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

IN THE MATTER OF THE PROTEST OF
CRAIG M. RAWLINGS **No. 01-20**
ID NO. 02-399251-00-4
ASSESSMENT NO. 2378227

DECISION AND ORDER

A formal hearing on the above-referenced protest was held August 15, 2001, before Margaret B. Alcock, Hearing Officer. Craig M. Rawlings ("Taxpayer") represented himself. The Taxation and Revenue Department ("Department") was represented by Javier Lopez, Special Assistant Attorney General. At the end of the hearing, the record was left open until August 25, 2001 to allow the submission of additional information concerning the date of the Taxpayer's divorce and the existence of nontaxable transaction certificates related to the services performed by the Taxpayer's former wife. No additional information was submitted for the Hearing Officer's consideration. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. During 1995, the Taxpayer worked as an independent contractor performing various services for Warp Speed Light Pens, Inc. ("WSLP"), a company that manufactured a computer device used to replace a computer "mouse".

2. The Taxpayer's work consisted primarily of machining barrels and assembling parts that became part of the company's final product.

3. The Taxpayer did not realize the New Mexico gross receipts tax applied to his receipts from working as an independent contractor. Accordingly, the Taxpayer did not register with the Department for payment of gross receipts tax and did not file gross receipts tax returns during 1995.

4. In 1995, the Taxpayer was married to Linda Westmacott, who worked as a nurse for Rapid Techs, Inc., a personnel agency that resold Ms. Westmacott's nursing services to the Bureau of Indian Affairs ("BIA").

5. Ms. Westmacott did not register with the Department for payment of gross receipts tax and did not file gross receipts tax returns during 1995.

6. All of the money the Taxpayer and his wife earned during their marriage was put into a joint account and used to pay joint expenses.

7. The Taxpayer and Ms. Westmacott filed a joint 1995 federal income tax return reporting the income he earned from WSLP and the income she earned from nursing as business income on separate Schedule Cs to their federal return.

8. The Taxpayer and Ms. Westmacott subsequently divorced and Ms. Westmacott moved to Texas.

9. On January 25, 1999, as a result of information obtained from the IRS, the Department mailed the Taxpayer and Ms. Westmacott a notice of limited scope audit concerning the discrepancy between business income reported to the IRS on Schedule C of their 1995 federal income tax return and business income reported to the Department for gross receipts tax purposes.

10. The January 25, 1999 notice stated that, pursuant to Section 7-9-43 NMSA 1978, the Taxpayer must be in possession of all required nontaxable transaction certificates ("NTTCs") within 60 days from the date of the notice or any deductions relating to NTTCs would be disallowed. The 60-day period expired on March 26, 1999.

11. After receiving the notice, the Taxpayer provided the Department with a Type 2 NTTC that WSLP had issued to him in June 1995.

12. Each NTTC issued by the Department shows the type of NTTC on the front of the form and gives an explanation of the permitted use of each type of NTTC on the back.

13. The NTTC form the Taxpayer accepted from WSLP reads: "02 RESALE" on the front. The back of the NTTC states that Type 2 certificates "may be executed for the purchase of tangible personal property or licenses FOR RESALE either alone or in combination with other tangible personal property or licenses in the ordinary course of business", and references Section 7-9-48 NMSA 1978.

14. The NTTC form also contains the following statement: "The seller must accept this certificate in good faith that the buyer will employ the property or service transferred in a nontaxable manner."

15. At the time he received the NTTC, the Taxpayer did not examine the front or the back of the NTTC and did not question WSLP to determine why they had issued him an NTTC applicable to selling tangible personal property rather than one applicable to the performance of services.

16. The Department told the Taxpayer the Type 2 NTTC would not support a deduction of his receipts because he had not been engaged in selling WSLP tangible personal property or licenses for resale.

17. There is no evidence that Linda Westmacott was ever issued a Type 5 NTTC which would have allowed her to deduct her receipts from selling nursing services to Rapid Techs for resale to the BIA.

18. On May 15, 1999, the Department issued Assessment No. 2378227 to the Taxpayer and Ms. Westmacott for reporting periods January-December 1995 in the amount of $3,860.82,

representing $2,313.60 gross receipts tax, $231.36 penalty and $1,315.86 interest on their joint income for 1995.

