

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

IN THE MATTER OF THE PROTEST OF
THOMAS W. STRAIN, M.D.
ID NO. 02-262078-00 8
ASSESSMENT NO. 2215502

No. 01-03

DECISION AND ORDER

A formal hearing on the above-referenced protest was held April 4, 2001, before Margaret B. Alcock, Hearing Officer. Thomas W. Strain, M.D. ("Taxpayer") was represented by his attorney, Timothy L. Garcia. The Taxation and Revenue Department ("Department") was represented by Gail MacQuesten, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. From January through March 1994, the Taxpayer worked as an employee of Lovelace, Inc., providing medical services to patients.
2. In March 1994, the Taxpayer accepted the job of State Medical Director with ARA Health Services, Inc., doing business as Correctional Medical Services ("CMS").
3. At the time he accepted the job with CMS, the Taxpayer understood he would be working as a salaried employee to oversee CMS' contract with the State of New Mexico to provide medical services to inmates at New Mexico correctional facilities.
4. The contract the Taxpayer signed with CMS stated that the Taxpayer would be responsible for all applicable taxes on fees earned under the contract.
5. When the Taxpayer asked what the language concerning taxes meant, he was told he would be responsible for payment of his own state and federal income taxes and social security

taxes. The Taxpayer did not understand that this language indicated CMS was treating him as an independent contractor rather than as a salaried employee.

6. CMS provided the Taxpayer with an office and a secretary in Albuquerque.

7. The Taxpayer was required to work 40 hours per week and to provide on-call services as needed.

8. The Taxpayer was paid an hourly wage, plus a fee for on-call services. He was also reimbursed for out-of-pocket expenses, including mileage and other travel expenses, telephone calls, business meals, etc.

9. CMS provided health insurance and medical malpractice insurance, for which it deducted a certain amount from the Taxpayer's paychecks.

10. At the correctional facilities where medical services were provided, CMS medical personnel had the use of an examining room and another, larger room where charts and other paperwork could be completed.

11. With the exception of stethoscopes, CMS provided all medical supplies needed to provide services to inmates.

12. Doctors, including the Taxpayer, generally wore street clothes and were not issued or required to purchase uniforms.

13. When he started his employment, it was the Taxpayer's understanding that his duties were primarily administrative and included responsibility for overseeing CMS' contract with the State of New Mexico to provide medical services to inmates. Under the terms of that contract, CMS was also responsible for insuring compliance with the Duran Consent Decree, a judicial order under which New Mexico was required, among other things, to provide a certain level of medical care to inmates at state correctional facilities.

14. The Taxpayer was supervised by Jane Haddad, the regional director for CMS, and W. C. Gaunce, another company administrator, neither of whom had medical training. Ms. Haddad and Mr. Gaunce did not supervise the Taxpayer's medical advice or decisions, but did control his schedule and many of his administrative activities.

15. The Taxpayer reported on behalf of CMS to New Mexico's Interim State Medical Director of Corrections. In connection with the Duran Consent Decree, the Taxpayer met with attorneys for inmates complaining of inadequate medical care and testified on behalf of the state in various court proceedings.

16. The Taxpayer's primary duty was to supervise the nine to eleven doctors and five nurses working for CMS to insure they complied with CMS' guidelines for providing medical services. If a question arose concerning medical care that was not addressed in the guidelines, the Taxpayer was required to contact the medical consultant at the company's headquarters in St. Louis, Missouri.

17. When one of the staff doctors was ill or otherwise unavailable, the Taxpayer was expected to cover that person's duties as a medical services provider to inmates.

18. CMS was chronically short of medical personnel and the Taxpayer was asked to recruit other doctors to work for the company. Once someone expressed an interest, Mr. Gaunce arranged for the Taxpayer to interview that person. Although the Taxpayer disagreed with Mr. Gaunce's practice of setting up interviews before a candidate's medical credentials and licensing status were reviewed, the Taxpayer was overruled and required to conduct the interviews according to the schedule set by Mr. Gaunce.

19. Because CMS was understaffed, the Taxpayer began to spend more and more time providing medical services and less time on administrative duties. He was also denied time off that

the company had previously approved and had to forfeit the prepayment on a vacation he had planned for May 1994.

