

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

IN THE MATTER OF THE PROTEST OF
RONALD AND GLORIA FROST
ID. NO. 02-404389-00 3, PROTEST TO
ASSESSMENT NO. 2499887

NO. 00-27

DECISION AND ORDER

This matter came on for formal hearing on August 21, 2000 before Gerald B. Richardson, Hearing Officer. Ronald and Gloria Frost, hereinafter, "Taxpayers", were represented by Ronald Frost. The Taxation and Revenue Department, hereinafter, "Department", was represented by Bruce J. Fort, Special Assistant Attorney General. Based upon the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. In 1996, Taxpayers filed a Federal Schedule C with the Internal Revenue Service ("IRS") reporting \$17,613 in gross receipts from a framing and carpentry business.
2. Mr. Frost is not a licensed contractor.
3. During 1996, Mr. Frost engaged in part-time work as a framer and carpenter, in addition to his full time salaried job. The jobs he performed were fairly small jobs such as building decks, patio covers, storage sheds and performing small remodeling jobs.
4. Prior to taking on a construction job, Mr. Frost would meet with his potential client to discuss their project to determine what the client envisioned and the materials to be used. He would then meet with a construction materials supplier, would disclose who his customer was and the materials needed and would obtain a price for the necessary materials and determine

their availability. Mr. Frost would then use this information to develop a price to be presented to his potential client for the proposed project.

5. If a client determined to proceed with engaging Mr. Frost for the project, Mr. Frost entered into written agreements with his customers which specified the work to be performed, the materials to be used, established a fixed price for the project and set forth the terms of payment for the project. The agreements specified that the price included all materials and labor but did not break out the specific amounts for either category. The terms of payment in each agreement required that the customer pay one half of the project cost upon the signing of the agreement. None of the agreements had any language authorizing Mr. Frost to act as an agent for the customer in purchasing materials nor did he discuss with his clients making materials purchases in their name for the project.

6. Although Mr. Frost discussed with his clients the materials needed to do the project contemplated, it was left to Mr. Frost to decide where to purchase the materials and the quantity and quality of the materials necessary to complete the project described in the agreements.

7. The money paid to Mr. Frost by his clients under the agreements was deposited by Mr. Frost into his checking account. Mr. Frost wrote checks on his checking account when purchasing materials to be used in the projects for his clients.

8. Although Mr. Frost disclosed the name of his client to the businesses from whom materials were purchased, he never used the word “agent” when discussing his relationship with his clients with the materials suppliers. Mr. Frost had accounts in his own name with some of the materials suppliers and received a contractor’s discount when he made purchases from those suppliers. All purchases were made in his name and paid for by him at the time of purchase.

9. Sometimes Mr. Frost arranged to have his materials purchases delivered by the supplier to his customer's address. Sometimes, Mr. Frost picked up the materials himself.

10. Of the \$17,613 reported as gross receipts on the Taxpayers' Federal Schedule C, \$8,105 represented the cost of materials. The Taxpayers admit that the remaining \$9,508 are gross receipts subject to gross receipts tax.

11. The Department has an information sharing agreement with the IRS through which it learned of the gross receipts reported by the Taxpayers on their 1996 Federal Schedule C.

12. The Department contacted Mr. Frost because he was not registered with the Department as a business for gross receipts tax purposes. Mr. Frost spoke with an employee of the Department, Pat Robertson, and explained his situation. After their discussion, Mr. Frost agreed that he was liable for gross receipts tax on the amount he received for his services but he did not believe that he was liable for gross receipts tax on the materials he purchased for his customers. Ms. Robertson advised Mr. Frost to file an amended Federal income tax return with an amended Schedule C, which treated the amounts of materials and supplies as a deduction from income as cost of goods sold rather than as an expense deduction for supplies.

13. On February 7, 2000, Taxpayers filed an amended Federal income tax return with an amended Schedule C in accordance with the advice of Ms. Robertson of the Department. The Amended Schedule C still reflected the Taxpayers total gross receipts to be \$17,613, and the amendments did not alter the amount of net profit reported from Mr. Frost's business.

14. Mr. Frost now believes that he was advised erroneously by the Department and that his gross receipts should not include the costs of materials used in the projects he built for his clients.

15. On March 1, 2000, the Department issued Assessment No. 2499887 to the Taxpayers, assessing \$898.44 in gross receipts tax, \$89.88 in penalty and \$ 488.53 in interest for the periods of January through December, 1996.

