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

IN THE MATTER OF THE PROTEST OF
WAYNE A. GAEDE **No. 01-27**
ID NO. 02-308200-00 3
ASSESSMENT NO. 2540741

DECISION AND ORDER

A formal hearing on the above-referenced protest was held October 9, 2001, before Margaret B. Alcock, Hearing Officer. Wayne A. Gaede ("Taxpayer") represented himself. 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. From 1994 through 1996, the Taxpayer was engaged in marketing and promoting the sale of long distance telephone services on behalf of Excel Telecommunications.

2. Pursuant to Excel's multi-level marketing program, the Taxpayer engaged in two types of activities: (1) making direct sales of Excel's long distance telephone services to individual customers; and (2) recruiting new sales representatives (referred to as 1st level representatives) who signed up their own long distance customers and also recruited additional sales representatives (referred to as 2nd level representatives).

3. For purposes of compensation, this process of direct sales and recruitment of new sales representatives continued down seven levels, with the Taxpayer receiving the following monthly commissions:

2% of long distance charges paid by the Taxpayer's own customers;

1% of long distance charges paid by customers of the Taxpayer's 1st level representatives;

0.25% of long distance charges paid by customers of the Taxpayer's 2nd through 6th level representatives; and

5% of long distance charges paid by customers of the Taxpayer's 7th level representatives.

In addition, the Taxpayer received a cash bonus of $185.00 for each sales representative he recruited and a smaller bonus for each sales representative recruited at subsequent levels.

4. Separate from his marketing activities for Excel, the Taxpayer conducted training activities for which he received additional compensation. All of the Taxpayer's training activities took place within New Mexico.

5. During 1996, the Taxpayer was registered with the Department for payment of gross receipts, compensating and withholding taxes, which are paid under the Department's combined reporting system ("CRS").

6. In April 2000, the Department conducted a limited scope audit of the Taxpayer's 1996 gross receipts tax reporting, during which it discovered a discrepancy between the business income reported on Schedule C of the Taxpayer's 1996 federal income tax return and the gross receipts reported on the Taxpayer's 1996 CRS returns.

7. On June 11, 2000, the Department issued Assessment No. 2540741 to the Taxpayer for tax periods January-December 1996 in the amount of $771.66 gross receipts tax, $77.16 penalty and $424.42 interest, representing tax on the discrepancy between his federal and state reporting.

8. On July 10, 2000, the Taxpayer filed a written protest to the Department's assessment.

9. In the course of correspondence and discussions with the Department's protest office, the Taxpayer conceded that the following unreported receipts were subject to New Mexico gross receipts tax:

$ 925.00	Bonuses for recruiting 1st level sales representatives in New Mexico;
$ 240.00	Commissions from long-distance telephone calls made by the Taxpayer's New Mexico customers; and
$ 840.00	Compensation from performing training services in New Mexico.
$2,005.00	

Based on this concession, the only issue remaining in dispute concerned the taxability of commissions based on the long-distance telephone charges of customers of the Taxpayer's 1st through 7th level representatives. The Taxpayer maintained that most of the customers of lower level representatives were located outside New Mexico and that commissions based on those customer's long-distance telephone charges were nontaxable receipts from out-of-state sales.

10. The Department disagreed with the Taxpayer's argument, but did agree that some of the Taxpayer's commissions were attributable to sales services the Taxpayer performed outside New Mexico. Based on documentation provided by the Taxpayer, the Department determined that 76.4706 percent of the disputed commissions were attributable to the Taxpayer's in-state services and 23.5294 percent were attributable to services performed outside the state. The Department made this determination by comparing the number of sales representatives the Taxpayer recruited in New Mexico during 1994 through 1996 to the total number of representatives the Taxpayer recruited during that period.

11. The Department subsequently abated $174.80 of the $771.66 of tax principal originally assessed against the Taxpayer, plus related penalty and interest. The amount of tax principal remaining in dispute is $596.78.