20. In June 1994, CMS terminated the services of two doctors and allowed a third doctor to work part-time, all over the Taxpayer's objections.

21. CMS gave the Taxpayer a pager and then required him to carry a cell phone so he could be reached when he was providing medical services at one the state correctional facilities.

22. Instead of working an average of 40 hours per week or 160 hours per month as called for in his contract, the Taxpayer found he was working 200 to 240 hours per month.

23. In late June or early July 1994, the Taxpayer renegotiated his contract with CMS. Pursuant to the contract amendment, the Taxpayer received an increase in his hourly wage, but was required to work "no less than" an average of 50 hours per week for 48 weeks per year and to provide on-call services.

24. The contract amendment still contained the statement that "Physician agrees to be responsible for all applicable taxes arising from all fees earned by Physician pursuant to this Agreement."

25. Because the Taxpayer was concerned about the number of miles he was putting on his personal car, CMS agreed to reimburse the Taxpayer for renting a car to travel between correctional facilities and later provided the Taxpayer with a leased vehicle.

26. In June 1994, a federal court determined that the State of New Mexico was not in compliance with the Duran Consent Decree, largely because of inadequate medical staffing. The State (and, therefore, CMS) was given until August 1994 to correct the deficiencies.

27. The Taxpayer spent the next two months working long hours to insure that inmates were seen in a timely manner and that adequate medical care was being provided under the terms of

the consent decree. At the subsequent hearing in August 1994, the Taxpayer's efforts were recognized as a major factor in bringing the state back into compliance with the terms of the decree.

28. On September 13, 1994, the Taxpayer submitted his resignation to CMS, effective October 13, 1994.

29. After leaving CMS, the Taxpayer decided to work as an independent contractor and went to the Department's Albuquerque office to obtain a tax identification number for payment of gross receipts tax.

30. In early 1995, the Taxpayer received two tax forms from CMS: a Form W-2 reporting \$4,131.44 in employee wages, and a Form 1099 reporting \$106,279.21 in nonemployee compensation. The Taxpayer did not understand the difference between these forms and took everything to the accountant who was preparing his 1994 income tax returns.

31. The Taxpayer's accountant explained that the income shown on Form 1099 was treated as business income earned by an independent contractor and had to be reported on Schedule C (Profit or Loss From Business) to the Taxpayer's federal income tax return.

32. The Taxpayer objected to this tax treatment of his income since he believed he was an employee of CMS. On March 4, 1995, the Taxpayer sent a letter to Jane Haddad at CMS asking, in part, "why the 1099 when I was your employee and worked as both a medical director and provider simultaneously?" The Taxpayer also made the following observation:

Jane: I would like to remind you that for someone who was not supposed to be an employee but yet a contractor based on what has come forth (1099). I was denied the privilege to take my pre-paid vacation in May, attend a club-sponsored competition in Aug '94 which was announced Sept '93, and spend time with my child back East during the Summer '94. This was because the company needed me to be present or was short staffed and I was to fill in.

34. The Taxpayer never received a response from Ms. Haddad or anyone else at CMS.

35. The Taxpayer's accountant refused the Taxpayer's request to report all of his compensation from CMS as wages and reported the 1099 income as business income on Schedule C to the Taxpayer's 1994 federal income tax return.

36. The Taxpayer was concerned about being late with the payment of his state and federal taxes and decided to go ahead and sign the income tax returns his accountant had prepared. Because of his disagreement with the accountant's method of reporting the 1099 income, the Taxpayer changed accountants the following year.

37. It did not occur to the Taxpayer that reporting his compensation from CMS as business income on his federal income tax return could result in a liability for New Mexico gross receipts tax, and the Taxpayer did not report or pay gross receipts tax on this income.

38. On November 3, 1997, the Department mailed the Taxpayer a notice of limited scope audit concerning the discrepancy between business income reported to the IRS on Schedule C of the Taxpayer's 1994 federal income tax return and business income reported to the Department for gross receipts tax purposes.

39. The November 3, 1997 notice advised the Taxpayer that he must be in possession of any nontaxable transaction certificates ("NTTCs") needed to support deductions from gross receipts within 60 days from the date of the notice or deductions relating to the NTTCs would be disallowed.

