

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

IN THE MATTER OF THE PROTEST
OF M. L. ROUSH CONSTRUCTION
ID. NO. 02-098728-00 5
ASSESSMENT NO. 2151440

98-31

DECISION AND ORDER

This matter came on for formal hearing on April 1, 1998, before Margaret B. Alcock, Hearing Officer. M. L. Roush Construction, a proprietorship, was represented by Mark L. Roush, its owner. The Taxation and Revenue Department ("Department") was represented by Gail MacQuesten, Special Assistant Attorney General. At the close of the hearing, the record was kept open and Mr. Roush was given until May 1, 1998 to provide additional documentation in support of his protest. The Department filed its response on May 20, 1998, at which time the matter was submitted for decision. Based on the evidence in the record and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Mr. Roush is a licensed residential contractor who has been in business in New Mexico since 1988.
2. At the time Mr. Roush started his business, which is a sole proprietorship, he opened a business account that was kept separate from his personal accounts.
3. During the audit period January 1993 through December 1996, Mr. Roush reported gross receipts tax on his receipts from construction projects he performed for third

parties. Mr. Roush used nontaxable transaction certificates when purchasing supplies and subcontractor services for these projects.

4. Mr. Roush did not report gross receipts tax on receipts from selling three houses that he sequentially built and briefly lived in before they were sold. For the most part, Mr. Roush did not use nontaxable transaction certificates when purchasing supplies and subcontractor services for these houses.

5. The first house Mr. Roush built was located at 602 Winged Foot in Carlsbad, New Mexico. Work began in January 1991; the house was sold in June 1993 for \$107,500.

6. The second house was located at 606 Winged Foot in Carlsbad, New Mexico. Work began in April 1993; the house was sold in May 1994 for \$96,100.

7. The third house was located at 201 Raymond in Carlsbad, New Mexico. Work began in February 1993; the house was sold in September 1995 for \$160,000.

8. Mr. Roush does not remember how long he lived in each house. He would usually move into a house as soon as there was running water. During periods when none of the houses was livable, he and his family lived with his wife's mother.

9. Mr. Roush could sell a house that was being lived in for more than he could sell an empty house.

10. Mr. Roush obtained the following loans to cover the costs of construction and his living expenses:

<i>Source</i>	<i>Amount</i>	<i>Date</i>
United New Mexico Bank:	\$ 76,000.00	09/92
United New Mexico Bank	\$ 36,000.00	04/93
United New Mexico Bank:	\$ 74,880.00	04/93
United New Mexico Bank	\$153,087.56	06/94

Mae Anderson	\$ 40,000.00	11/94
Mae Anderson	\$ 25,000.00	1996

Each of the United New Mexico Bank loans, except the April 1993 loan for \$36,000, was made in the form of a line of credit, rather than a lump sum, and funds were drawn out in small amounts at various times.

11. Mr. Roush does not know and does not have any records indicating whether he deposited the loan money to a personal account or to his business account.

12. Mr. Roush treated the three houses he built and sold as personal investments, not as part of his construction business. For income tax purposes, Mr. Roush reported receipts from the sale of each house on Schedule D (Capital Gains and Losses) to his federal Form 1040. Receipts from his construction work for third parties were reported on Schedule C (Profit and Loss from Business) to federal Form 1040.

13. Because Mr. Roush did not believe his receipts from selling the houses were business receipts, he did not report them on his state gross receipts tax returns.

14. In November 1996, Mr. Roush was audited by the Department. The audit was initiated to investigate the discrepancy between the amounts listed on Mr. Roush's building permits with the city of Carlsbad and the amounts listed on his gross receipts tax returns.

15. The auditor determined that Mr. Roush's receipts from selling the houses located at 602 Winged Foot, 606 Winged Foot and 201 Raymond were taxable receipts on which Mr. Roush should have paid gross receipts tax. The auditor calculated these receipts by taking the sales price of each house shown on Mr. Roush's Schedule D to his Federal Forms 1040 and subtracting the value of the real estate on which the house was built.

16. The auditor made a list of all the deposits made to Mr. Roush's business account. The source of most of the deposits could not be identified. The auditor determined that the amount of monthly deposits that exceeded the amount of gross receipts Mr. Roush reported for that month were underreported gross receipts subject to tax.

17. The auditor did not examine Mr. Roush's personal accounts. None of the deposits to those accounts were treated as taxable receipts and no gross receipts tax was assessed on the funds in those accounts.

18. On July 2, 1997, the Department mailed Mr. Roush Assessment No. 2151440 in the amount of \$24,647.96 gross receipts tax, \$2,713.41 penalty and \$9,493.79 interest.

