Star Builders. The Taxpayer was required to work from 8:00 A.M. to 5:00 P.M, Monday through Friday, with a lunch hour from noon to 1:00 P.M. every day.

5. The Taxpayer could not delegate the jobs assigned to him to anyone else.

6. During the time that the Taxpayer worked for Four Star Builders, he did not work for anyone else.

7. The Taxpayer worked in the offices of Four Star Builders and used the office equipment and other machinery of Four Star Builders.

8. The Taxpayer was paid an hourly wage of $7.00 per hour.

9. The Taxpayer believed that he was an employee of Four Star Builders. Four Star Builders never informed the Taxpayer that he was an independent contractor.

10. For tax years 1992 and 1993, Four Star Builders reported the compensation it paid to the Taxpayer on a Federal Form 1099, as nonemployee compensation. The amounts reported were $13,015 for 1992 and $13,361.53 for 1993.

11. Four Star Builders made no income or other tax withholdings from the compensation it paid the Taxpayer, nor did it provide worker's compensation coverage or make contributions to the Department of Labor for unemployment compensation purposes.

12. The only previous job that the Taxpayer had was working at McDonalds while going to school. He had been paid as an employee and his wages were reported on a Federal Form W-2. The Taxpayer had been able to figure out his federal income taxes and had prepared his own federal tax return for the wages he received from McDonalds.

13. The Taxpayer was confused by how to report and compute his federal income taxes for 1992 because of the fact that they were reported on a form 1099. Because of this confusion, the Taxpayer did not initially report or pay income taxes to the Internal Revenue Service ("IRS") for 1992.

14. Because the Taxpayer's paychecks from Four Star Builders did not include a pay stub breaking down the calculation of the amount being paid, the first time that the Taxpayer learned that Four Star Builders was not making income tax or other withholdings from his pay was when he was issued a Form 1099 after the close of 1992. Even then, the Taxpayer did not understand the significance of how his compensation was being reported to the IRS by Four Star Builders.

15. After receiving another Form 1099 for 1993, the Taxpayer decided that he needed to get assistance with how to report and pay his federal income taxes. The Taxpayer went to the Albuquerque offices of the IRS and asked for assistance. He was directed to a person who directed him to report his compensation for 1992 and 1993 on a Federal Schedule C, reporting the compensation as income from a business or profession.

16. On the Taxpayer's 1993 Federal Schedule C-EZ, the Taxpayer filled out line A which requests a listing of a taxpayer's principal business or profession as "None-actually an employee". Additionally, Taxpayer claimed no expenses against his receipts reported on his Schedule C-EZ.

17. After filing his 1992 and 1993 Federal income tax returns, the Taxpayer had a fairly substantial liability of nearly $7,000, including penalty and interest. Because he was unable to pay the amount, he began making installment payments of $152 per month. After making payments for several months, he found that he could not really manage to make the payments. At the suggestion of his father, the Taxpayer approached the IRS about making an Offer in Compromise based upon his inability to pay. On September 19, 1995, the Taxpayer filed a Form 656, Offer in Compromise, with the IRS, offering to compromise his Federal income tax liabilities for tax years 1992 and 1993 for the amount of $3,600, based upon his inability to pay the full liability.

18. Sometime in 1996, the IRS accepted the Taxpayer's Offer in Compromise and the Taxpayer borrowed the $3,600 from his father and paid the liability in accordance with the terms of the Offer in Compromise. When the IRS accepted the Taxpayer's Offer in Compromise, the IRS informed the Taxpayer that upon acceptance of the Offer in Compromise, it was a legally binding contract between the Taxpayer and the IRS and that if he were to amend his federal returns for the years covered by the agreement, that the agreement would be null and void and the IRS could hold him liable for the entire amount of his 1992 and 1993 tax year liability.

19. Subsequently, the Department contacted the Taxpayer because of the information it had received from the IRS showing that the Taxpayer had reported income from a business or profession for the 1993 tax year, but the Department had no record that the Taxpayer had reported or paid gross receipts tax for receipts from his business or profession for that year. The Taxpayer informed the Department's representative that he was an employee during that year and was not engaging in business.

20. On April 17, 1997, the Department issued Assessment No. 2129413 to the Taxpayer, assessing $733.92 in gross receipts tax, $73.44 in penalty and $408.25 in interest for the 1993 tax year.

21. On May 14, 1997, the Taxpayer filed a written protest to Assessment No. 2129413.

22. In order to resolve his protest with the Department, on December 21, 1998, the Taxpayer filed a Federal Form SS-8 with the IRS seeking a determination of his employee work status with respect to his work for Four Star Builders.

23. On January 15, 1999, the IRS responded to the Taxpayer's request for a determination of his work status with Four Star Builders. The IRS informed the Taxpayer that it was prohibited from issuing a determination due to the fact that the statute of limitations had expired on the returns filed for the years in question, 1992 and 1993.

24. The Department is willing to treat the compensation the Taxpayer received from Four Star Builders during 1993 as wages paid to the Taxpayer as an employee if the Taxpayer will filed an amended 1993 Federal income tax return reporting his compensation as wages from employment.