40. On February 5, 1998, the Department issued Assessment No. 2215502 to the Taxpayer for tax periods January-December 1994 in the amount of \$5,444.36 gross receipts tax, \$544.44 penalty and \$2,824.27 interest.

41. On February 19, 1998, the Taxpayer filed a written protest to the Department's assessment.

42. On February 19, 2001, at the request of the Taxpayer's attorney, CMS issued a Type 5 NTTC (Sale of Service for Resale) to the Taxpayer.

DISCUSSION

The Taxpayer has raised two alternative arguments in support of his protest to the Department's assessment of gross receipts tax: (1) the Taxpayer was an employee of CMS during 1994 and is entitled to claim the deduction for employee wages provided in Section 7-9-17 NMSA 1978; and (2) in the event the Taxpayer is found to be an independent contractor, the NTTC issued to the Taxpayer in February 2001 should be accepted to support the deduction for selling services for resale provided in Section 7-9-48 NMSA 1978.

Burden of Proof. Section 7-1-17(C) NMSA 1978 states that any assessment of taxes made 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). 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). Accordingly, it is the Taxpayer's burden to come forward with evidence and legal arguments to show that he is entitled to the deductions claimed and that the Department's assessment is incorrect.

Employee v. Independent Contractor. The Taxpayer maintains he worked for CMS as an employee, rather than as independent contractor, and is therefore entitled to the exemption from gross receipts found in Section 7-9-17 NMSA 1978, which states:

Exempted from the gross receipts tax are the receipts of employees from wages, salaries, commissions or from any other form of remuneration for personal services.

The Department contends that the Taxpayer was an independent contractor whose self-employment income did not qualify for the exemption provided in Section 7-9-17. The Department further argues that the Taxpayer is required to treat his income in a consistent manner: he cannot report his compensation from CMS as business income for income tax purposes while reporting the same income as employee wages for gross receipts tax purposes.

In determining whether a person is an employee or an independent contractor, the principal consideration is the right to control. 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, and not the details of the performance, the worker is usually considered to be an independent contractor. *Burruss 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, and 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: (1) direct evidence of control; (2) the right to terminate the employment at will, by either party, without liability; (3) the right to delegate the work or to hire and fire assistants; (4) the method of payment, whether by time or by the job; (5) whether the party employed engages in a distinct occupation or business; (6) whether the work is part of the employer's regular business; (7) the skill required in the particular occupation; (8) whether the employer supplies the instrumentalities, tools or the place of work; (9) the duration of a person's

employment and whether that person works full-time or regular hours; and (10) whether the parties believe they have created the relationship of employer and employee, insofar as this belief indicates an assumption of control by one and submission to control by the other. *Benavidez v. Sierra Blanca Motors*, 125 N.M. 235, 238, 959 P.2d 569, 572 (Ct. App. 1998). While all of the above factors may be considered, it is the totality of the circumstances that should determine whether the employer has the right to exercise essential control over a particular worker.

Department Regulation 3.2.105.7 NMAC sets out the following questions to be asked in determining whether a worker qualifies as an employee: is income tax withheld from the worker's paychecks; is the worker covered by worker's compensation insurance; is the "employer" obligated to pay social security taxes and make unemployment insurance contributions on behalf of the worker; does the "employer" consider the worker to be an employee; and does the "employer" have a right to exercise control over the means of accomplishing a result or only over the result?

In this case, there is evidence supporting both parties' positions. The following facts support the Taxpayer's contention that he was an employee of CMS:

CMS was in the business of providing medical services.

The Taxpayer was hired to perform medical services for CMS on an hourly basis and was paid an hourly wage. The Taxpayer's compensation was not based on his completion of a particular job or project and his employment could be terminated by either party on 30 days' notice.

The Taxpayer was required to work a minimum of 50 hours per week and provide on-call services. The Taxpayer was required to carry a pager or cell phone so that CMS personnel could contact him at any time. The job monopolized all of the Taxpayer's time, effectively denying him the option of contracting to perform services for another employer.

The Taxpayer could set his own work schedule, but Mr. Gaunce, a CMS administrator, had authority to override the Taxpayer's schedule and require his attendance at meetings and interviews set by Mr. Gaunce. The Taxpayer was denied vacation time CMS had verbally agreed to at the time the Taxpayer was hired.

