

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

IN THE MATTER OF THE PROTEST OF
JAMES G. CHAMPION,
ID. NO. 02-321661-00 1, PROTEST
TO ASSESSMENT NOS. 2078499 & 2083144

NO. 97-25

DECISION AND ORDER

This matter came on for hearing before Gerald B. Richardson on June 6, 1997. James G. Champion, hereinafter, "Taxpayer", represented himself at the hearing. The Taxation and Revenue Department, hereinafter, "Department", was represented by Frank D. Katz, Chief Counsel.

Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Since 1992, the Taxpayer has worked as an independent contractor for Craft-Matic Pacific, a company which sells adjustable beds directly to consumers. The Taxpayer works as a salesman and receives compensation for his efforts in the form of a commission on the sales he generates.

2. The price of the Taxpayer's average sale is approximately \$2,500. His average commission is in the \$300 to \$400 range.

3. The Taxpayer contacts potential customers in their homes. If the customers decide to buy a bed, the Taxpayer writes up the paperwork and forwards it with any customer

deposit to Craft-Matic Pacific.

4. All of the money paid for beds is handled by Craft-Matic Pacific. After delivery of the bed to the customer, the Taxpayer is paid his commission on the sale.

5. Craft-Matic Pacific includes New Mexico gross receipts tax in the purchase price charged the customer, and reports and pays gross receipts tax on its receipts from the sale of beds in New Mexico.

6. The Taxpayer believed that Craft-Matic Pacific's payment of gross receipts tax upon the sale of the bed satisfied all gross receipts tax obligations from the sale of the beds and he did not report or pay gross receipts tax upon the commission he received from Craft-Matic Pacific.

7. The Taxpayer did report his income from commissions to the Internal Revenue Service on a Schedule C, which form is used to report income or loss from a business or profession.

8. The Department has a program in which it receives information from the Internal Revenue Service with respect to income reported by New Mexico residents. Through its Schedule C matching program, the Department attempts to match a taxpayer's receipts from engaging with business as reported on Federal Schedule C to receipts reported to the Department for gross receipts tax purposes.

9. As a result of the information the Department received concerning the Taxpayer's commissions, on October 13, 1996, the Department issued Assessment No. 2078499, assessing gross receipts tax upon the Taxpayer's commissions in calendar year 1993. The Assessment assesses \$1,455.84 in gross receipts tax, \$700.62 in interest and \$145.56 in penalty.

10. As a result of the information the Department received concerning the Taxpayer's commissions, on November 8, 1996, the Department issued Assessment No. 2083144, assessing gross receipts tax upon the Taxpayer's commissions in calendar year 1994. The Assessment assesses \$2,749.56 in gross receipts tax, \$747.74 in interest and \$275.04 in penalty.

11. By letter postmarked December 2, 1996, the Taxpayer timely protested Assessment No. 2083144. The letter also protested Assessment No. 2078499, but was not within the 30 day time limit of NMSA 1978, § 7-1-24(B). On January 23, 1997, the Department, however, granted a retroactive extension of time to file a protest, pursuant to its authority under the same statute, thereby rendering the Taxpayer's protest to Assessment No.2078499 timely.

DISCUSSION

The Taxpayer disputes the imposition of gross receipts tax upon his commissions and the imposition of penalty and interest for failing to report and pay gross receipts tax.

Gross receipts tax is imposed upon the gross receipts of any person engaging in business in New Mexico for the privilege of engaging in business. Gross receipts is defined at NMSA 1978, § 7-9-3(F). In pertinent part, it provides:
"gross receipts" means the total amount of money or the value of other consideration received from selling property in New Mexico,...or from performing services in New Mexico....

(1) "Gross receipts" includes:

...

(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;

Applying this definition, Craft-Matic Pacific had gross receipts amounting to the total amount of money received from selling beds in New Mexico. The Taxpayer also has gross receipts amounting to the total commissions received from his business of selling or promoting the sale of the beds. The net effect is that there are two taxable transactions arising from the same sale of a bed by the Taxpayer. There is no applicable exemption or deduction in the Gross Receipts and Compensating Tax Act, Chapter 7, Article 9 NMSA 1978 which can be found which would apply

to prevent the double taxation which results from the application of the Act to the circumstances of this case.

The Taxpayer objects to the imposition of tax based upon the differential treatment he receives as an independent contractor as opposed to an employee of Craft-Matic Pacific who would not be subject to gross receipts taxes. It is true that there is an exemption in the Gross Receipts and Compensating Tax Act for wages, salaries and commissions received by employees. NMSA 1978, § 7-9-17. There is a difference in the form in which the Taxpayer has chosen to conduct his business affairs and that choice of form has tax consequences. The Taxpayer objects to the unequal treatment of employees and independent contractors, but there is nothing unlawful about this differential treatment. Especially in the area of taxation, the legislature is free to make different classifications and to treat different classifications differently for tax purposes. In order to succeed in challenging a tax classification as a violation of constitutional requirements of equal protection of the laws, the person challenging the classification has the burden of proving that there is no conceivable rational basis to support the legislative classification. *Michael J. Maloof & Co. v. Bureau of Revenue*, 80 N.M. 485, 458 P.2d 89 (1969). This, the Taxpayer has not done, and the imposition of gross receipts tax is upheld.

