

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

IN THE MATTER OF THE PROTEST OF
SILVER HOUSE TRADING COMPANY
ID. NO. 02-087433-00 2
ASSESSMENT NO. 2294944

No. 00-13

DECISION AND ORDER

A formal hearing on the above-referenced protest was held April 25, 2000, before Margaret B. Alcock, Hearing Officer. Silver House Trading Company ("Taxpayer") was represented by Lutfi Nassar and Hafiz Nassar, two of its partners. The Taxation and Revenue Department ("Department") was represented by Bridget A. Jacober, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is a partnership engaged in the business of selling Native American jewelry, pottery and paintings. The Taxpayer's partners are two brothers, Hafiz Nassar and Lutfi Nassar, and their sister, Samia Nassar.
2. The business started in 1986 and operates out of a wholesale and retail store located in Gallup, New Mexico.
3. During the period 1992-1995, a number of the Taxpayer's sales were to out-of-state customers. In many cases, the items purchased were shipped to the customer's out-of-state address or personally delivered to the customer by Hafiz Nassar.

4. In 1993, the Taxpayer entered into an informal joint venture with Mel Silva, who owned a pawn shop and arts and crafts store in Colorado. The parties referred to their joint venture by the name of Mel Silva's Colorado store, Waci-ci.

5. Mr. Silva obtained a substantial loan commitment from Robert Baer, a private lender in Colorado. Mr. Baer agreed to advance funds for Mr. Silva and Hafiz Nassar to purchase Native American jewelry in Gallup, New Mexico, and sell the merchandise to merchants and dealers throughout the west.

6. Because the Taxpayer was located in Gallup, the loan proceeds were deposited into the Taxpayer's bank account, from which Hafiz Nassar withdrew the cash needed to purchase jewelry from Native Americans located in Gallup.

7. Once a sufficient inventory of jewelry was purchased, Hafiz Nassar and Mel Silva traveled through the western states, making sales along the way. The proceeds of those sales were turned over to Mrs. Silva, who acted as bookkeeper for the joint venture.

8. Hafiz Nassar and Mel Silva did not keep track of the expenses and profits of the joint venture. Instead, they used the sales proceeds to purchase additional jewelry and repay Mr. Baer. They withdrew funds for their personal use on an as-needed basis: if Mr. Silva withdrew \$2,000, Mr. Nassar would withdraw \$2,000 at the same time. All disbursements were made by Mrs. Silva.

9. Periodically, Mrs. Silva sent checks to the Taxpayer, which were deposited in the Taxpayer's account and used to purchase jewelry. Some of the funds were used to cover the Taxpayer's utility bills and other expenses. The checks deposited in the Taxpayer's account for these purposes were typically made out in even amounts, such as \$1,000, \$3,500, \$5,000 or \$15,000.

Although most deposits were Waci-ci checks, a few of the checks were written by Mel Silva or Robert Baer.

10. On occasion, the Silvas purchased items from the Taxpayer for their own account. These items were paid for with Waci-ci checks, but were sold in the Silvas' Colorado store, which was not part of the joint venture.

11. In the summer of 1996, Hafiz Nassar and Mel Silva terminated the joint venture. At that time, the Taxpayer took over the existing jewelry inventory and accounts receivable, as well as the liability for repayment of the loan from Robert Baer.

12. In December 1996, Hafiz Nassar discontinued his road sales. From that time on, all of Taxpayer's sales were made through the Gallup store.

13. In 1994, Hafiz Nassar agreed to find a buyer for some coral that K. M. Salem, the owner of Kachina Trading Co. in Gallup, New Mexico, had brought back from Tunisia.

14. K. M. Salem paid Hafiz Nassar one-half of the profits from the sale. This money was deposited into the Taxpayer's account: \$8,550.00 was deposited on November 16, 1994 and \$18,970.34 was deposited on December 20, 1994.

15. In November 1995, the Department began a field audit of the Taxpayer.

16. On November 29, 1995, the auditors issued a "60-day letter" notifying the Taxpayer that it had 60 days to demonstrate timely possession of nontaxable transaction certificates ("NTTCs") required to support deductions from gross receipts.

17. Although the Taxpayer was required to file monthly CRS-1 returns reporting gross receipts, compensating, and withholding taxes to the state, the auditors determined that the Taxpayer had stopped filing CRS-1 returns in August 1993.