The Taxpayer was provided an office and secretary at CMS' Albuquerque location. When the Taxpayer and other doctors worked on-site at state correctional facilities, CMS arranged for them to have the use of an examining room and provided all necessary medical supplies.

All of the Taxpayer's out-of-pocket expenses were reimbursed by CMS, including travel expenses, meals and telephone charges. At the Taxpayer's request, CMS provided him with a leased vehicle to use in traveling between correctional facilities.

CMS provided the Taxpayer with health insurance and medical malpractice insurance, to which the Taxpayer contributed through payroll deductions.

One of the Taxpayer's primary duties was to insure that the medical personnel hired by CMS complied with company guidelines for providing medical services. If a question arose concerning medical care that was not addressed in the guidelines, the Taxpayer could not exercise his own judgment in dealing with the problem, but was required to contact the medical consultant at the company's headquarters in St. Louis, Missouri.

CMS issued the Taxpayer a Form W-2 reporting at least some of the payments it made to the Taxpayer as employee wages.

The Department points to the the following facts to support its position that the Taxpayer was an independent contractor:

The Taxpayer was hired to oversee CMS's contract with the State of New Mexico and reported directly to New Mexico's Interim State Medical Director of Corrections. The Taxpayer was not given any training on how to carry out his duties.

The Taxpayer was a doctor and his medical decisions were not subject to the control of CMS administrators who had no medical training.

Both the original contract and the amended contract the Taxpayer entered into with CMS stated that the Taxpayer "agrees to be responsible for all applicable taxes arising from all fees earned" pursuant to the contract.

CMS did not withhold state, federal or social security taxes from the Taxpayer's paychecks, nor did it contribute to unemployment insurance for the Taxpayer.

CMS issued the Taxpayer a Form 1099, reporting most of its payments to the Taxpayer as nonemployee compensation.

The Taxpayer reported the income shown on the Form 1099 as business income on Schedule C to his 1994.

With regard to the issue of control, the Department relies on *Chin v. United States*, 57 F.3d 722 (9th Cir. 1995) to argue that CMS hired the Taxpayer to achieve a specific result, *i.e.*, to insure CMS was in compliance with its contract with the State of New Mexico, and that CMS did not control the means the Taxpayer used to accomplish this result. The facts in this case are significantly different than those in *Chin*, however, and do not support the conclusion that the Taxpayer was given autonomy to administer the New Mexico contract as he saw fit or was free from the control of CMS.

The taxpayer in *Chin* was a medical doctor and a world renowned specialist in malariology. Dr. Chin entered into a contract with AID, an agency of the United States, to serve as the malaria control advisor to the country of Pakistan. The primary factors the court looked at in concluding that Dr. Chin was an independent contractor were:

(1) Dr. Chin's office was located at Pakistan's Ministry of Health, and the government of Pakistan, not AID, provided Dr. Chin with office furniture and a secretary. Dr. Chin went to the AID office only to collect his mail, cash checks and attend an occasional meeting.

In this case, the Taxpayer's office and secretary were provided by CMS and his office was located in the same building as the offices of other CMS employees in Albuquerque.

(2) Dr. Chin spent approximately one-third of his time in the field and set his own schedule, which was different than the schedule followed by other AID workers.

While it is true that the Taxpayer spent a large portion of his time on-site at correctional facilities, his control over his schedule was limited. He usually received very little notice of the need to travel to one of the state facilities to fill in for a doctor who was ill. His movement between facilities was often directed by CMS, which required the Taxpayer to carry a pager or cell phone so he could be reached at all times. CMS also directed the Taxpayer's

attendance at meetings and interviews and even required the Taxpayer to cancel long-standing vacation plans.

(3) Dr. Chin received policy and program guidance from the Pakistani ministry and reported to the Chief of the Pakistani Department of Health. Although Dr. Chin submitted quarterly reports to AID and attended monthly meetings at the AID office, the doctor in charge testified that AID exercised no control over Dr. Chin.