19. On August 1, 1997, Mr. Roush requested a 60-day extension of time to file a protest, which was granted. On September 27, 1997, Mr. Roush filed a written protest to the Department's assessment.

DISCUSSION

Mr. Roush raises the following arguments in support of his protest: (1) construction of the three houses at issue were isolated or occasional transactions entitled to the exemption provided in Section 7-9-28 NMSA 1978; (2) because Mr. Roush paid gross receipts tax on the materials and services he purchased to build the houses, taxing his receipts from the sale of the houses would be double taxation; (3) some of the unidentified deposits the auditor included as taxable receipts were actually loan proceeds not subject to gross receipts tax.

I Exemption for Isolated or Occasional Sales.

Section 7-9-4 NMSA 1978 imposes an excise tax on the gross receipts of any person engaging in business in New Mexico. The definition of “engaging in business” is quite broad

and includes “carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit.” Section 7-9-3(E) NMSA 1978. In this case, Mr. Roush built houses intending to sell them at a profit. He testified that one reason for moving into each house prior to sale was that a house that was being lived in would sell for more than an empty house. Mr. Roush's activity of building and selling houses meets the statutory definition of engaging in business.

Mr. Roush argues that his receipts from selling houses are exempt from gross receipts tax under Section 7-9-28 NMSA 1978, which states:

Exempted from the gross receipts tax are the receipts from the isolated or occasional sale of or leasing of property or a service by a person who is neither regularly engaged nor holding himself out as engaged in the business of selling or leasing the same or similar property or service.

Mr. Roush fails to qualify for this exemption for two reasons: first, because the construction and sale of three houses within a period of less than three years cannot be characterized as either isolated or occasional transactions; and second, because Mr. Roush is regularly engaged in business as a licensed residential contractor.

Mr. Roush limited his work on his houses to evenings and weekends when he was not engaged in construction projects for third parties. Nonetheless, he was continuously working on one or more houses during the period in question and sold all three houses in less than three years' time. The facts of this case are very similar to those in Regulation 3 NMAC 2.28.9.2, Example 5 (formerly GR 28:2):

K purchases vacant land, builds a home, lives in it for a few months, sells it, and then repeats the process three months later. K's activity is not an isolated or occasional transaction. K is regularly engaged in the business of selling homes because of the frequency of the sales. Therefore, K's receipts from the sale of the improvements are subject to gross receipts tax. Such regular and repeated activity does not meet the requirements of Section 7-9-28.

Mr. Roush's repeated pattern of building a house, living in it for a brief period of time and then selling it disqualifies him for the exemption in Section 7-9-28.

Even if Mr. Roush's activities met the definition of isolated or occasional, his receipts from the construction and sale of houses still would not qualify for the exemption. Regulation 3 NMAC 2.28.9.1 (formerly GR 28:2) provides that any person who holds a license to carry on services is engaged in the business of selling the same or similar services. In this case, Mr. Roush holds a residential contractor's license. He is in the business of performing construction services as a general contractor for third parties. Acting as his own general contractor to construct and sell houses is simply an extension of Mr. Roush's regular business activity. The exemption in Section 7-9-28 is limited to "a person who is neither regularly engaged nor holding himself out as engaged in the business of selling or leasing the same or similar property or service." Because Mr. Roush is regularly engaged in the residential construction business, he cannot claim an exemption for receipts from constructing and selling residential houses.

II. Double Taxation.

When engaged in construction work for third parties, Mr. Roush used nontaxable transaction certificates ("NTTCs") to purchase materials and services without having to pay the passed-on gross receipts tax. When engaged in construction work for himself, Mr. Roush did not use NTTCs, but paid gross receipts tax on his purchase of materials and services incorporated into the houses he built. Mr. Roush argues that assessing him for gross receipts tax on his receipts from sale of the completed houses results in double taxation.

It is a popular misconception that double taxation is inherently illegal or unconstitutional. Almost 80 years ago, in *Ft. Smith Lumber Co. v. Arkansas*, 251 U.S. 532 (1920), the United States

Supreme Court summarily disposed of the plaintiff's argument that the federal constitution prohibits a state from taxing the same transaction twice. As stated by Justice Oliver Wendell Holmes, writing for the majority:

The objection to the taxation as double may be laid on one side. That is a matter of State law alone. The Fourteenth Amendment no more forbids double taxation than it does doubling the amount of a tax....

