

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

IN THE MATTER OF THE PROTEST OF
KENT AND JORGE JONES
ID. NO. 02-327016-00 0
ASSESSMENT NO. 2110387

98-10

DECISION AND ORDER

This matter came on for formal hearing on February 5, 1998 before Margaret B. Alcock, Hearing Officer. Kent H. Jones ("Mr. Jones") appeared on his own behalf. The Taxation and Revenue Department ("the Department"), was represented by Bruce J. Fort, Special Assistant Attorney General. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. From 1986 through May 1996, Mr. Jones worked as a sales representative for Encyclopaedia Britannica ("the company"). In 1996, the company discontinued the use of in-state sales representatives and began conducting all of its solicitations by mail.
2. When the company hired Mr. Jones, it told him that he was responsible for making all required tax payments on his commissions. Mr. Jones understood he was being hired as an independent contractor and accepted the job on that basis.
3. The company did not withhold income taxes, social security taxes or workmen's compensation insurance on behalf of Mr. Jones. Each year, the company issued Mr. Jones a federal Form 1099 reporting his commissions as "nonemployee compensation" (Department Exhibit A)
4. Mr. Jones was given three days of classroom training before beginning his work as a sales representative.

5. The 1991 Sales Representatives' Training and Policy Manual (Taxpayer Exhibit 6)¹ required the company's sales representatives to fully comply with Federal Trade Commission (FTC) orders and regulations. The company also provided its sales representatives with checklists instructing them not to misrepresent any facts in the course of their sales presentation or take any action that would violate FTC requirements (Taxpayer Exhibit 5).

6. Highlights of FTC requirements were set out in the company's training and policy manuals (Taxpayer Exhibit 6, Section II, pp. 1-2; Taxpayer Exhibit 8, p. 151). Certain FTC requirements were also included on a "Full Service Courtesy Checklist" (Taxpayer Exhibit 2) that had to be signed by both the sales representative and the customer whenever a set of encyclopedias was sold.

7. The company would not accept an order without a signed courtesy checklist. The courtesy checklist required the sales representative to:

present a business card and give the customer the opportunity to read it;

give the customer a price list;

give the customer two completely filled out copies of the sales contract and oral and written disclosure of the customer's 3-day cancellation right;

give the customer a copy of his completed credit application;

explain to the customer that the primary purpose of the representative's presentation was to give the customer an opportunity to acquire the company's products;

explain the company's Instant Research Service, the full details of which were set out on the reverse side of the courtesy checklist;

give the customer a copy of the Lifetime Education Folder containing a delivery and replacement guarantee, and information on the Instant Research Service.

¹ Although the assessment period covers calendar year 1993, rather than 1991, Mr. Jones testified that the training and policy manual introduced as Taxpayer Exhibit 6 was representative of manuals used during the entire period he worked for the company.

8. Sales Representatives obtained the names of potential customers from “leads” provided by their district manager. The leads were developed from responses to advertisements the company placed with different media. Each lead contained the prospect’s name and address and a lead message that alerted the sales representative to the type of offer involved (Taxpayer Exhibit 6, Section II, p. 36).

9. Sales representative were required to pay for leads obtained from the company. The cost of the lead was based on the type of advertising that generated the lead. Accordingly to a list set out in the training and policy manual, a national advertising lead generated through major publications cost \$6.00; a television lead cost \$8.00; a direct mail lead cost \$10.00. Certain leads, such as telephone inquiry and referral leads, cost up to \$50 or 50% of the sales representative’s commission, but were only charged if the lead resulted in a sale (Taxpayer Exhibit 6, Section II, p. 37).

10. Leads were offered to sales representatives at the discretion of the district manager. Sales representatives were not required to accept leads. Mr. Jones would not accept leads in an out-of-town location unless there were enough leads to make it worth his while to travel to that location.

11. The company also sold its products at counter locations in shopping malls, airports, fairs, etc, where there was usually one person designated by the company to oversee the display and operation of the counter. When sales representatives chose to sell at counter locations, they were required to conform to the hours set by the mall, airport, fair, etc

12. The cost of counter space rental, drayage, electricity and display usage was shared among the sales representatives participating in those events (Taxpayer Exhibit 6, Section II, p. 38).

13. If a sales representative used the facilities of the company’s local office, he could be charged up to \$25 per week for using the telephone, plus the cost of long-distance calls; \$1.00 to \$2.00

per week as a postage fee for sending orders to the home office; and \$1.00 to \$2.00 per week for use of the copying machine (Taxpayer Exhibit 6, Section II, p. 38).

14. Sales representatives were required to order and pay for their business cards through the company. *See*, Taxpayer Exhibit 4.