19. On June 1, 1999, the Taxpayer filed a written protest to the Department's assessment.

DISCUSSION

The Taxpayer raises the following arguments in support of his protest: (1) he accepted the Type 2 NTTC issued by WSLP in good faith and should be allowed to deduct his receipts pursuant to the provisions of Section 7-9-75 NMSA 1978; (2) the tax on his receipts results in double taxation; and (3) he should not be liable for gross receipts tax on his former wife's earnings.

Acceptance of the Wrong NTTC. The Gross Receipts and Compensating Tax Act provides several deductions from gross receipts for taxpayers who meet the statutory requirements set by the legislature. The Taxpayer claims the deduction provided in Section 7-9-75 NMSA 1978:

> Receipts from selling the service of combining or processing components or materials may be deducted from gross receipts if the sale is made to a person engaged in the business of manufacturing who delivers a nontaxable transaction certificate to the seller....

The fact that the Taxpayer performed the service of combining or processing materials for WSLP is not sufficient to support a deduction under Section 7-9-75. The statute is very specific—the buyer of services must deliver an NTTC to the seller before the seller is entitled to claim a deduction from gross receipts.

The requirements for obtaining NTTCs to support deductions from gross receipts are set out in Section 7-9-43 NMSA 1978, which provides, in pertinent part:

> All nontaxable transaction certificates of the appropriate series executed by buyers or lessees should be in the possession of the seller or lessor for nontaxable transactions at the time the return is due for receipts from the transactions.... The nontaxable transaction certificates shall contain the information and be in a form

> prescribed by the department.... When the seller or lessor accepts a nontaxable transaction certificate within the required time and in good faith that the buyer or lessee will employ the property or service transferred in a nontaxable manner, the properly executed nontaxable transaction certificate shall be conclusive evidence, and the only material evidence, that the proceeds from the transaction are deductible from the seller's or lessor's gross receipts.

The Department bases its denial of the Taxpayer's claimed deduction on the fact that the Type 2 NTTC he received from WSLP does not apply to the services performed by the Taxpayer and is not "in a form prescribed by the department". The Taxpayer relies on the language in Section 7-9-43 that an NTTC accepted "in good faith that the buyer or lessee will employ the property or service transferred in a nontaxable manner" serves as conclusive proof that the seller is entitled to a deduction. The Taxpayer argues that he accepted the Type 2 NTTC from WSLP in "good faith" and is therefore entitled to deduct his receipts under the provisions of Section 7-9-75.

The purpose of the good faith provision is to protect a seller who has no way of verifying whether the buyer's subsequent use of goods or services complies with the requirements for issuance of a particular NTTC. For example, a seller of tools who accepts a Type 2 NTTC (which applies to sales of tangible personal property for resale) from a hardware store must have a good faith belief that the hardware store will use the tools in a nontaxable manner, *i.e.,* will resell the tools in the ordinary course of business. If the seller can establish such a good faith belief, the seller will be entitled to deduct his receipts from the sale even if it is later discovered that the owner of the hardware store took the tools home for his personal use.

The good faith provision in Section 7-9-43 NMSA 1978 does not apply to situations where the NTTC accepted by the seller does not cover the goods or services being sold. In *Arco Materials, Inc. v. New Mexico Taxation and Revenue Department*, 118 N.M. 12, 15, 878 P.2d 330, 333 (Ct. App.), *rev'd on other grounds*, 118 N.M. 647, 884 P.2d 803 (1994), the court held that taxpayers

have a continuing duty to assess the validity of deductions made in reliance on NTTCs, including the duty to insure that the NTTC is of the type needed to cover the transaction at issue. In making its decision, the court relied on the following language in Department Regulation GR 43:9 (now renumbered as 3.2.201.14 NMAC):

> Acceptance of nontaxable transaction certificates (NTTCs) in good faith that the property or service sold thereunder will be employed by the purchaser in a nontaxable manner is determined at the time the certificates are initially accepted. *The taxpayer claiming the protection of a certificate continues to be responsible that the goods delivered thereafter are of the type covered by the certificate* (emphasis the court's).