18. The audit report notes that the Taxpayer's records were "in disarray." There was no general ledger, and the Taxpayer was unable to provide a summary of cash sales or a listing of sales invoices or other information reflecting each month's sales and the deductions taken.

19. The Taxpayer maintained that most of its sales were wholesale and no gross receipts tax was due on these transactions. The Taxpayer was not aware that the Gross Receipts and Compensating Tax Act requires a seller to be in possession of NTTCs before deducting receipts from wholesale transactions. Accordingly, the Taxpayer was unable to produce NTTCs supporting deductions taken on sales for resale.

20. The Taxpayer also maintained that most of its sales were made to out-of-state buyers. After reviewing the invoices provided, the auditors were unable to determine which sales were made to in-store customers and which sales were shipped or delivered to out-of-state customers.

21. Because the auditors were unable to determine the nature of the Taxpayer's sales or confirm which sales had been reported to the state, all income reflected on the Taxpayers' federal partnership returns, state CRS-1 returns and bank deposit records were treated as taxable receipts.

22. On September 17, 1998, the Department issued Assessment No. 2294944 to the Taxpayer in the total amount of \$132,444.58, representing gross receipts tax, penalty and interest for the period January 1990 through October 1995.

23. On December 16, 2000, pursuant to an extension of time granted by the Department, the Taxpayer filed a written protest to the assessment.

24. After the protest was filed, the Taxpayer's partners met several times with the Department's attorneys and the protest auditor. Following the April 25, 2000 hearing, the record was kept open for a period of ten days so the Taxpayer could provide additional information concerning the source of certain wire transfers of funds into the Taxpayer's bank account.

25. Based on the additional information and records provided, the Department agreed to the following partial abatements:

(1) gross receipts tax, penalty and interest assessed for the periods January 1990 through December 1991 (see page 6 of Exhibit 2). By the time the assessment was issued, these periods were beyond the six-year statute of limitations set out in Section 7-1-18(D) NMSA 1978;

(2) gross receipts tax, penalty and interest assessed on receipts from out-of-state sales evidenced by C.O.D. sales invoices and UPS shipping documents; receipts from a deductible sale of tangible personal property to San Juan County Museum (a governmental entity); bank deposits traced to utility, tax and airline refunds; and a bank deposit identified as a capital contribution to the partnership by Samia Nassar. These adjustments are described on page 6.1 of Exhibit 2 and pages PC 11 and PC 11.1 of Exhibit 3; and

(3) gross receipts tax, penalty and interest assessed on a \$45,000 wire transfer deposited in the Taxpayer's account on or about July 29, 1993 and a \$5,000 wire transfer deposited into the Taxpayer's account on or about September 21, 1993, both of which were identified as loans from Robert Baer (see documentation attached to Bridget Jacober's May 8, 2000 letter to the hearing officer).

26. The Department did not adjust tax on sales invoiced to out-of-state buyers when there was no evidence to show whether the transactions were in-store sales or sales where the goods were shipped or delivered to the buyer's out-of-state address.

27. Lutfi Nassar, the partner managing the daily operation of the store, attempted to identify additional out-of-state sales based on his recollection, but there were no shipping documents or other evidence to indicate whether his memory of these transactions was reliable. The notations Lutfi Nassar made on the Taxpayer's invoices to assist the auditors in identifying out-of-state sales were not consistent. In some cases, for example, the notation "delivered" or "del." indicated the item was delivered to the customer in the Taxpayer's store in Gallup, New Mexico; in other cases,

the notation indicated the item was delivered to the customer at the customer's out-of-state location.

28. Even when there was evidence to show that goods sold to a particular customer were shipped or delivered out-of-state, there was often no way to determine whether receipts from the sale of those goods were included in the audit. Unless the protest auditor could verify that gross receipts tax was actually assessed on receipts from the transaction, no adjustment was made.

DISCUSSION

The Taxpayer maintains the Department erroneously assessed gross receipts tax on loan proceeds and out-of-state sales. The issue presented for decision is whether the Taxpayer has met its burden of proof concerning these transactions. Section 7-1-17(C) NMSA 1978 provides that any assessment of tax 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); *Wing Pawn Shop*, 111 N.M. 735, 741, 809 P.2d 649, 655 (Ct. App. 1991). Additionally, "it is presumed that all receipts of a person engaging in business are subject to the gross receipts tax." Section 7-9-5 NMSA 1978.

