

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

IN THE MATTER OF THE PROTEST OF
KERRY D. AND KATHY L. SHAHAN
PROTEST TO DENIAL OF CLAIM FOR REFUND

NO. 97-41

DECISION AND ORDER

This matter came on for formal hearing on October 28, 1997, before Gerald B. Richardson, Hearing Officer. Kerry and Kathy Shahan, hereinafter, "Taxpayers", represented themselves 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:

1. On April 8, 1996, the Taxpayers filed a New Mexico personal income tax return with the Department. On line 7 of the return, the Taxpayers reported that they had zero Federal adjusted gross income, as reported on line 31 of federal form 1040 or line 16 of federal form 1040A. The Taxpayers also reported that \$1516.19 of New Mexico income tax had been withheld from them and they requested a refund in that amount.

2. On August 9, 1996, the Department wrote the Taxpayers and proposed to make adjustments to the Taxpayers' return. Among the proposed adjustments was that no New Mexico income tax had been withheld from the Taxpayers because the Taxpayers' original return did not provide copies of the Taxpayers' W-2 forms to support their claim that income tax had been withheld.

3. On August 26, 1996 the Taxpayers responded to the Department's letter. They provided copies of two W-2 forms and reiterated their demand for a refund in the amount of income tax withheld, \$1516.19.

4. The W-2 forms provided confirmed that the Taxpayers had had \$1516.19 of New Mexico income tax withheld. The W-2 forms also indicated that in 1995, Kerry Shahan had received wages, tips or other compensation from Queen Oil & Gas Company in the amount of \$6164.53 and he had also received wages, tips or other compensation from Andarko Petroleum Corporation in the amount of \$33,793.96

5. Based upon its review of the Taxpayers' W-2 forms and returns, on November 8, 1996 the Department wrote to the Taxpayers and informed them that it had denied their claim for refund.

6. On December 30, 1996 the Taxpayers filed a written protest to the Department's denial of their claim for refund.

7. The Taxpayers are residents of New Mexico.

DISCUSSION

The sole issue to be determined herein is whether the Department erroneously denied the Taxpayers a refund of the income taxes withheld from Mr. Shahan's wages from employment in New Mexico.

The Taxpayers declined to present any factual evidence in support of their claim of entitlement to the refund claimed. Instead, the Taxpayers chose to rely upon various legal arguments in support of their claim.

New Mexico imposes its income tax upon the net income of "every resident individual". New Mexico is among the majority of states which "piggy-back" or use the federal income tax system as the basis for calculating state income taxes. The calculation of personal income taxes in New Mexico begins with a determination of "base income" which is defined to be the taxpayer's "adjusted gross income" as defined in Section 62 of the Internal Revenue Code, plus certain net operating loss deductions which can be deducted for federal purposes in arriving at federal adjusted gross income but which New Mexico does not allow to be deducted in the same manner. *See*, NMSA 1978, § 7-2-2(B). New Mexico then allows certain deductions, such as the federal standard or itemized deductions and deductions for income from federal obligations, to arrive at "net income" upon which income tax is imposed. *See*, NMSA 1978, 7-2-2(N) and 7-2-3.

The primary issue raised by the Taxpayers is the Department's authority to make an independent determination that the zero amount that the Taxpayers reported on line 7 of their New Mexico return did not accurately reflect their federal adjusted gross income. The Taxpayers argue that until the Internal Revenue Service makes a determination that their federal adjusted gross income is other than zero, that the Department is bound by their declaration of zero federal adjusted gross income. Although the Taxpayers presented no evidence that they also reported zero federal adjusted gross income to the Internal Revenue Service for the tax year at issue, it will be assumed for purposes of this discussion that they did so.

The Taxation and Revenue Department is established under the Taxation and Revenue Department Act, Sections 9-11-1 to 9-11-13 NMSA 1978. As stated at Section 9-11-3, “[T]he purpose of the Taxation and Revenue department act is to establish a single, unified department to administer all laws and exercise all functions relating to taxation, revenue and vehicles charged to the department.” Section 9-11-6 NMSA 1978 sets forth the authority of the Secretary of the Taxation and Revenue Department. Specifically, Subsection A provides that it is the Secretary’s duty to, “manage all operations of the department and to administer and enforce the laws with which the secretary or the department is charged.” The Income Tax Act, Sections 7-2-1 to 7-2-31 NMSA 1978 is one of those laws relating to taxation which the Department administers. Although there is no specific provision which explicitly states that the Department administers the Income Tax Act, there are numerous references to the Department and the Secretary of Taxation and Revenue within the act to support this conclusion. For instance, Section 7-2-12 requires that individuals required to file income tax returns to file them with the Department. Additionally, the Income Tax Act is administered pursuant to the provisions of the Tax Administration Act. See, Sections 7-2-22 and 7-1-2(A)(1) NMSA 1978. Section 7-1-4 of the Tax Administration Act provides the authority for the Secretary of the Department to investigate and determine tax liabilities. Specifically, Subsection A provides:

For the purpose of establishing or determining the extent of the liability of any person for any tax, for the purpose of collecting any tax or for the purpose of enforcing any statute administered under the provisions of the Tax Administration Act, the secretary or the secretary’s delegate is authorized to examine equipment and to examine and require the production of any pertinent records, books, information or evidence, to require the presence of any person and to require that person to testify under oath concerning the subject matter of the inquiry and to make a permanent record of the proceedings.