See also, McKinley Ambulance Serv. v. Bureau of Revenue, 92 N.M. 599, 601, 592 P.2d 515, 517 (Ct. App. 1979) (conclusive evidence provision of Section 7-9-43 only applies if the certificate covers the receipts in question).

In this case, WSLP issued a Type 2 NTTC to the Taxpayer. Had the Taxpayer read the explanation printed on the certificate itself, he would have realized he had the wrong form. The front of the NTTC reads: "02 RESALE". The back of the NTTC states that Type 2 certificates "may be executed for the purchase of tangible personal property or licenses FOR RESALE either alone or in combination with other tangible personal property or licenses in the ordinary course of business" (emphasis in the original). Clearly, this NTTC did not apply to the Taxpayer's sale of machining and assembly services to WSLP. Under these circumstances, the Taxpayer cannot argue that he accepted the Type 2 NTTC in the good faith belief that the NTTC would support a deduction of his receipts from performing services on a manufactured product.

There is a statutory presumption that the Department's assessment of gross receipts tax is correct. Section 7-1-17(C) NMSA 1978. 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). Because the Taxpayer in this case has not established his right to an exemption or deduction under the Gross Receipts and Compensating Tax Act, he is liable for gross receipts tax on his receipts from performing services for WSLP.

Double Taxation. The Taxpayer argues that requiring him to pay gross receipts tax on receipts from performing services for WSLP will result in double taxation since the company charged tax when it sold its computer products to the final consumer. Although it is a popular misconception that double taxation is illegal or unconstitutional, New Mexico courts have 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 Line, 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).

In construing the Gross Receipts and Compensating Tax Act, New Mexico courts have also 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*, 87 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. During 1995, the Taxpayer and WSLP were separate taxpayers, each of which was engaged in business in New Mexico. The Taxpayer was liable for gross receipts tax on his receipts from performing services for WSLP, and WSLP was liable for gross receipts tax on its sale of computer devices to its customers. Under the facts presented, the Taxpayer is required to pay gross receipts tax on his receipts only once, and there is no double taxation.

Liability for Gross Receipts Tax on a Spouse's Business Income. The assessment issued to the Taxpayer and Linda Westmacott is based on their joint income for 1995. At the hearing, the Taxpayer questioned whether he should be held liable for gross receipts tax on the $19,774 of income earned by his former wife. The answer to this question is found in the laws governing the property rights of husband and wife in New Mexico.

New Mexico law holds that income earned from the labor of either spouse during marriage is community property. *DeTevis v. Aragon*, 104 N.M. 793, 798, 727 P.2d 558, 563 (Ct. App. 1986); *Douglas v. Douglas*, 101 N.M. 570, 686 P.2d 260 (Ct. App.1984). Section 40-3-9 NMSA 1978 defines a "community debt" as "a debt contracted or incurred by either or both spouses during marriage which is not a separate debt." A "separate debt" is defined as follows:

> (1) a debt contracted or incurred by a spouse before marriage or after entry of a decree of dissolution of marriage;
> (2) a debt contracted or incurred by a spouse after entry of a decree entered pursuant to Section 40-4-3 NMSA 1978, unless the decree provides otherwise;
> (3) a debt designated as a separate debt of a spouse by a judgment or decree of any court having jurisdiction;
> (4) a debt contracted by a spouse during marriage which is identified by a spouse to the creditor in writing at the time of its creation as the separate debt of the contracting spouse;
> (5) a debt which arises from a tort committed by a spouse before marriage or after entry of a decree of dissolution of marriage or a separate tort committed during marriage; or
> (6) a debt declared to be unreasonable pursuant to Section 2 [40-3-10.1 NMSA 1978] of this act.

The gross receipts tax liability at issue arose from Ms. Westmacott's performance of nursing services in New Mexico during her marriage to the Taxpayer. The income Ms. Westmacott earned was community income which was deposited in a joint account and used to pay joint expenses. Under these circumstances, the gross receipts tax imposed on Ms. Westmacott's income was a community debt.

Section 40-3-11 NMSA 1978 sets out the following priorities for the satisfaction of community debts while both spouses are living:[1]

> A. Community debts shall be satisfied first from all community property and all property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common, excluding the residence of the spouses. Should such property be insufficient, community debts shall then be satisfied from the residence of the spouses, except as provided in Subsection B of this section or Section 42-10-9 NMSA 1978. Should such property be insufficient, only the separate property of the spouse who contracted or incurred the debt shall be liable for its satisfaction. If both spouses contracted or incurred the debt, the separate property of both spouses is jointly and severally liable for its satisfaction.