DISCUSSION

This protest raises the following issues: (1) whether the Taxpayer is liable for gross receipts tax on sales commissions based on long-distance telephone charges paid by customers of the Taxpayer's 1st through 7th level sales representatives; (2) whether the Department's method of calculating the percentage of commissions subject to gross receipts tax was reasonable; and (3) whether Excel's payment of gross receipts tax on its receipts from the sale of long-distance telephone services relieved the Taxpayer from liability for gross receipts tax on commissions measured by those receipts.

(1) Taxability of the Taxpayer's Commissions. During the period at issue, Excel used a multi-level marketing program to promote direct sales of its long-distance telephone services. Under the program, Excel's sales representatives engaged in two types of activities: making direct sales of Excel's long distance services to individual customers; and recruiting new sales representatives (referred to as 1st level representatives) who signed up their own long distance customers and also recruited additional sales representatives (referred to as 2nd level representatives). For compensation purposes, this process of direct sales and recruitment continued down seven levels, with each representative receiving the following monthly commissions: 2% of long distance charges paid by the representative's own customers; 1% of long distance charges paid by customers of 1st level representatives; 0.25% of long distance charges paid by customers of 2nd through 6th level representatives; and 5% of long distance charges paid by customers of 7th level representatives.

The issue presented in this case is whether the 1996 commissions the Taxpayer received under Excel's marketing program are subject to New Mexico gross receipts tax. The Taxpayer argues that his commissions are nontaxable receipts from out-of-state sales because they were based on long-

distance telephone charges incurred by Excel customers located outside New Mexico.[1] The problem with the Taxpayer's argument is that the telephone charges were simply a means of calculating or measuring the compensation he received. There is no contention that the Taxpayer was engaged in providing long-distance telephone services to Excel or its customers. The Taxpayer was engaged in providing marketing services to Excel, which included selling Excel's telephone services directly to new customers and promoting the further expansion of Excel's customer base by recruiting additional sales representatives.

Section 7-9-3(F)(1)(b) NMSA 1978 of the Gross Receipts and Compensating Tax Act defines "gross receipts" to include:

> (b) the total commissions or fees derived from the business of buying, selling or promoting the purchase, sale or leasing, as an agent or broker on a commission or fee basis, of any property, service, stock, bond or security;

The commissions the Taxpayer received from Excel come within this definition of gross receipts. To the extent his sales and promotional services were performed in New Mexico, his receipts are subject to gross receipts tax. The fact that part of the Taxpayer's commissions were measured by the long-distance charges paid by customers of his 1st through 7th level representatives—some of whom may have been located outside New Mexico—does not change the underlying transaction from an in-state sale of promotional services to an out-of-state sale of long-distance telephone services. The commissions still represent compensation for sales services performed by the Taxpayer: if the Taxpayer recruited effective sales people who generated a lot of new customers and sales

[1] At the October 9, 2001 hearing, the Taxpayer was unable to provide any evidence to show how many customers recruited by his 1st through 7th level representatives were located outside New Mexico. The Taxpayer attempted to remedy this lack of evidence with speculative arguments concerning the likely distribution of Excel customers throughout the country. In light of the following discussion, which concludes that the Taxpayer's commissions were receipts from his individual marketing services and not receipts from providing long-distance service to Excel's customers, these arguments need not be addressed.

representatives for Excel, the Taxpayer's commissions increased; if the sales people the Taxpayer recruited were not effective and failed to generate much new business, the Taxpayer's commissions decreased.

In summary, Excel's multi-level marketing program created the potential for the Taxpayer to receive a continuing stream of commissions based on the success of his own direct sales efforts and his success in recruiting effective representatives to expand Excel's marketing program. To the extent the Taxpayer's commissions were attributable to sales and recruitment services he performed in New Mexico, they are subject to gross receipts tax.

(2) Method of Calculating Percentage of Taxable Receipts. Based on information provided by the Taxpayer, the Department agreed that some of the Taxpayer's sales and recruiting services were performed outside New Mexico and that commissions attributable to those services were not subject to New Mexico gross receipts tax. The Department determined the percentage of taxable commissions attributable to in-state services by comparing the number of sales representatives the Taxpayer recruited in New Mexico from 1994 through 1996 to the total number of representatives the Taxpayer recruited during that period. This methodology resulted in 76.4706 percent of the Taxpayer's commissions being subject to gross receipts tax.