15. Sales representatives made a refundable deposit of \$65.00 to use the company's sales kit. They had the option of purchasing additional sales and promotional materials (Taxpayer Exhibit 6, Section II, p. 39).

16. Sales representatives were responsible for all travel expenses they incurred in their sales activities, including transportation, parking, motels and food.

17. Sales representatives were paid a commission on sales made within their assigned territory. The company did not pay a base salary or stipend or make any payment for sales presentations that did not result in a sale.

18. The amount of a sales representative's commission varied depending on the number of sales made. The more sales made by a representative during a specified period, the higher his commission on each sale.

19. Sales representatives were also eligible for bonus payments. Bonuses were paid for securing a cash payment or a high down payment, for making a sale based on certain types of leads, and for recruiting new sales representatives (Taxpayer Exhibit 6, Section II, pp. 24-25).

20. The training and policy manual states that "a Representative will be free to exercise his own judgment as to the persons from whom he will solicit such orders and the time and place of such solicitations..." (Taxpayer Exhibit 6, Section II, p. 42).

21. Mr. Jones did not work a full-time or regular schedule and sometimes went for several weeks without engaging in any sales activity for the company. Mr. Jones had control over his schedule,

although he usually kept his district manager apprised of his decision not to work during certain periods.

22. Mr. Jones spent about half his time selling at counter locations and half his time selling on the road. Mr. Jones worked 4 to 5 hours a day when he was on the road.

23. Sales representatives were trained and strongly urged to follow the company's sales presentation materials, which included examples of how to approach sales prospects and how to handle different situations that might arise during the presentation (Taxpayer Exhibit 6, Section I and Taxpayer Exhibit 7).

24. The only requirements placed on sales representatives was that they avoid misrepresentation and follow FTC orders and the procedures set out on the courtesy checklist. A sales representative who wanted to use his own sales materials was required to obtain approval from the company's legal department to insure the materials complied with FTC rules and regulations (Taxpayer Exhibit 6, Section II, p.2).

25. Mr. Jones reported and paid self-employment taxes to the federal government and reported his commission income and business deductions on Schedule C of federal Form 1040 (Department Exhibit A). Mr. Jones did not understand that his status as an independent contractor would make him liable for payment of New Mexico gross receipts tax on his commissions.

26. In 1997, the Department determined that Mr. Jones failed to report gross receipts tax on commissions reported as business income on his 1993 federal income tax return. On February 25, 1997, the Department issued Assessment No. 2110387 for \$770.10 gross receipts tax, \$77.02 penalty and \$1,232.17 interest for calendar year 1993.

27. On March 7, 1997, Mr. Jones filed a written protest to the Department's assessment.

DISCUSSION

I. Employee v. Independent Contractor.

Mr. Jones maintains that he is not liable for gross receipts tax on his sales commissions because he was an employee of Encyclopaedia Britannica and was therefore entitled to the exemption found in Section 7-9-17, NMSA 1978, which states:

Exempted from the gross receipts tax are the receipts of employees from wages, salaries, commissions or from any other form of remuneration for personal services.

The Department argues that Mr. Jones was an independent contractor whose self-employment income did not qualify for the exemption provided in Section 7-9-17.

In determining whether a person is an employee or an independent contractor, the common law meaning of those terms will apply unless there is persuasive evidence of a contrary legislative intent. *Harger v. Structural Services, Inc.*, 121 N.M. 657, 663, 916 P.2d 1324, 1330 (1996). In *Harger*, the New Mexico Supreme Court adopted the approach set out in the Restatement (Second) of Agency § 220(1) (1958) to determine a worker's status as an employee or an independent contractor:

The important distinction is between service in which the actor's physical activities and his time are surrendered to the control of the master, and service under an agreement to accomplish results or to use care and skill in accomplishing results. Those rendering service but retaining control over the manner of doing it are not servants.

Among the factors to be considered are: whether the party employed engages in a distinct occupation or business; whether the work is part of the employer's regular business; the skill required in the particular occupation; whether the employer supplies the instrumentalities, tools, or the place of work; the duration of a person's employment and whether that person works full-time or regular hours; or whether the parties believe they have created the relationship of employer and

employee, insofar as this belief indicates an assumption of control by one and submission to control by the other. *Id.*, comments h-m. The manner and method of payment is also relevant to the issue of control. *Harger*, 121 N.M. at 667, 916 P.2d at 1334; *Tafoya v. Casa Vieja, Inc.*, 104 N.M. 775, 777, 727 P.2d 83, 85 (Ct. App. 1986). While all of these factors may be considered, it is the totality of the circumstances that should determine whether the employer has the right to exercise essential control over a particular worker.