25. The Taxpayer believes that he is prohibited from filing an amended Federal income tax return for 1993 because the statute of limitations for filing 1993 income tax returns has expired and because it would constitute a breach of the Offer in Compromise agreement with the IRS.

DISCUSSION

The primary issue to be determined is whether the compensation the Taxpayer received from Four Star Builders was compensation for services performed as an employee or as an independent contractor. This is because there is an exemption from gross receipts tax for the

receipts of employees from wages, salaries, commissions or other remuneration for personal services. Section 7-9-17 NMSA 1978.

An employee is not defined in the Gross Receipts and Compensating Tax Act, Chapter 7, Article 9 NMSA 1978, so we will look to the common law definition of employee. In determining whether a person is an employee or an independent contractor, the rule in New Mexico and in general is that the principal consideration is the right to control. Thus, the relationship of employer and employee usually results where there is control over the manner and method of performance of the work to be performed. Where there is only control over the results, however, and not the details of the performance, the worker is usually considered to be an independent contractor. ***Buruss v. B.M.C. Logging Co.***, 38 N.M. 254, 31 P.2d 263 (1934). A more recent pronouncement of this rule can be found in ***Harger v. Structural Services, Inc.***, 121 N.M. 657, 663, 916 P.2d 1324, 1330 (1996). In that case the New Mexico Supreme Court adopted the approach set out in the Restatement (Second) of Agency § 220(1) to determine a worker's status as an employee or an independent contractor:

> The important distinction is between service in which the actor's physical activities and his time are surrendered to the control of the master, as service under an agreement to accomplish results or to use care and skill in accomplishing results. Those rendering service but retaining control over the manner of doing it are not servants.

Among the factors to be considered are: whether the party employed engages in a distinct occupation or business; whether the work is part of the employer's regular business; the skill required in the particular occupation; whether the employer supplies the instrumentalities, tools or the place of work; the duration of a person's employment and whether that person works full-time or regular hours; whether the parties believe they have created the relationship of employer and employee and the manner and method of payment. The totality of all of the circumstances

must be considered in determining whether the employer has the right to exercise that degree of control over a worker so as to make the worker an employee.

The Department has adopted a regulation under Section 7-9-17 to provide criteria by which the status of a worker may be determined. Regulation 3 NMAC 2.12.7. provides as follows:

> In determining whether a person is an employee, the department will consider the following indicia:
> 1. is the person paid a wage or salary;
> 2. is the "employer" required to withhold income tax from the person's wage or salary;
> 3. is F.I.C.A. tax required to be paid by the "employer";
> 4. is the person covered by workmen's compensation insurance;
> 5. is the "employer" required to make unemployment insurance contributions on behalf of the person;
> 6. does the person's "employer" consider the person to be an employee;
> 7. does the person's "employer" have a right to exercise control over the means of accomplishing a result or only over the result (control does not mean "mere suggestion').
>
> If all of the indicia mentioned are present, the department will presume that the person is an employee. However, a person may be an employee even if one or more of the indicia are not present.

Under the facts of this case, it is concluded that the Taxpayer was an employee of Four Star Builders based upon the degree of control it exercised over the Taxpayer. Other than the fact that Four Star Builders treated the Taxpayer as an independent contractor in the manner in which it reported his compensation to the IRS and failed to withhold taxes and pay other amounts which it would have been required to pay if the Taxpayer was an employee[1], all of the

[1] In the absence of other factors indicating an independent contractor status, the fact that the entity paying compensation treats a person as an independent contractor is of little persuasive effect. Treating employees as independent contractors for tax purposes can result in significant cost savings to employers. ***See***, Nunnally, *Why Congress Needs to Fix the Employee /Independent Contractor Tax Rules: Principles, Perceptions, Problems and Proposals*, 20 N.C. Cent. L.J. 93 (1992). Given the substantial difference in bargaining power between employers and employees in need of work, I believe that it is not uncommon for employers to take advantage of employees by misclassifying them as independent contractors in order to benefit from the substantial cost savings available to them by doing so.

indicia demonstrate that he was an employee. Four Star Builders set the Taxpayer's hours of work, paid an hourly wage, directed his work, provided the workplace and equipment needed to perform his work and otherwise exercised complete control over the Taxpayer's work.

The Department argues that even if the Taxpayer is found to qualify as an employee, because he filed with the IRS as an independent contractor by reporting his compensation from Four Star Builders on a Schedule C, that he is barred from claiming the exemption provided by Section 7-9-17 NMSA 1978 by controlling New Mexico precendent. New Mexico's courts have required that taxpayers report taxes consistently for both state and federal purposes. The first case to address this issue 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, pieces of construction equipment common to the operations of both corporations were utilized by both on their construction projects without regard to which corporation held legal title to the equipment. Each corporation owning the equipment attributed a value to the use of its equipment and reflected that value as "gross rentals" for federal income tax purposes. The department assessed gross receipts tax on those gross rental amounts reflected on the federal returns of Co-Con, Inc. and Universal Constructors, Inc. as gross receipts from leasing property in New Mexico. The corporations argued that they did not have gross receipts from equipment rental. The Court of Appeals upheld the assessments, finding that the treatment by the corporations of the transactions as gross rentals for federal income tax purposes indicated that the intent of the taxpayers was to treat the arrangements as rentals or leases. The court went on to state:

> 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 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 on the compensation he was paid by various individuals for doing carpentry. Mr. Stohr argued that these amounts were wages exempt from gross receipts tax under § 72-16A-12.5 NMSA 1953, the predecessor to § 7-9-17 NMSA 1978. The court noted that Mr. Stohr had filed self employment tax returns for social security purposes with the Internal Revenue Service ("IRS") for the compensation he received from the customers who did not withhold FICA tax, and had filed a Federal Schedule C during the audit years, reporting his compensation as being from a business or profession. In determining that Mr. Stohr had gross receipts subject to tax, the court found that:

> 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).

Id., 90 N.M. at 46.

The most recent case to address the issue of whether consistency is required 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 NM 293, 694 P.2d 1358 (1986). That case concerned whether a taxpayer could claim a wage deduction for state corporate income tax reporting purposes that exceeded the wage deduction claimed for federal corporate income tax purposes. Under the Tax Reduction and Simplification Act of 1977, Pub. L. No. 95030, a new jobs tax credit was enacted to provide employers with a tax

incentive to create new jobs. Under the act, a corporation could either claim a federal tax deduction for the wages paid to its employees or elect a jobs credit for wages paid to certain new employees. New Mexico did not have a similar jobs credit. The taxpayer had claimed a jobs credit with the IRS, forgoing a deduction for wages paid to those employees for whom the credit was claimed. Because New Mexico did not have a similar jobs credit, the taxpayer claimed a deduction for those wages on its New Mexico return that it had not claimed on its federal return, arguing that to deny it the wage deduction would be unfair and result in overstating its taxable income for state tax purposes. The court denied the taxpayer's claim of deduction, stating 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.

In ***Co-Con, Inc.*** and ***Stohr,*** the court considered the manner by which a taxpayer had filed for federal tax purposes as an indication of a taxpayer's intention as to how a given transaction should be treated for tax purposes. In ***Sutin, Thayer & Browne,*** the court found it significant that the taxpayer had made an election for federal tax purposes that entitled it to claim a federal tax benefit it would not otherwise have been entitled to. This matter is distinguishable in both respects.

In this case, the Taxpayer derived no benefit from the manner in which he filed his Federal return. He claimed no expenses against the receipts reported on Schedule C, thus rendering his entire compensation part of his taxable income, just as it would have been had it been reported as wages from employment[2]. Additionally, there was also no conscious election to file in the manner in which he did and thus, the manner in which the Taxpayer filed cannot be

[2] The Department points out that the Taxpayer received a deduction against his taxable income for one half of the self-employment tax he reported and paid, but when one considers that the Taxpayer became liable for $1,889 in self

considered to indicate the Taxpayer's intention to treat his compensation from Four Star Builders as income received from engaging in business as an independent contractor. Schedule C, Line A, asks taxpayers to list their principal business or profession as well as its product or service. The Taxpayer answered this query, stating, "None, actually an employee." This Taxpayer[3] had no understanding of the distinction between an independent contractor or an employee when he filed his Federal return or of its tax ramifications. He filed the Schedule C because he was told that that was the proper manner to file his taxes by the person who assisted him at the IRS offices. Thus, the fact that the Taxpayer filed a Federal Schedule C reporting his compensation as gross receipts from a business or profession cannot be considered under the facts of this case as indicative of the Taxpayer's intention as to how the compensation at issue should be treated for tax purposes. Given this and the fact that the Taxpayer did not elect to file a Schedule C in order to receive a tax benefit from the manner in which he filed with the IRS, the conceptual underpinnings of the otherwise sound policy which normally requires that taxpayers file consistently with both the state and federal taxing authorities do not exist in this case. For these reasons, the Taxpayer's claim of exemption under Section 7-9-17 NMSA 1978 for the wages he was paid as an employee of Four Star Builders should not be barred because his Federal return does not treat his compensation as employee wages.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest of Assessment No. 2129413 and jurisdiction lies over both the parties and the subject matter of this protest.

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employment tax as a result of reporting his compensation on Schedule C and he only received a deduction against income upon which tax was calculated in the amount of $945, this can hardly be considered a tax benefit.

[3] The Taxpayer was only 22 years old, unsophisticated in the ways of business and taxes, and was confused as to how to file his taxes. His confusion was caused by his own understanding that he was an employee, which was consistent with how his employer treated him for all purposes except for taxes and employee related expenses.

2. The Taxpayer was an employee of Four Star Builders.

3. The Taxpayer's compensation from Four Star Builders is exempt from gross receipts tax pursuant to Section 7-9-17 NMSA 1978.

4. The Taxpayer's claim for exemption from gross receipts tax pursuant to Section 7-9-17 NMSA 1978 is not barred due to his failure to treat his compensation from Four Star Builders consistently for both state and Federal tax purposes.

For the following reasons, the Taxpayer's protest IS HEREBY GRANTED.

DONE, this 23rd day of August, 2000.