The Department concedes that loans and out-of-state sales of tangible personal property are not subject to New Mexico gross receipts tax. The Department contends, however, that the Taxpayer's records were inadequate to clearly establish the nature of the sales and deposits at issue.

Waci-ci Deposits. During the audit period, the Taxpayer deposited into its bank account large sums of money received from Robert Baer, Mel Silva and Waci-ci, the informal joint venture entered into between the Hafiz Nassar and Mr. Silva. In 1993, Mel Silva obtained a substantial loan commitment from Robert Baer, a private lender who agreed to advance funds for Mr. Silva and Hafiz Nassar to purchase Native American jewelry in Gallup, New Mexico, and sell the jewelry to

merchants and dealers throughout the west. Because the Taxpayer was located in Gallup, the loan proceeds were deposited into the Taxpayer's bank account, from which Hafiz Nassar withdrew the cash needed to purchase jewelry from Native Americans in Gallup. Once a sufficient inventory of jewelry was acquired, Hafiz Nassar and Mel Silva traveled through the western states, making sales along the way.

The proceeds of the Baer loan and the out-of-state sales were turned over to Mrs. Silva, who acted as bookkeeper for the joint venture. Periodically, Mrs. Silva sent checks to the Taxpayer, which were deposited in the Taxpayer's account and used to purchase jewelry, although some of the funds were used to cover the Taxpayer's utility bills and other expenses. A few checks were written by Mel Silva or Robert Baer. Most of the checks deposited were issued by Waci-ci. On occasion, the Silvas purchased items from the Taxpayer for their own account. Many of these items were paid for with Waci-ci checks, but were sold in the Silvas' Colorado store, which was not part of the joint venture.

The Taxpayer argues that deposits made in large, even amounts represent proceeds from the Baer loan and the out-of-state sales of jewelry by Hafiz Nassar and Mel Silva, neither of which are subject to New Mexico gross receipts tax. While conceding that at least some of the deposits were attributable to loans and out-of-state sales, the Department maintains there is insufficient evidence to distinguish between these deposits and the deposits attributable to the Taxpayer's sale of goods to the Silvas and Robert Baer in their individual capacities.

While a great deal of confusion was created by the overlapping use of Waci-ci checks and invoices, I believe the evidence is sufficient to conclude that deposits made between 1993 and 1995 for large, even sums of money represent proceeds of the Baer loan and the out-of-state sales made by Hafiz Nassar and Mel Silva on behalf of the joint venture. As Lutfi and Hafiz Nassar both testified,

goods are rarely sold in even lots of \$3,000, \$5,000 or \$15,000. A review of the many invoices admitted into evidence supports this testimony since the vast majority of the invoices are for odd amounts (*see, e.g.*, Exhibit 10 invoices for \$1262.80, \$629.00, \$1382.00, and \$1,029.00). In addition, while there are a few deposits from Waci-ci, Mel Silva, and Mel's Pawn Shop in 1992 and early 1993, the large even-dollar Waci-ci deposits first appear in the Taxpayer's records in mid-1993, the same time the parties' joint venture got underway. Based on the documentary evidence in the record and the Nassars' testimony, I find that the following \$151,500 of deposits listed in Exhibit 2 were proceeds from the Baer loan or from out-of-state sales by the joint venture and are not subject to New Mexico gross receipts tax:¹

<i>Page/Exhibit 2</i>	<i>Month/Year</i>	<i>Deposit</i>	<i>Name</i>
12.11	May-93	\$ 500	Waci-ci
12.11	Jun-93	\$ 3,000	Mel Silva
12.11	Jun-93	\$ 4,500	Robert Baer
12.11	Jun-93	\$15,500	Waci-ci
12.11	Jun-93	\$ 4,500	Waci-ci
12.12	Jun-93	\$15,000	Waci-ci
12.12	Jul-93	\$ 3,000	Waci-ci
12.13	Jul-93	\$ 3,000	Waci-ci
12.14	Aug-93	\$ 5,000	Robert Baer
12.14	Sep-93	\$ 5,000	Robert Baer
12.14	Sep-93	\$ 5,000	Waci-ci
12.14	Sep-93	\$ 5,000	Waci-ci
12.14	Sep-93	\$ 5,000	Waci-ci
12.14	Sep-93	\$ 5,000	Waci-ci
12.15	Oct-93	\$ 6,000	Waci-ci
12.15	Oct-93	\$ 1,000	Waci-ci
12.15	Nov-93	\$ 5,000	Waci-ci
12.15	Dec-93	\$ 2,000	Waci-ci
12.15	Jan-94	\$ 5,000	Waci-ci
12.16	Jan-94	\$ 5,000	Waci-ci
12.16	Jan-94	\$ 8,500	Waci-ci
12.16	Jan-94	\$ 7,000	Waci-ci