The Taxpayer argues that the Department should have included only those sales representatives recruited during 1996 to calculate the percentage of 1996 commissions subject to tax (this methodology would reduce the Taxpayer's in-state percentage to 71.4286 percent). The Taxpayer reasons that since only 1996 commissions are at issue, the Department should only consider the Taxpayer's 1996 recruiting activity in computing the portion of those commissions subject to tax. What the Taxpayer's argument overlooks is the fact that some of the commissions the Taxpayer received during 1996 were attributable to the Taxpayer's recruitment activities in earlier years. For

example, a number of the Taxpayer's November 1996 commissions were based on long-distance telephone calls made by customers of Bryant & Associates, a sales representative the Taxpayer recruited in 1994 (*see*, Exhibits 1 and 2). Given the residual nature of the Taxpayer's commissions, it was reasonable for the Department to calculate the New Mexico percentage of 1996 receipts based on the total number of sales representatives whose recruitment could have generated commissions for the Taxpayer during 1996.

The method used to calculate the New Mexico percentage was devised by the Department's protest auditor, who is a certified public accountant and has also taken courses in statistics. At the hearing, the auditor gave his opinion that the method used to compute the Taxpayer's 1996 gross receipts taxes was reasonable given the limited information provided by the Taxpayer. Section 7-1-17(C) NMSA 1978 states that any assessment of tax by the Department is presumed to be correct, and it is the burden of the taxpayer protesting an assessment to overcome this presumption. *Tipperary Corp. v. New Mexico Bureau of Revenue*, 93 N.M. 22, 24, 595 P.2d 1212, 1214 (Ct. App. 1979); *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). As illustrated by the court's decision in *Torridge Corp. v. Commissioner of Revenue*, 84 N.M. 610, 613, 506 P.2d 354, 357 (Ct. App. 1972), *cert. denied*, 84 N.M. 592, 506 P.2d 336 (1973) the presumption of correctness encompasses the audit methods employed by the Department to determine the amount of tax assessed:

> The "test months" method was used for the audit period.... There is evidence that the test months method is acceptable practice. Although there is conflicting evidence, the Commissioner could draw the inference from the evidence of the auditor, that the gross receipts were the amount computed by use of the test months and bank deposit methods. *See Archuleta v. O'Cheskey*, 84 N.M. 428, 504 P.2d 638 (Ct. App.), decided November 30, 1972. The Commissioner's decision, that the taxpayers failed to establish the inaccuracy of the gross receipts ascertained by the audit, is supported by evidence. Accordingly, the presumption of correctness of the assessments for January 1, 1968 to March 31, 1971, has not been overcome.

In this case, the Taxpayer failed to present any evidence to contradict the auditor's testimony or to show that the audit method used by the Department was unreasonable or invalid. Accordingly, the Taxpayer has failed to overcome the presumption of correctness that attaches to the Department's assessment.

(3) Excel's Payment of Gross Receipts Tax. The Taxpayer argues that Excel's payment of gross receipts tax on its receipts from the sale of long-distance telephone services relieved the Taxpayer from liability for gross receipts tax on commissions measured by those receipts. The Taxpayer failed, however, to present any evidence that Excel paid gross receipts tax on the long-distance telephone charges used to calculate the Taxpayer's 1996 commissions. The Taxpayer failed to establish that Excel would even be liable for gross receipts tax on these charges. As discussed under Point (2), above, it is the Taxpayer's burden to come forward with evidence to show that the Department's assessment is incorrect. This burden cannot be met by raising arguments based on unproven or hypothetical facts. Accordingly, there is no need to address the Taxpayer's arguments on this issue.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2540741, and jurisdiction lies over the parties and the subject matter of this protest.

2. To the extent the Taxpayer's commissions from performing marketing services for Excel were attributable to services the Taxpayer performed in New Mexico, they are subject to gross receipts tax.

3. The Department's method of calculating the percentage of commissions subject to New Mexico gross receipts tax was reasonable.

4. The Taxpayer failed to overcome the presumption of correctness that attaches to the Department's assessment.

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

DATED October 29, 2001.