

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

IN THE MATTER OF THE PROTEST OF  
**SHARON AND JOHN ASKWITH**  
PARTIAL DENIAL OF CLAIM FOR REFUND

No. 00-10

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held February 24, 2000, before Margaret B. Alcock, Hearing Officer. Sharon and John Askwith ("Taxpayers") were represented by Sharon Askwith. The Taxation and Revenue Department ("Department") was represented by Monica M. Ontiveros, Special Assistant Attorney General. The record was left open to allow the parties time to review the mathematical calculations in the Taxpayers' 1998 New Mexico personal income tax return and reach agreement on the amount of tax that is in dispute. On March 3, 2000, the parties submitted a Stipulation of Facts setting out additional facts concerning the refund. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

**FINDINGS OF FACT**

1. Between 1985 and 1996, Taxpayers were residents of the state of Illinois.
2. During this period, John Askwith was a full-time employee of Outside Magazine, a division of Mariah Publications Corporation ("Mariah Publications").
3. In July 1985, Mr. Askwith entered into a "phantom stock" agreement with Mariah Publications under which Mr. Askwith was credited with a specified number of hypothetical shares of corporate stock. The agreement provided that upon termination of employment, Mr. Askwith would be entitled to a cash payment equal to the increase in book value of the phantom stock between the time of issuance and the time of termination.

4. Phantom stock plans are not retirement plans, but are incentive compensation plans that allow key employees to participate in the corporation's growth without having to assume the cost and risk of stock ownership. If the incentive program meets IRS requirements, the employee is not liable for income tax at the time the plan is implemented, but reports the phantom stock payments as ordinary income in the year received, while the employer takes a corresponding deduction for compensation paid.

5. In 1996, the Taxpayers sold their home in Illinois and established residence in New Mexico.

6. In 1998, Mr. Askwith received a payment under his phantom stock agreement with Mariah Publications. Mariah Publications issued Mr. Askwith a 1998 federal form W-2 reflecting the payment as "wages, tips, other compensation" and showing income tax withholding payments to both the federal government and New Mexico, which was the Taxpayers' state of residence for all of 1998.

7. On March 30, 1999, the Taxpayers filed a joint New Mexico income tax return, form PIT-1. On accompanying form PIT-B, New Mexico Allocation and Apportionment of Income Schedule, the Taxpayers allocated 32 percent of the phantom stock payment to New Mexico. This amount reflected the appreciation in the value of the phantom stock that occurred while the Taxpayers were residents of New Mexico.

8. As a result of allocating most of the phantom stock payment outside New Mexico, the Taxpayers' return showed a refund due of \$15,532.00. The filing of a New Mexico income tax return showing a balance due the taxpayer constitutes the filing of a claim for refund under Section 7-1-26 NMSA 1978.

9. On April 21, 1999 and May 17, 1999, the Department sent adjustment notices to the Taxpayers reallocating the entire phantom stock payment to New Mexico and crediting the Taxpayers with \$6,191.00 of tax they paid on the same income to the state of Illinois. Based on the adjustments, which served as a partial denial of the Taxpayer's claim for refund, the Taxpayers received a reduced refund of \$8,484.00.

10. On June 25, 1999, pursuant to an extension of time granted by the Department, the Taxpayers filed a protest to the Department's partial denial of their claim for refund. After making additional adjustments for mathematical errors discovered after the protest was filed, the parties stipulated that the refund amount at issue is \$6,344.00.

### **DISCUSSION**

The issue in this case is whether New Mexico has the right to tax a full-year New Mexico resident on compensation attributable to work the resident performed in another state. The Taxpayers argue that only Illinois has the right to tax the deferred compensation Mr. Askwith received for his work as an employee of Mariah Publications in the state of Illinois. The Department maintains that New Mexico has the right to tax the entire income of its residents, without regard to the source of that income.

Payment of New Mexico personal income taxes is governed by the Income Tax Act, Sections 7-2-1, *et seq.*, NMSA 1978. New Mexico is among the majority of states that "piggy-back" or use the federal income tax system as the basis for calculating state income taxes. As reflected on the Department's 1998 form PIT-1, New Mexico taxable income is calculated by starting with the taxpayer's federal adjusted gross income, deducting the taxpayer's federal personal exemption and itemized deductions, and making certain adjustments reflected on Schedule A. The amount of tax is then drawn from the tax rate table or tax schedule.