¹ A September 22, 1993 deposit in the amount of \$5,000 has been excluded from the list. As set out in Finding of Fact No. 25(3) on page 5, the Department has already agreed to abate tax on this deposit, which was identified as a wire transfer from Robert Baer.

12.16	Feb-94	\$ 1,000	Waci-ci
12.16	Mar-94	\$ 2,000	Waci-ci
12.16	Mar-94	\$ 2,000	Waci-ci
12.16	Mar-94	\$ 3,000	Waci-ci
12.16	Mar-94	\$ 1,000	Waci-ci
12.17	Apr-94	\$ 3,000	Waci-ci
12.17	Jun-94	\$ 3,000	Waci-ci
12.17	Jun-94	\$ 4,000	Waci-ci
12.18	Jul-94	\$ 1,000	Waci-ci
12.18	Aug-94	\$ 3,500	Waci-ci
12.18	Aug-94	\$ 3,500	Waci-ci
12.19	Nov-94	\$ 2,500	Waci-ci
12.20	Jul-95	\$ 3,500	Waci-ci

The following deposits in odd amounts are assumed to represent purchases by the Silvas or Robert Baer in their individual capacities. Because there is no satisfactory evidence to the contrary, these sales must be treated as New Mexico sales subject to gross receipts tax:

<i>Page/Exhibit 2</i>	<i>Month/Year</i>	<i>Deposit</i>	<i>Name</i>
12.5	Aug-92	\$1,088	Waci-ci
12.8	Dec-92	\$ 120	Mel's Pawn Shop
12.10	May-93	\$1,688	Mel Silva
12.11	Jun-93	\$4,322	Mel Silva
12.14	Aug-93	\$ 975	Robert Baer
12.14	Aug-93	\$6,966	Waci-ci
12.16	Mar-94	\$2,805	Waci-ci
12.16	Mar-94	\$2,775	Waci-ci
12.17	May-94	\$5,443	Waci-ci
12.18	Jul-94	\$5,050	Waci-ci
12.18	Jul-94	\$4,950	Waci-ci
12.19	Oct-94	\$4,750	Waci-ci

Out-Of-State Sales. The Taxpayer contends the Department erroneously included receipts from out-of-state sales when calculating the Taxpayer's gross receipts tax liability. The Department responds that the Taxpayer's records were inadequate to clearly establish the nature of the sales at issue. Section 7-1-10 NMSA 1978 requires every taxpayer to "maintain books of account or other records in a manner that will permit the accurate computation of state taxes...." As stated in the

concurring opinion to *Archuleta v. O'Cheskey*, 84 N.M. 428, 504 P.2d 638 (Ct. App. 1972), which approved the Department's method of estimating tax in the absence of adequate taxpayer records: "The taxpayer has a duty to provide the commissioner with books and records upon which to establish a standard for taxation as provided by law. If he fails to do so, he cannot complain of the best methods used by the commissioner."

In this case, the Taxpayer did not maintain a general ledger and was unable to provide a summary of cash sales or a listing of sales invoices or other information reflecting each month's sales and the deductions taken. Although the Taxpayer's invoices list the customer by name and address, there is no way to determine which sales were made to in-store customers and which sales were shipped or delivered to customers located out-of-state. After extensive review of the Taxpayer's records, the auditors were able to trace only two or three sales to UPS shipping documents. The Department also allowed one or two sales where the invoices showed delivered was "COD".

Lutfi Nassar, the partner managing the daily operation of the store, attempted to identify out-of-state sales based on his recollection. But the notations Mr. Nassar made on the Taxpayer's invoices to indicate that an item was shipped or delivered to the customer were inconsistent. An example of this inconsistency was evidenced in Mr. Nassar's testimony concerning Invoice 7237 (found on the last page of Exhibit 7), which documents a transaction with De Jeunes Perfume Parlour in San Antonio, Texas. The invoice reads as follows:

Refund Returned Merchandise	(-200)
took Merchandise	<u>850.00</u>
balance	650.00.