In the present case, the Taxpayer acted as a liaison between CMS and New Mexico's Interim State Medical Director of Corrections, but the policy and program guidelines he was required to follow came from CMS. If a question arose concerning medical care that was not addressed in the guidelines, the Taxpayer was required to contact the medical consultant at the company's headquarters in St. Louis, Missouri. In addition, the Taxpayer had no control over the hiring or firing of doctors and nurses needed to carry out the program he was supposed to administer. Mr. Gaunce fired two doctors over the Taxpayer's objection and implemented interview procedures the Taxpayer believed were inappropriate. The Taxpayer was not given a specific goal with payment dependent on completion of the goal, but was required to work a specified number of hours per week and was paid an hourly wage. The Taxpayer's employment could be terminated by either party upon 30 days' notice.

Unlike Dr. Chin, the Taxpayer was not given autonomy to administer the New Mexico contract as he saw fit, but was subject to the direction and supervision of CMS. Based on the totality of the circumstances, the Taxpayer was an employee of CMS and not an independent contractor.

Consistency in Reporting. Having determined that the Taxpayer was an employee of CMS, the next question is whether the Taxpayer may claim a deduction against gross receipts for employee wages when he reported the same income as business income on his state and federal income tax

returns. 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 wages 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.” *Id.*, 87 N.M. at 121-122, 529 P.2d at 1242-1243.

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.

In this case, the Taxpayer reported most of the income he received from CMS as business income on Schedule C to his 1994 federal income tax return. While it is true that the Taxpayer believed this income should have been treated as employee wages and tried to get CMS to correct the situation, the Taxpayer ultimately acceded to his accountant's advice and reported the income reported on Form 1099 as business income. As the *Co-Con* and *Stohr* decisions establish, when there is a conflict between the way a taxpayer reports a transaction for federal and state tax purposes, the taxpayer is bound by the manner in which he reported for federal purposes. If a taxpayer's method of reporting does not reflect the true nature of a transaction, the taxpayer has the option—if not the obligation—to file amended federal returns. Tax reporting, even when it does not distort income or result in tax savings, is not a matter of convenience. Tax returns should accurately reflect that which is being reported.

At the April 4, 2001 hearing, the Taxpayer stated that he was willing to file amended 1994 income tax returns, but was still waiting to obtain his file of 1994 tax information from his New

York accountant.¹ The parties agreed that if the Taxpayer were determined to be an employee, he should be given a specified period of time to correct his returns. Once amended returns are filed to report the Taxpayer's income from CMS as employee wages, rather than as business income, he will be entitled to deduct those wages from gross receipts under Section 7-9-17 NMSA 1978.

NTTC Issue. Having found that the Taxpayer was an employee of CMS, there is no need to address the Taxpayer's alternative issue concerning NTTCs.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2215502, and jurisdiction lies over the parties and the subject matter of this protest.
2. Although CMS treated the Taxpayer as an independent contractor, because of the degree of control CMS exercised over the Taxpayer, the Taxpayer was an employee of CMS.
3. The Taxpayer is not entitled to claim the gross receipts tax deduction provided in Section 7-9-17 NMSA 1978 as long as his 1994 federal income tax return reflects this income as business income on Schedule C to Form 1040.
4. The Taxpayer will be entitled to claim the gross receipts tax deduction provided in Section 7-9-17 NMSA 1978 if the Taxpayer files amended 1994 state and federal income tax returns to report his income from CMS as employee wages.

For the foregoing reasons, the Taxpayer's protest is DENIED IN PART AND GRANTED IN PART. The Department is ordered to abate Assessment No. 2215502 if the Taxpayer provides the Department with proof, on or before July 30, 2001, that he has filed amended state and federal income

¹ The primary reason for requiring amended returns is to prevent a taxpayer from "double-dipping" by simultaneously claiming to be an independent contractor entitled to business deductions on Schedule C of his federal income tax return and an employee entitled to gross receipts tax deductions on his New Mexico CRS-1 returns. In this case, the Taxpayer did work as an independent contractor after leaving CMS and may have a number of legitimate deductions for the period October-December 1994. To the extent deductions were claimed for expenses

tax returns to report his 1994 income from CMS as employee wages. In the event the Taxpayer does not provide the required proof of filing by July 30, 2001, the Taxpayer shall be bound by his original method of reporting his income from CMS and shall be liable for payment of the gross receipts, tax, penalty and interest assessed against him.

DATED April 17, 2001.

related to the Taxpayer's work for CMS, however, those deductions must meet IRS requirements for unreimbursed employee expenses and may not be deducted as business expenses on Schedule C.