Prior to the parties' divorce, all of their community property and all property owned as joint tenants or tenants-in-common was liable for payment of gross receipts tax due on Linda Westmacott's business income. Ms. Westmacott's separate property was also liable for these taxes. The Taxpayer's separate property, if any, could not have been reached by the Department because he did not incur the tax debt attributable to the business activities of his wife.

The issue presented is whether the severance of the marital community by divorce has any effect on the Taxpayer's liability for payment of a community debt incurred by his former wife. It does not appear that this issue has been addressed by New Mexico's appellate courts. In *Moucka v. Windham*, 483 F.2d 914, 916-917 (10th Cir. 1973), however, the federal court of appeals applied New Mexico state law to find that community property remains liable for payment of community debts, even after the community has been severed by divorce:

> [U]nder New Mexico law, a community debt incurred prior to the dissolution of the marital community, and for the benefit thereof, would properly be payable out of "community" funds notwithstanding the fact that such

[1] Section 40-3-11(D) NMSA 1978 states: "This section shall apply only while both spouses and living and shall not apply to the satisfaction of debts after the death of one or both spouses."

> "community" property had been transmuted into "separate" property by virtue of a decree of divorce....
>
> Thus, assuming that the "community" funds now in Peggy V. Windham's possession can be traced and identified as such, they are subject to the payment of the amount due on the promissory note to Jean Moucka. *See Eaves v. United States*, 433 F.2d 1296 (10th Cir.), and cases cited therein.

In the *Eaves* case, cited in *Moucka*, the court held that the federal income tax refund of one spouse was community property that could be reached to satisfy the income tax liability of the other spouse, even though the spouses had filed separate returns, stating: "It is the rule in New Mexico ... that as long as identity can be traced, community assets retain their community property characteristics." 433 F.2d at 1297. With regard to the issue of whether a tax liability comes within the technical definition of a "debt", the court concluded that it "is in the nature of a debt and is an obligation to which the same rule should apply as applies to a debt within the technical definition of that technical term." *Id.*

The conclusion that each spouse's interest in community property remains subject to payment of community debts even after the community has been severed by divorce is consistent with New Mexico law governing payment of community debts after the community has been severed by death. Section 45-2-805(B) NMSA 1978 of the New Mexico Probate Code specifically provides: "Upon the death of either spouse, the entire community property is subject to the payment of community debts." Such a provision is necessary to protect the rights of creditors. As the New Mexico Supreme Court noted in *Huntington National Bank v. Sproul*, 116 N.M. 254, 264, 861 P.2d 935, 945 (1993), New Mexico law grants creditors an expectation that community debts may be satisfied from community property. There is nothing to indicate the legislature intended a couple's unilateral decision to terminate their marriage by divorce to have the effect of denying creditors of

the martial community access to assets that were subject to payment of community debts at the time those debts were incurred.

In this case, the Taxpayer's interest in property that was community or jointly held property at the time of his divorce is subject to payment of the Department's assessment of gross receipts tax on Ms. Westmacott's 1995 earnings. All of the Taxpayer's property, whether characterized as community or separate property, is liable for payment of gross receipts tax on his 1995 earnings.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2378227, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer is liable for gross receipts tax on his 1995 income from WSLP.

3. The Taxpayer is not entitled to deduct his receipts from performing services on a manufactured product because he did not have timely possession of an NTTC applicable to that transaction as required by Sections 7-9-75 and 7-9-43 NMSA 1978.

3. There is no prohibition against double taxation; in addition, the assessment of gross receipts tax against the Taxpayer does not constitute double taxation.

4. To the extent the Taxpayer's interest in property that was either community or jointly held property at the time of his divorce from Linda Westmacott can be identified, the Taxpayer is liable for gross receipts tax on Ms. Westmacott's 1995 community income.

For the foregoing reasons, the Taxpayer's protest IS DENIED, except to the extent collection of gross receipts tax on his former wife's income is limited by Conclusion of Law No. 4.

DATED August 30, 2001.