The Department has adopted a regulation under Section 7-9-17 that uses similar criteria to determine whether a worker qualifies as an employee. Regulation 3 NMAC 2.17.7 (formerly GR 17:1) provides as follows:

7.1 In determining whether a person is an employee, the department will consider the following indicia:

1. is the person paid a wage or salary;
2. is the “employer” required to withhold income tax from the person’s wage or salary;
3. is F.I.C.A. tax required to be paid by the “employer”;
4. is the person covered by workmen’s compensation insurance;
5. is the “employer” required to make unemployment insurance contributions on behalf of the person;
6. does the person’s “employer” consider the person to be an employee;
7. does the person’s “employer” have a right to exercise control over the means of accomplishing a result or only over the result (control does not mean “mere suggestion”).

7.2 If all of the indicia mentioned in 3 NMAC 2.17.7.1 are present, the department will presume that the person is an employee. However, a person may be an employee even if one or more of the indicia are not present.

A second regulation under Section 7-9-17 deals specifically with commissioned salespersons.

Regulation 3 NMAC 2.17.10 (formerly GR 17:5) states:

A salesperson who sells for a company on a commission basis is not an employee of the company where the company exercises no direct control over the details of performance of the salesperson's duties beyond general statements about the scope and nature of the salesperson's obligations under the contract between the salesperson and the company. In addition, where commissions paid to a salesperson are not subject to withholding taxes or social security taxes, the salesperson is not considered an employee of the company. Therefore, receipts from commissions paid to such salesperson for selling property in New Mexico are subject to the gross receipts tax.

Mr. Jones argues that the first sentence of Regulation 3 NMAC 2.17.10 controls the outcome of this case. He reads the regulation to set up an "either/or" test: a person is an employee if a company exercises some direct control over the person's activities *or* withholds taxes from his commissions. Because Mr. Jones believes that Encyclopaedia Britannica exercised direct control over his sales activities, he maintains that the second sentence of the regulation, as well as the factors set out in Regulation 3 NMAC 2.17.10, are irrelevant.

Mr. Jones' reading of the Department's regulations is too narrow. It must be noted that the method of paying a worker is a consideration in determining the existence of control over that worker. The second sentence of Regulation 3 NMAC 2.17.10 simply highlights one of the factors to be used in determining the existence of control discussed in the first sentence. The seven indicia listed in Regulation 3 NMAC 2.17.7.1 also bear on the issue of whether a worker's "physical activities and his time are surrendered to the control of the master." Restatement (Second) of Agency § 220(1) (1958). While no one factor is conclusive, all must be considered in determining whether Mr. Jones was working as an employee or an independent contractor.

II. Burden of Proof.

There is a statutory presumption that the Department's assessment of gross receipts taxes is correct. Section 7-1-7, NMSA 1978; *Mears v. Bureau of Revenue*, 87 N.M. 240, 241, 531 P.2d 1213, 1214 (Ct. App. 1975). In order for the taxpayer to be successful, he must clearly overcome this presumption. *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). Moreover, where an exemption from tax is claimed, the exemption is strictly construed in favor of the taxing authority. *Stohr v. New Mexico Bureau of Revenue*, 90 N.M. 43, 46, 559 P.2d 420, 423 (Ct. App. 1976), *cert. denied*, 90 N.M. 254, 561 P.2d 1347 (1977); *Rock v. Commissioner*, 83 N.M. 478, 479, 493 P.2d 963, 964 (Ct. App. 1972).

III Application of Law to Facts.

In arguing that Encyclopaedia Britannica exercised direct control over his sales activities, Mr. Jones relies on the company's admonitions not to misrepresent any facts in the course of a sales presentation or take any action that would violate FTC rules or regulations. Mr. Jones maintains that the company's refusal to accept an order that was not accompanied by a signed courtesy checklist establishes that the company exercised direct control over its representatives' sales activities. A requirement that sales representatives provide assurances that they have complied with applicable law goes to the product of their work, *i.e.*, a legal and binding contract of sale, not to the details of performance.

When a construction contractor is hired to build a house, the owner will require him to comply with local building codes. In that case, a government inspector determines whether the completed house--the result of the contractor's work--meets this requirement. In the case of Encyclopaedia Britannica sales representatives, there was no tangible product that could be examined to determine whether a sales presentation complied with FTC rules and regulations. Accordingly, the company

required its representatives to provide a signed statement that would assure the company that applicable laws were followed and the sale would be binding on the customer. This requirement goes to the sales representatives' agreement to accomplish a specific result and does not indicate an employer/employee relationship.

