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

IN THE MATTER OF THE PROTEST OF
G. M. & BERNICE THOMPSON 98-19
ID. NO. 01-187010-00 9
ASSESSMENT NO. 2093538

DECISION AND ORDER

This matter came on for formal hearing on April 3, 1998 before Margaret B. Alcock, Hearing Officer. G. M. and Bernice Thompson were represented by Dennis R. Francish, their attorney. The Taxation and Revenue Department ("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. During the assessment period January-December 1993, G. M. Thompson performed services for three different construction businesses located in Albuquerque, New Mexico: Component Building Corporation, Superior Exteriors & Supplies, Inc. and Humberto Hernandez Construction.

2. When one of the three businesses received an inquiry concerning a construction job, Mr. Thompson would meet with the potential customer at the site and then give the customer a contract proposal setting out the specific work to be done and an estimate of the cost of the job. Work on the project would commence after the customer agreed to and signed the proposal.

3. Mr. Thompson was not the only person performing these services for Component Building Corporation, Superior Exteriors & Supplies, Inc. and Humberto Hernandez Construction.

4. Mr. Thompson received a straight commission of 10 to 15 percent of the total cost of jobs for which he negotiated contracts for Humberto Hernandez Construction.

5. Mr. Thompson received 55 percent of the net profit of Component Building Corporation and Superior Exteriors & Supplies, Inc. on each job for which Mr. Thompson negotiated the contract.

6. For purposes of Mr. Thompson's commission, net profit was calculated by taking the total cost of the job and subtracting the cost of all materials, labor and overhead, including gross receipts tax.

7. Each contract negotiated by Mr. Thompson included gross receipts tax as part of the cost of the job.

8. Mr. Thompson assumes that the gross receipts tax was reported and paid to the state. Mr. Thompson did not have access to the books of Component Building Corporation, Superior Exteriors & Supplies, Inc. or Humberto Hernandez Construction and he cannot confirm that the tax was actually paid.

9. Mr. Thompson did not have a formal partnership agreement with any of the businesses for which he performed services.

10. Mr. Thompson never discussed a partnership with any of the businesses for which he performed services.

11 Mr. Thompson never filed a partnership return with any of the businesses for which he performed services.

12. None of the three businesses withheld income or social security taxes from the payments made to Mr. Thompson.

13. The Thompsons reported all income from services performed on Schedule C of their 1993 federal income tax return.

14. The Thompsons' accountant of twenty years prepared their 1993 income tax returns. The accountant did not tell Mr. Thompson he should be paying gross receipts tax on the business income reported on Schedule C of his federal income tax return.

15. At various times prior to 1993, Mr. Thompson owned three different businesses: Exterior Coatings of New Mexico, Universal Pools, and Jade Company. Mr. Thompson reported and paid gross receipts tax on his receipts from each of these businesses.

16. When Mr. Thompson owned Exterior Coatings of New Mexico, he obtained non-taxable transaction certificates from the Department to give to vendors from whom he purchased supplies and materials.

17. It did not occur to Mr. Thompson that he was engaging in business when he performed services for Component Building Corporation, Superior Exteriors & Supplies, Inc. and Humberto Hernandez Construction.

18. It did not occur to Mr. Thompson that he should be paying gross receipts tax on the payments he received for his services or that he should obtain nontaxable transaction certificates from the businesses buying his services.

19. On December 18, 1996, as a result of information obtained from the Thompsons' Schedule C to their 1993 federal income tax return, the Department issued Assessment No. 2093538 for the period January-December 1993 in the amount of $2,344.44 gross receipts tax, $234.48 penalty and $1,186.88 interest for a total assessment of $3,765.80.

20. On January 13, 1997, Dennis R. Francish filed a letter protesting the assessment on the Thompsons' behalf.

DISCUSSION

The Thompsons raise the following arguments in support of their protest to the Department's assessment: (1) Mr. Thompson was in partnership with Component Building Corporation and Superior Exteriors & Supplies, Inc., and the payments he received from these two companies represented distributions of partnership profits rather than compensation for services; (2) Mr. Thompson was performing construction services for Component Building Corporation, Superior Exteriors & Supplies, Inc. and Humberto Hernandez Construction and was therefore entitled to the deduction provided in Section 7-9-52 NMSA 1978; and (3) denying Mr. Thompson a deduction from gross receipts results in unconstitutional double taxation. Mr. Thompson's testimony concerning his reliance on the advice of his accountant raises the additional issue of whether the negligence penalty was properly assessed under Section 7-1-69 NMSA 1978.