When a taxpayer has income that is taxable both within and without New Mexico, Section 7-2-11 NMSA 1978 allows the taxpayer to file a form PIT-B to allocate and apportion certain categories of income between New Mexico and non-New Mexico sources. The percentage of total income allocated or apportioned to New Mexico is then applied to the tax previously calculated to determine the tax due. There are some categories of income that must be allocated 100 percent to New Mexico on form PIT-B, regardless of the source of the income. Subsection A(3) of Section 7-2-11 NMSA 1978 requires compensation of full-year residents to be allocated to New Mexico. Regulation 3 NMAC 3.11.11.1 states that "all compensation received while a resident of New Mexico shall be allocated to this state whether or not such compensation is earned from employment in this state." The term "compensation" is defined in Section 7-2-2(C) NMSA 1978 to include "wages, salaries, commissions and any other form of remuneration paid to employees for personal services."

In this case, the 1998 payment Mr. Askwith received under the phantom stock agreement was deferred compensation for services rendered while he was an employee of Mariah Publications. The payment falls within the Income Tax Act's definition of "compensation" and was reported as such on the 1998 form W-2 issued to Mr. Askwith by his employer. Because Mr. Askwith was a full-year resident of New Mexico in the year he received the payment, the Taxpayers were required to allocate the entire payment to New Mexico when calculating their New Mexico income tax liability. The fact that the payment was attributable to work performed outside New Mexico is irrelevant.

There is nothing illegal or unconstitutional in requiring New Mexico residents to pay state income tax on all income received during the taxable year, including income attributable to activities in other states. More than 70 years ago, the United States Supreme Court recognized the rights of the several states "to exercise the widest liberty with respect to the imposition of internal taxes"

noting that “states have full power to tax their own people....” *Shaffer v. Carter*, 252 U.S. 37, 51 (1919). In *Lawrence v. State Tax Commission of Mississippi*, 286 U.S. 276 (1932), the Court addressed the same issue raised in this protest, holding that Mississippi had the right to tax a Mississippi resident on income earned from services performed on a construction project in the state of Tennessee. As stated by the Court:

The obligation of one domiciled within a state to pay taxes there, arises from the unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits. Hence, domicile in itself establishes a basis for taxation.

286 U.S. at 279.

In assessing the legality of New Mexico’s income tax scheme, it should be noted that New Mexico provides a tax credit to residents required to pay tax to both New Mexico and another state on the same income. Section 7-2-13 NMSA 1978 provides, in pertinent part:

When a resident individual is liable to another state for tax upon income derived from sources outside this state but also included in net income under the Income Tax Act as income allocated or apportioned to New Mexico pursuant to Section 7-2-11 NMSA 1978, the individual...shall receive a credit against the tax due this state in the amount of the tax paid the other state with respect to income that is required to be either allocated or apportioned to New Mexico.

Here, the Taxpayers were given credit against their 1998 New Mexico income tax for \$6,191.00 of tax they were required to pay to the state of Illinois. The credit provided by Section 7-2-13 NMSA 1978 insures that New Mexico residents will not be taxed twice on the same income. Given this statutory tax scheme, there is neither a legal nor an equitable basis for the Taxpayers to challenge the Department’s partial denial of their claim for refund of 1998 income taxes.

## CONCLUSIONS OF LAW

1. The Taxpayers filed a timely written protest to the Department's partial denial of their claim for refund of 1998 personal income taxes, and jurisdiction lies over the parties and the subject matter of this protest.

2. There is nothing illegal or unconstitutional in requiring full-year New Mexico residents to allocate all compensation received during the taxable year to New Mexico when calculating their personal income tax liability to New Mexico.

3. The Taxpayers were required to allocate the entire amount of Mr. Askwith's 1998 phantom stock payment to New Mexico when calculating their 1998 New Mexico income tax.

For the foregoing reasons, the Taxpayers' protest is DENIED.

DATED March 20, 2000.