251 U.S. at 533. New Mexico courts have also held, on numerous occasions, that there is no constitutional prohibition against double taxation. *New Mexico State Board of Public Accountancy v. Grant*, 61 N.M. 287, 299 P.2d 464 (1956); *Amarillo-Pecos Valley Truck Lines, Inc. v. Gallegos*, 44 N.M. 120, 99 P.2d 447 (1940); *State ex rel. Attorney General v. Tittmann*, 42 N.M. 76, 75 P.2d 701 (1938).

It should also be noted that in construing the New Mexico Gross Receipts and Compensating Tax Act, the New Mexico courts have held that there is no double taxation where the two taxes complained of are imposed on the receipts of different taxpayers. *See, e.g., House of Carpets, Inc. v. Bureau of Revenue*, 84 N.M. 747, 507 P.2d 1078 (Ct. App. 1973); *New Mexico Sheriffs & Police Association v. Bureau of Revenue*, 85 N.M. 565, 514 P.2d 616 (Ct. App. 1973). That is the case here. Mr. Roush and his suppliers and subcontractors are all separate taxpayers, each of which is engaged in business in New Mexico. The gross receipts tax is imposed—once—on the supplier's or subcontractor's receipts from selling materials and services to Mr. Roush. The gross receipts tax is also imposed—once—on Mr. Roush's receipts from selling the completed construction project. Under these facts, there is no double taxation.

Even though taxing successive transactions is not double taxation, the New Mexico legislature has been careful to provide a number of statutory deductions to prevent the pyramiding

or stacking of the gross receipts tax. Thus, it has provided a deduction for the sale of tangible personal property and construction services to persons who are engaged in the construction business and provide the seller with an NTTC. Sections 7-9-51 and 7-9-52 NMSA 1978. These deductions would have been available to Mr. Roush's suppliers and subcontractors if he had given them an NTTC when he purchased supplies and services incorporated into the houses he built. He did not do so. Mr. Roush's misunderstanding of the law and his decision not to use NTTCs when purchasing materials and services does not excuse him from payment of the gross receipts tax on his receipts from selling the completed houses.

III Gross Receipts Tax on Loan Proceeds.

Mr. Roush argues that the auditor's calculation of underreported gross receipts included bank deposits that represented loan proceeds rather than taxable receipts from performing construction services. Although Mr. Roush did not discuss the existence of the loans with the auditor, he has now provided documentation to establish that he obtained several bank and family loans to finance the construction of the houses he built. Unfortunately, Mr. Roush is unable to trace the loan proceeds to specific deposits made to his business account. The problem is compounded by the fact that most of the loans were made in the form of a line of credit with funds drawn out in small amounts rather than in a lump sum. Accordingly, it is not possible to review the record of deposits to Mr. Roush's business account and match the amount and date of a specific loan to a corresponding deposit.

There is a statutory presumption that the Department's assessment of gross receipts taxes is correct. Section 7-1-7, NMSA 1978; *Mears v. Bureau of Revenue*, 87 N.M. 240, 241, 531 P.2d 1213, 1214 (Ct. App. 1975). In order for the taxpayer to be successful, he must clearly overcome

this presumption. *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). In this case, Mr. Roush has failed to meet his burden of establishing that deposits on which gross receipts tax was assessed were the proceeds of loans rather than taxable receipts. As set out in the auditor's report, most of the deposits into the business account were unidentified. Mr. Roush maintained more than one bank account and testified that he did not know which account he used to deposit the loan proceeds. Since Mr. Roush treated the houses he built as personal investments, rather than as part of his construction business, it would be logical to assume that he deposited the funds borrowed to build the houses into one of his personal accounts. Given the absence of any records or other evidence that loan proceeds were deposited to Mr. Roush's business account, there is no basis for adjusting the Department's assessment.

CONCLUSIONS OF LAW

1. Mr. Roush filed a timely, written protest to Assessment No. 2151440, and jurisdiction lies over the parties and the subject matter of this protest.
2. Mr. Roush, as a licensed residential contractor, was regularly engaged in the construction business and cannot claim the exemption provided in Section 7-9-28 NMSA 1978 for receipts from constructing and selling houses.
3. Mr. Roush's sales of three houses during a period of less than three years do not qualify as isolated or occasional transactions qualifying for the exemption provided in Section 7-9-28 NMSA 1978.
4. Mr. Roush's decision not to use NTTCs when purchasing construction materials and services incorporated into the houses he built does not excuse him from payment of gross receipts tax on his receipts from selling those houses.

5. Mr. Roush failed to meet his burden of proving that deposits made to his business account represented loan proceeds rather than taxable receipts.

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

DONE, this 27th day of May 1998.