I. EXISTENCE OF PARTNERSHIP.

The Uniform Partnership Act, Sections 54-1-1 to 43 NMSA 1978, applies to partnership relationships during the period at issue.[1] A partnership is defined as "an association of two or more persons to carry on as co-owners a business for profit." Section 54-1-6. The Act also provides rules for determining the existence of a partnership, Section 54-1-7, denotes the nature of a partner's liability, Section 54-1-15, and sets forth rules determining rights and duties of partners, Section 54-1-18. In *Armstrong v. Reynolds*, 102 N.M. 261, 262, 694 P.2d 517, 518 (1985), the New Mexico Supreme Court stated that in the absence of a written partnership agreement, "a *pattern of conduct*, such as the sharing of profits and expenses of the business, filing of partnership tax forms, previous execution of contracts on behalf of the partnership, and control of a partnership bank account will

[1] An amended version of the Uniform Partnership Act became effective on July 1, 1997, replacing the previous act in its entirety. Sections 54-1A-101 to -1005 NMSA 1978 (1997 Supp.).

suffice to show the creation of a partnership relationship." citing *Dotson v. Grice*, 98 N.M. 207, 209, 647 P.2d 409, 411 (1982) (emphasis in the original).

The Thompsons argue that Mr. Thompson's commission was based on a sharing of profits, which is prima facie evidence of a partnership under Section 54-1-7(D), which states:

> D. the receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:
>
> (1) as a debt by installments or otherwise;
>
> (2) as wages of an employee or rent to a landlord;
>
> (3) as an annuity to a widow or representative of a deceased partner;
>
> (4) as interest on a loan, though the amount of payment vary with the profits of the business;
>
> (5) as the consideration for the sale of a good will of a business or other property by installments or otherwise.

The presumption of partnership can be overcome by contrary evidence. Even circumstantial evidence consisting of improbabilities and suspicious circumstances may be sufficient to overcome direct evidence of the existence of a partnership. *See*, *Vaughan v. Wolfe*, 80 N.M. 141, 144, 452 P.2d 475, 478 (1969). In this case, the overall pattern of conduct indicates that a partnership relationship never existed between Mr. Thompson and Component Building Corporation or between Mr. Thompson and Superior Exteriors & Supplies, Inc. The facts against finding the existence of a partnership include the following:

> Mr. Thompson did not have a formal partnership agreement with Component Building Corporation or Superior Exteriors & Supplies, Inc., nor did he ever discuss a partnership with either of them.
>
> Mr. Thompson never filed a partnership return with Component Building Corporation or Superior Exteriors & Supplies, Inc. He treated the payments he received from these companies in the same way he treated the payments he received as commissions from Humberto Hernandez Construction, reporting them as business income on Schedule C of his federal income tax returns.
>
> Mr. Thompson was not the only person Component Building Corporation or Superior Exteriors & Supplies, Inc. used to perform estimating services and negotiate contracts. Mr. Thompson's right to a share of profits was limited to the jobs on which he worked.

Mr. Thompson testified that he would not have received payment for his work if a job which he negotiated did not make a profit; there is no indication that Mr. Thompson would have been required to share in any losses suffered.

Mr. Thompson did not have access to the books of Component Building Corporation or Superior Exteriors & Supplies, Inc. and had no control over their payment of gross receipts taxes.

The evidence supports the finding that Mr. Thompson received a commission from net profits for services rendered as an independent contractor. The evidence does not support a finding of partnership.

II DEDUCTION FOR SALE OF CONSTRUCTION SERVICES PROVIDED IN SECTION 7-9-52 NMSA 1978.

The Thompsons maintain that Mr. Thompson was performing construction services. At the hearing, Mr. Thompson took issue with statements made in a February 3, 1997 letter written by Nancy Pagel, a tax auditor in the Department's Protest Office. Ms. Pagel stated that Mr. Thompson was not engaged in performing construction services but was engaged in promoting the sale of those services.[2] Mr. Thompson testified that he did not solicit customers for any of the businesses for which he worked but simply provided cost estimates and negotiated contract proposals at their request. The Thompsons argue that Mr. Thompson's services qualified as construction services under the New Mexico Court of Appeals' decision in *Miller v. Bureau of Revenue*, 93 N.M. 252, 599 P.2d 1049 (Ct. App. 1979). The Thompsons further argue that to the extent Department Regulations GR 3(C):1 (now 3 NMAC 2.1.11.1) and GR 52:1 (now 3 NMAC 2.52.8) would prevent Mr. Thompson's services from being characterized as construction services, the regulations are inconsistent with the statutes and unconstitutionally vague.