The Taxpayer also challenges the imposition of penalty and interest on the basis that his failure to report tax was based upon a misconception that all applicable gross receipts taxes were paid by Craft-Matic Pacific and that he was simply unaware of his obligation to report and pay gross receipts taxes on his commissions. The Taxpayer also argues that he reported and paid income taxes on his commissions and made no attempt to conceal the nature or source of his receipts or otherwise deceive the Department with respect to his tax liabilities.

The imposition of penalty is governed by the provisions of NMSA 1978, Section 7-1-69(A) NMSA 1978 (1995 Repl. Pamp.), which imposes a penalty of two percent per month, up to a maximum of ten percent:

In the case of failure, due to negligence or disregard of rules and regulations, but without intent to defraud, to pay when due any amount of tax required to be paid or to file by the date required a return regardless of whether any tax is due,....

This statute imposes penalty based upon negligence (as opposed to fraud)¹ for failure to timely pay tax. Thus, there is no contention that the failure to report and pay taxes was based upon any conscious attempt by the Taxpayer to underreport taxes. What remains to be determined is whether the Taxpayer was negligent in failing to report its taxes properly. Taxpayer "negligence" for purposes of assessing penalty is defined in Regulation TA 69:3 as:

- 1) failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
- 2) inaction by taxpayers where action is required;
- 3) inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

In this case the Taxpayer's failure to report and pay taxes was based upon Mr. Champion's lack of knowledge about New Mexico taxes. New Mexico has a self-reporting tax system which requires that taxpayers voluntarily report and pay their tax liabilities to the state. Because of this, the case law is well settled that every person is charged with the reasonable duty to ascertain the possible tax consequences of his actions, and the failure to do so has been held to amount to negligence for purposes of the imposition of penalty pursuant to Section 7-1-69 NMSA 1978. *Tiffany Construction Co. v. Bureau of Revenue*, 90 N.M. 16, 558 P.2d 1155 (Ct. App. 1976), *cert. denied*, 90 N.M. 255, 561 P.2d 1348 (1977). In this case, the Taxpayer was negligent in that he failed to take steps to ascertain the tax consequences of engaging in business as an independent contractor. Thus, the imposition of penalty is proper. Although the imposition of penalty is intended to penalize taxpayers who fail to report and pay taxes in a timely manner, there are sound policy reasons behind the imposition of penalty. A self-reporting tax system relies upon taxpayers

¹ There is a 50% of tax penalty provided for the failure to pay tax due the State when such failure to pay is based upon an intention to defraud the State. See, NMSA 1978, Section 7-1-69(B).

accurately reporting their tax liabilities to the government. There are insufficient government resources to audit every taxpayer periodically to otherwise assure tax compliance. The imposition of penalty provides taxpayers with an incentive to understand the tax consequences of their actions and to accurately report their taxes. Otherwise, if the only consequence of an audit and determination of underpayment of tax was the payment of the tax which was owed, it would always advantage a taxpayer to simply underreport taxes and to pay them if they were found out.

Section 7-1-67(A) NMSA 1978 addresses the imposition of interest on tax deficiencies and provides as follows:

- A. If any tax imposed is not paid on or before the day on which it becomes due, *interest shall be paid* to the state *on such amount* from the first day following the day on which the tax becomes due, without regard to any extension of time or installment agreement, *until it is paid.* (emphasis added)

It is a well settled rule of statutory construction that the use of the word "shall" in a statute indicates that the provisions are intended to be mandatory rather than discretionary, unless a contrary legislative intent is clearly demonstrated. *State v. Lujan*, 90 N.M. 103, 560 P.2d 167 (1977). Applying this rule to Section 7-1-67, the statute requires that interest be paid to the state on any unpaid taxes and no exceptions to the imposition of interest are countenanced by the statute. Thus, it doesn't matter why taxes were unpaid. Interest is imposed for the period of time that they are unpaid.

The Taxpayer's argument essentially conceives of interest as a penalty imposed to punish a taxpayer for the late payment of taxes. This argument misapprehends the nature of the assessment of interest. Interest is imposed to compensate the state for the lost value of having tax revenues at the time they are required to be paid. Those tax revenues could have been invested by the state and interest earned upon those revenues, until the state needed to use the money to meet its obligations. While one may disagree with the rate of interest set by the legislature, as being excessive in comparison with market rates of interest, that is a matter within the sound discretion of

the legislature, and the Department is without authority to substitute its own judgment for that of the legislature in setting the rate of interest to be imposed. Because the Taxpayer failed to pay tax on his commission receipts at the time such taxes were due, interest is properly imposed.

CONCLUSIONS OF LAW

1. The Taxpayer filed timely, written protests to Assessment Nos. 2078499 and 2083144 and jurisdiction lies over both the parties and the subject matter of this protest.

2. The Taxpayer's receipts from commissions are a separate transaction from the sale of the beds which generated the commissions paid to the taxpayer, and gross receipts tax was properly assessed upon the Taxpayer's commissions.

3. The Taxpayer was negligent in failing to take steps to ascertain the tax consequences of engaging in business as an independent contractor compensated on a commission basis, and thus penalty was properly imposed for failure to timely report and pay gross receipts taxes on the Taxpayer's commissions.

4. The Taxpayer was late in paying gross receipts taxes upon his commission receipts and interest was properly imposed.

For the foregoing reasons, **THE TAXPAYER'S PROTEST IS HEREBY DENIED.**

DONE, this 2nd day of July, 1997.