16. On March 27, 2000, the Taxpayers filed a written protest to Assessment No. 2499887.

17. The Taxpayers have paid \$427.56 towards the gross receipts tax assessed.

DISCUSSION

The sole issue to be determined herein is whether the amounts Mr. Frost received from his customers and used to purchase construction materials to be used in the projects he was building for them constituted gross receipts subject to gross receipts tax.

As a starting point, Section 7-9-5 NMSA 1978 provides a presumption that all receipts of a person engaging in business are subject to the gross receipts tax. Section 7-1-17(C) provides that any assessment of taxes by the Department is presumed to be correct. Thus, the Taxpayers carry the burden of establishing that the amounts Mr. Frost received to purchase construction materials are not gross receipts subject to gross receipts tax.

Taxpayers argue that the amounts received for the purchase of materials fall under the express exclusion from the definition of “gross receipts” found at § 7-9-3(F)(2)(f), which excludes “amounts received solely on behalf of another in a disclosed agency capacity.” The Department has implemented a regulation, 3 NMAC 19.3.1 which further clarifies the exclusion from gross receipts under § 7-9-3(F)(2)(f) by explaining the legal requirements of an agency relationship. It provides that:

The receipts of any person received as a reimbursement of expenditures incurred in connection with the performance of a service or the sale or lease of property are gross receipts as defined by Subsection F of Section 7-9-3, unless that person incurs such expense as agent on behalf of a principal while acting in a disclosed agency capacity. An agency relationship exists if a

person has the power to bind a principal in a contract with a third party so that the third party can enforce the contractual obligation against the principal.

In this case Mr. Frost informed the materials vendors of the name of his customer, so there is no issue that the vendors were aware of the relationship between Mr. Frost and his customer. It remains to be determined whether the relationship between Mr. Frost's customer and himself constituted an agency relationship such that the materials vendors would have the right to enforce payment for the materials against Mr. Frost's customers. This requires an examination of the contractual relationship between the customers and Mr. Frost to determine whether the contract establishes an agency relationship such that Mr. Frost was empowered to bind his customers in his transactions with the third-party materials vendors.

The contracts each specify that the contracted price includes the cost of materials as well as labor. Those costs are not broken down separately. The contracts provide no authorization for Mr. Frost to purchase the materials in the customer's name nor do they contain any language which could be considered as creating an agency relationship with respect to the materials purchases. Mr. Frost testified that the decisions as to where to purchase materials, and the quantity and quality of the materials to be used were his decisions.

These terms do not establish an agency relationship. This case is analogous to that in *Brim Healthcare v. State, Taxation and Revenue Department*, 119 N.M. 818, 498 P.2d 498 (Ct. App. 1995). In that case, Brim contracted with hospitals to manage them and also to provide key management personnel who were employees of Brim. Under its contracts with hospitals, Brim received compensation for its management services and also reimbursement for the salaries, fringe benefits and expenses for Brim's management employees working at the hospitals. Brim had claimed that its receipts for the reimbursement of the salaries, benefits and expenses of its

employees should not be considered gross receipts subject to tax because it was acting as an agent for the hospitals in paying these expenses. The Court of Appeals rejected this argument, noting that when it received the expense reimbursements under its contract with the hospitals, it was receiving them for its own account and expended them to meet its own responsibilities pursuant to its contract. The same holds true in the instant matter. Mr. Frost's contracts with his clients are contracts to perform certain construction projects. They obligate Mr. Frost to furnish both materials and labor to complete the projects for an agreed price. Mr. Frost, in fact, did just that. He purchased the materials in his own name and used them to build the projects agreed to. As such, the money he received from his clients under the contracts cannot be characterized as reimbursements. They are payments for the services Mr. Frost provided pursuant to his obligations under the contracts. The obligations to the materials suppliers were Mr. Frost's obligations incurred in his own name to fulfill his obligations under his contracts with his clients to provide the materials and labor to complete the agreed upon projects. Thus, all amounts Mr. Frost received from his customers are gross receipts subject to gross receipts tax.

CONCLUSIONS OF LAW

1. The Taxpayers filed a timely, written protest, pursuant to § 7-1-24 NMSA 1978, and jurisdiction lies over both the parties and the subject matter of this protest.
2. Mr. Frost was not acting as an agent in a disclosed agency capacity when purchasing construction materials for use in the construction projects he built for his clients. Rather, Mr. Frost made those purchases in his own name and to fulfill his own obligations to his clients pursuant to his contract with his clients.
3. The total amount of money Mr. Frost received from his clients pursuant to his contracts with his clients are gross receipts pursuant to § 7-9-3(F) NMSA 1978.

For the foregoing reasons, Taxpayers' protest IS HEREBY DENIED.

DONE, this 19th day of September, 2000.