The invoice is signed by the customer. In the upper left-hand corner of the invoice, Lutfi Nassar made the notation "Del." When questioned, Mr. Nassar testified that since he did not remember

making any deliveries to San Antonio, Texas, this was most likely a transaction that took place in the Taxpayer's store in Gallup, New Mexico. When the Department's attorney asked whether this meant that all invoices with the notation "Del." or "Delivered" were transactions where the merchandise was delivered to the customer in Gallup, Mr. Nassar said no, not necessarily.

Even when the Department could verify that goods sold to a particular customer were shipped or delivered out-of-state, there was often no way to determine whether receipts from the sale of those goods were included in the audit exception base. Unless the auditor could verify that gross receipts tax was actually assessed on receipts from the transaction, no adjustment was made.

Based on the evidence presented, the Taxpayer has failed to establish that receipts included in the audit exception base were receipts from out-of-state sales. Accordingly, the Taxpayer has not overcome the presumption of correctness that attaches to the Department's assessment. The Taxpayer has an obligation to maintain books of account and records that allow the Department to verify whether a sale was made in New Mexico or outside the state; whether the receipts from that sale were deposited into the Taxpayer's bank account; and whether the receipts were reported (or reported and deducted) to the Department on the Taxpayer's monthly CRS-1 returns. The Department cannot be expected to rely on a taxpayer's memory of specific sales transactions, particularly when several years have passed since those transactions took place. Section 7-1-5 NMSA 1978 creates a presumption that all receipts of a person engaging in business in New Mexico are subject to the gross receipts tax. In the absence of adequate records to establish out-of-state sales, all of the Taxpayer's receipts are presumed taxable.

Receipts from Kachina Trading Co. The final issue raised by the Taxpayer concerns two 1994 bank deposits: a November 16, 1994 deposit of \$8,550.00 and a December 20, 1994 deposit of \$18,970.34 (Exhibit 12). Hafiz Nassar testified that these receipts represented his profit or

commission from selling coral on behalf of K. M. Salem, the owner of Kachina Trading Co., another business located in Gallup, New Mexico. Mr. Nassar said that Mr. Salem brought the coral back from Tunisia, but did not know who how to market it. Mr. Nassar offered to find a buyer for the coral in exchange for half the profits. Mr. Nassar does not believe these deposits should be treated as taxable receipts because the coral was not part of the Taxpayer's regular inventory.

Section 7-9-4 NMSA 1978 imposes an excise tax on the gross receipts of any person engaging in business in New Mexico. "Engaging in business" is defined in Section 7-9-3(E) NMSA 1978 to mean "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." The term "gross receipts" is defined in Section 7-9-3(F) NMSA 1978, as:

the total amount of money or the value of other consideration received from selling property in New Mexico, from leasing property employed in New Mexico, from selling services performed outside New Mexico the product of which is initially used in New Mexico or from performing services in New Mexico.

Whether the sale of the coral is characterized as a sale of tangible personal property or as a sale of Hafiz Nassar's services, the proceeds of the transaction are gross receipts. Although the coral may not have been part of the Taxpayer's regular inventory, Mr. Nassar's services in finding a buyer for the coral were very similar to his sales activities as a partner of the Taxpayer. The money Mr. Nassar earned from the sale was deposited in the Taxpayer's bank account, and there is no evidence that Mr. Nassar treated this money as his personal funds, rather than as funds belonging to the business. Given these circumstances, the proceeds from the sale of the coral were properly included in the Taxpayer's taxable receipts.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2294944, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer is entitled to the partial abatements of gross receipts tax, penalty and interest set out in Finding of Fact 25 on page 5 of this decision.

3. The Taxpayer is entitled to the abatement of gross receipts tax, penalty and interest assessed on the \$151,500 of loans and out-of-state sales listed at pages 8 and 9 of this decision.

4. The Taxpayer has not met its burden of proving its right to additional adjustments for out-of-state sales or for the sale of coral on behalf of Kachina Trading Co. and has failed to overcome the presumption of correctness that attaches to the Department's assessment of tax on these sales.

For the foregoing reasons, the Taxpayer's protest is partially granted and the Department is ordered to make the adjustments set out in Conclusions of Law 2 and 3, above. In all other respects, the Taxpayer's protest is denied.

DATED May 10, 2000.