This provision gives the Secretary or his delegates the authority to investigate and determine the extent of liability of any person for any tax. This language is sufficiently broad to authorize the Department to make its own determinations with respect to any taxpayer's income tax liability. Although the calculation of an individual's New Mexico's income tax liability starts with a taxpayer's adjusted federal gross income, there is no reason to think that only the Internal Revenue Service can make the determination of what that is. Tax preparers and professionals, as well as millions of individuals make their own determination of what their client's or their own federal adjusted gross income is every time they complete and file a federal income tax return. They make this calculation by applying the provisions of the Internal Revenue Code to their own individual circumstances. Section 7-1-4 authorizes the Department to make its own investigation of the facts and make its own determination of the proper amount of tax owing whenever the Department has cause to disagree with the information contained in a taxpayer's return. Thus, the Taxpayer's argument that only the Internal Revenue Service can determine a taxpayer's federal adjusted gross income is simply erroneous.¹

The Internal Revenue Code, hereinafter, "Code", defines adjusted gross income to be gross income, less certain deductions which are listed in Section 62 of the Code. Gross income is defined in Section 61 of the Code as follows:

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

- (1) Compensation for services, including fees, commissions, fringe benefits and similar items;

¹ A more difficult issue would be posed if the Internal Revenue Service and the Department made separate determinations of the amount of a given taxpayer's federal adjusted gross income which disagreed. As the Taxpayers presented no evidence to suggest that the IRS had accepted their declaration of their adjusted gross income nor that it had made its own determination, that issue is not presented by this case.

- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowments contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

26 U.S.C. § 61 (1997). This definition is quite broad and inclusive, and is certainly broad enough to include under the first listed category of compensation for services the wages or salary paid by Andarko Petroleum Corporation and Queen Oil Company to Mr. Shahan. Thus, the evidence establishes that the Taxpayer's representation that they had zero federal adjusted gross income is erroneous. We know that they had at least \$39,978.49 in income from wages. We don't know whether they had additional income to be included in the calculation of federal adjusted gross income based upon the record herein. Given this state of affairs, and given the Secretary's

authority, pursuant to Section 7-1-26 NMSA 1978 to deny any claim for refund of tax, there is sufficient evidence to justify the Secretary in denying the Taxpayer's claim for refund based upon a doubt as to the Taxpayer's correct income tax liability.

The second argument made by the Taxpayers is that they are non-resident aliens of the United States and are therefore not subject to taxation under the Internal Revenue Code. By this argument, I understand the Taxpayers to argue that the Internal Revenue Code applies only to federal employees or to those residing within the territorial jurisdiction of the United States. There is nothing in the Internal Revenue Code which limits its applicability to federal employees. Individual income tax is imposed upon "individuals" pursuant to 26 U.S.C. 1. Although "individual" is not defined in the Code, words used in statutes are presumed to be used in their ordinary and usual sense. *Bettini v. City of Las Cruces*, 82 N.M. 633, 485 P.2d 967 (1971). An individual is commonly understood to mean a person and there is nothing in the ordinary understanding of what an individual or a person is which would limit the term to only apply to those persons employed by the federal government.

This decision maker has no quarrel with the concept that the Internal Revenue Code would apply only to those residing within the territorial jurisdiction of the United States. The United States first acquired territorial jurisdiction over this region from the Republic of Mexico under the terms of the Treaty of Guadalupe Hidalgo in 1848. I would further direct the Taxpayers' attention to the Organic Act Establishing the Territory of New Mexico, (Sept. 9, 1850, 9 Stat. 446, ch. 49), which established the Territory of New Mexico; the joint resolution of Congress to admit the Territory of New Mexico into the union as a state, (Aug. 21, 1911, No. 8, 37 Stat 39) and the

presidential Proclamation Admitting New Mexico as a State Into the Union, (Jan. 6, 1912, 37 Stat 1723). New Mexico is clearly within the territorial jurisdiction of the United States.

The Taxpayers also submitted as an exhibit an “open letter to IRS Commissioner” which was printed in the September, 1996 edition of Media Bypass Magazine, which claims to find no authority within the Internal Revenue Code authority which created the Internal Revenue Service. By submitting this article, I assume the Taxpayers argue that if the Internal Revenue Service does not exist, that its authority to enforce the Internal Revenue Code also does not exist. While I have not researched the issue of the authority of the Internal Revenue Service, it is really quite irrelevant to the determination of this matter. New Mexico’s Income Tax Act does not rely upon the authority of the Internal Revenue Service, but merely refers to definitions in the Code to determine how taxpayers subject to New Mexico’s income tax must calculate their income taxes for New Mexico. As noted above, the Department can make its own determination as to what a taxpayer’s federal adjusted gross income is and apply the Income Tax Act to determine the income tax liability under that act of those subject to income taxation in New Mexico. Since there is no dispute that the Taxpayers are residents of New Mexico and since New Mexico’s Income Tax Act imposes a tax on the net income of every resident individual deriving income from any property or employment within the state, Section 7-2-3 NMSA 1978, it is simply irrelevant whether or not the Internal Revenue Service is legally constituted.