With regard to the details of performance, Mr. Jones had a great deal of control over his sales activities. He was not required to work a specific number of hours or weeks during the year. Mr. Jones testified that he set his own schedule and sometimes went for several weeks without engaging in any sales activity for the company. When Mr. Jones was ready to work, it was up to him to take the initiative to obtain leads from the district manager, usually by attending weekly sales meetings. Mr. Jones was not required to accept any particular lead and would only take leads that were likely to provide him with sufficient business to make it worth his time and travel expenses. The only time Mr. Jones worked set hours was when he chose to engage in sales activities at a counter location. In those cases, the hours were set by the entity that operated the facility in which the counter was located, i.e., the mall, fair, theme park, etc.

Sales representatives were strongly encouraged to use the company's sales materials, which included a formal presentation and suggestions on how to handle various situations, such as a customer's concern over the price of a set of encyclopedias or hesitancy to make a final commitment to purchase. Nonetheless, it was up to the individual sales representative to determine whether and when to use a particular selling technique. It was also up to the sales representative to determine whether to continue a presentation or terminate the presentation because the prospect was not sufficiently interested. Sales representatives were not prohibited from using their own sales materials as long as the company's legal department confirmed that the materials met FTC rules and regulations.

Acknowledging there was no supervision of his in-home sales presentations, Mr. Jones testified that he was subject to supervision when he participated in sales at counter locations. The company usually assigned one person, who Mr. Jones thought was an employee,² to oversee the operation of counter locations at fairs and malls. There was one woman with whom Mr. Jones worked on a regular basis when selling at counter locations. According to Mr. Jones, she told him where to put displays, when to take breaks, etc. On cross-examination, it became apparent that the primary reason Mr. Jones followed her instructions was because she was “a very bossy woman” and he did not want to risk a confrontation with her. There is no evidence of the extent to which the company instructed or required individual sales representatives to take direction from the person assigned to oversee the counter locations.

Sales representatives were required to pay all the expenses of their sales activities, including the cost of leads, the shared cost of counter locations, sales and promotional materials, transportation, parking, motels and food. To the extent a representative used the company’s local office, he could be charged a fee for use of the telephone, copying machine and postage to send orders to the home office. Sales representatives such as Mr. Jones were paid a commission on completed sales. If Mr. Jones spent a substantial amount of time making sales presentations that did not result in a sale he did not receive any base salary or other compensation for his time.

At the time Mr. Jones was hired, he was told that he would be responsible for making all required tax payments on his commissions. The company did not withhold income taxes, social security taxes or workmen’s compensation insurance on Mr. Jones’ behalf. At the end of each year, the company issued a federal Form 1099 to Mr. Jones reporting his commissions as “nonemployee compensation.” Mr. Jones testified that he knew the company was hiring him as an independent

² Salespeople on employee status included district field trainers, assistants to division managers, branch managers, district managers and division managers (Taxpayer Exhibit 6, Section II, p. 45).

contractor and accepted the job on that basis. In 1993 he reported and paid self-employment taxes to the federal government and reported his commission income and business deductions on Schedule C of federal Form 1040.

It should be noted that while Mr. Jones insists he was an employee and not an independent contractor, there is no indication that he has amended his federal and state income tax returns to reflect his income as wages rather than as business income. New Mexico case law holds that a taxpayer must treat transactions uniformly for all purposes within the tax laws. The taxpayer may not treat a transaction one way for purposes of federal tax and another way for purposes of state gross receipts tax. *Stohr v. New Mexico Bureau of Revenue*, 90 N.M. 43, 46, 559 P.2d 420, 423 (Ct. App. 1976), *cert. denied*, 90 N.M. 254, 561 P.2d 1347 (1977); *Co-Con, Inc. v. Bureau of Revenue*, 87 N.M. 118, 121-122, 529 P.2d 1239, 1241-1242 (Ct. App.), *cert. denied*, 87 N.M. 111, 529 P.2d 1232 (1974).

Considering the totality of the circumstances surrounding Mr. Jones' sales activities, it is clear that Encyclopaedia Britannica did not exercise control over his time and physical activities, nor did it control his means of accomplishing sales of encyclopedias. Rather, Mr. Jones was engaged to obtain a particular result--a legal and binding contract for the sale of Britannica products. Mr. Jones engaged in his sales activities as an independent contractor.

CONCLUSIONS OF LAW

1. Mr. Jones filed a timely, written protest to Assessment No. 2110387 pursuant to Section 7-1-24, NMSA 1978, and jurisdiction lies over the parties and the subject matter of this protest.
2. Mr. Jones was not an employee of Encyclopaedia Britannica and is not entitled to claim the exemption from gross receipts tax provided in Section 7-9-17, NMSA 1978.

For the foregoing reasons, the Taxpayers' protest IS HEREBY DENIED.

DONE, this 18th day of February 1998.