As just noted, the legal authority of the Internal Revenue Service and even the legality or constitutionality of the federal income tax are really irrelevant to the determination of the issue at hand, which is whether New Mexico may impose its income taxes on those who reside within its borders and earn income in New Mexico. The fact that New Mexico may use a well understood

and widely accepted standard, federal adjusted gross income, to measure the calculation of its tax does not depend upon the legality of the federal income tax itself. Nonetheless, since the Taxpayer's arguments really go to the legality of the federal income tax itself, I feel it incumbent to direct them to the ample federal authority sustaining the federal income tax and upholding the imposition of federal income tax on wages, specifically, in the face of many of the same arguments the Taxpayers' apparently hold dear. There is one case in particular, which addresses the standard tax resister arguments and cites to numerous federal cases upholding federal income taxes in the face of these arguments. In *Coleman v. Commissioner of Internal Revenue*, 791 F.2d 68, the Seventh Circuit Court of Appeals addressed the consolidated cases of Mr. Norman Coleman and Mr. Gary Holder. Both of these individuals had argued that their wages were not subject to federal income taxation. The court had this to say about those arguments:

Coleman says that wages may not be taxed because they come from his person, a depreciating asset. The personal depreciation offsets the wage, leaving no net income. Coleman thinks that only net income may be taxed under the Sixteenth Amendment--net income as Coleman defines it, not as Congress does. Holder, who styles himself a "private citizen," insists that wages may not be taxed because the Sixteenth Amendment authorizes only excise taxes, and in Holder's world excises may be imposed only on "government granted privileges." Because Holder believes that he is exercising no special privileges, he thinks he may not be taxed. ***These are tired arguments. The code imposes a tax on all income. See, 26 U.S.C. § 61. Wages are income, and the tax on wages is constitutional. See, among hundreds of other cases, United States v. Thomas***, 788 F.2d 1250, 1253 (7th Cir. 1986); *Lovell v. United States*, 755 F.2d 517 (7th Cir. 1984); *Granzow v. CIR*, 739 F.2d 265, 267 (7th Cir. 1984); *United States v. Koliboski*, 732 F.2d 1328, 1329 & n. 1 (7th Cir. 1984). See also *Brushaber v. Union Pacific R.R.*, 240 U.S. 1, 12, 24-15, 36 S.Ct. 236, 239, 244-45, 60 L.Ed. 2d 493 (1916).

Id. at 70. As this case and the cases cited therein indicate, there is really no question that Mr. Shahan's income from wages paid is income for federal tax purposes, and as such, would be included in federal adjusted gross income for federal purposes, and by statutory reference, would also be included in "base income" for purposes of calculating New Mexico personal income taxes. The Taxpayers may also have had other income which would also be considered to be included in both federal adjusted gross income and New Mexico base income during the tax year at issue, but the record is silent on this point. It is the Taxpayers who bear the burden of establishing their entitlement to the refund which they claimed and the record, so far as it exists, is sufficient to establish that they have substantially underreported their New Mexico base income upon which taxes are calculated. It is possible that the Taxpayers are due some amount of refund based upon an accurate rendition of their New Mexico base income and the Taxpayers may file an accurate amended return to claim any such refund if they choose to do so. Unless and until they do so, however, they have failed to meet their burden of proving their entitlement to the refund claimed in this proceeding. For these reasons, the Taxpayers' protest will be denied.

CONCLUSIONS OF LAW

1. The Taxpayers filed a timely, written protest, pursuant to Sections 7-1-26 and 7-1-24 NMSA 1978 to the Department's denial of their claim for refund and jurisdiction lies over the parties and the subject matter of this protest.

2. Mr. Shahan's wages from employment in New Mexico are included in both gross income and federal adjusted gross income as defined in the Internal Revenue Code.

3. Mr. Shahan's wages from employment in New Mexico are included in both "base income" and "net income" as those terms are defined in the Income Tax Act, Chapter 7, Article 2, NMSA 1978.

4. The Department has the authority and responsibility to ensure that persons subject to income tax in New Mexico properly report, calculate and pay their taxes to the Department and pursuant to this authority, may determine, independently of the Internal Revenue Service, whether taxpayers are properly reporting and calculating their income taxes owing to the Department.

5. The Taxpayers failed to accurately report their New Mexico base income on the 1995 personal income tax return they filed with the Department.

6. The Taxpayers failed to carry their burden of establishing their entitlement to a refund of taxes withheld from Mr. Shahan's wages for tax year 1995.

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

DONE, this 12th day of November, 1997.