[2] Ms. Pagel's conclusion was based on three affidavits from the owners or corporate officers of Component Building Corporation, Superior Exteriors & Supplies, Inc. and Humberto Hernandez Construction which were attached to the Thompsons' protest. Each affidavit states that Mr. Thompson performed "sales" or "selling" services for which he was paid a commission.

There is no need to reach the constitutional issue raised by the Thompsons' challenge to Regulations GR 3(C):1 and GR 52:1. Characterizing the services rendered by Mr. Thompson as construction services, rather than as sales services, would not change the outcome of this protest. Under either scenario, Mr. Thompson is liable for gross receipts tax on his receipts from negotiating contract proposals.

Section 7-9-4 NMSA 1978 imposes an excise tax on the gross receipts of any person engaging in business in New Mexico. The definition of "engaging in business" includes "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." Section 7-9-3(E) NMSA 1978. The statute makes no distinction between activities engaged in by large corporations and activities engaged in by small "mom and pop" operations or by individuals acting as independent contractors. The term "gross receipts" is defined in Subsection F of Section 7-9-3 NMSA 1978 to include the total amount of money or the value of other consideration received from performing services in New Mexico. Unless a specific statutory exemption or deduction applies, Mr. Thompson is liable for gross receipts tax on his 1993 business income.

Mr. Thompson maintains that he is entitled to the deduction provided in Section 7-9-52 NMSA 1978. Subsection A states:

> A. Receipts from selling a construction service may be deducted from gross receipts if the sale is made to a person engaged in the construction business *who delivers a nontaxable transaction certificate to the person performing the construction service*. (Emphasis added).

Even assuming that Mr. Thompson was engaged in selling a construction service, he could not claim the deduction provided in Section 7-9-52 because he did not receive a nontaxable transaction certificate ("NTTC") from any of the businesses for which he performed those services. Mr. Thompson testified that although he had owned three businesses at various times in the past, it never occurred to him that

he was engaging in business when he performed services for the three construction companies. Nor did it occur to him to obtain NTTCs in order to deduct his receipts for purposes of the gross receipts tax.

Mr. Thompson's oversight does not excuse him from payment of gross receipts tax. Nor does it allow him to claim a deduction for which he does not qualify. There is a statutory presumption that the Department's assessment of gross receipts taxes 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). Where a party claiming a right to a tax exemption or deduction fails to follow the method prescribed by statute or regulation, he waives his right thereto. *Proficient Food v. New Mexico Taxation & Revenue Department*, 107 N.M. 392, 397, 758 P.2d 806, 811 (Ct. App. 1988).

In this case, Mr. Thompson would not be entitled to claim a deduction under Section 7-9-52 in the absence of properly executed NTTCs. Accordingly, he is liable for gross receipts tax on his 1993 income from services regardless of whether he was performing a sales service or a construction service.

III. DOUBLE TAXATION.

The Thompsons argue that denying Mr. Thompson a deduction in this case results in double taxation. It is a popular misconception that there is something inherently illegal or unconstitutional with double taxation. Almost 80 years ago, in *Ft. Smith Lumber Co. v. Arkansas*, 251 U.S. 532 (1920), the United States Supreme Court summarily disposed of the plaintiff's argument that Arkansas had imposed a double tax on corporate stock in violation of the federal constitution. As stated by Justice Oliver Wendell Holmes, writing for the majority:

> The objection to the taxation as double may be laid on one side. That is a matter of State law alone. The Fourteenth Amendment no more forbids double taxation than it does doubling the amount of a tax..."

251 U.S. at 533. New Mexico courts have also 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).

It should also be noted that in construing the New Mexico Gross Receipts and Compensating Tax Act, the New Mexico courts have 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.

To illustrate, Taxpayer Exhibit No. 5 evidences a contract between Component Building Corporation and Bruce G. to reroof Mr. G's home. Under the contract, Component Building Corporation received $8,326.00 for this work, plus an additional $483.95 representing the passed-on gross receipts tax. The legal incidence of the gross receipts tax was on Component Building Corporation. Mr. Thompson had no liability for reporting or paying gross receipts tax on Component Building Corporation's receipts from selling reroofing services to Mr. G.

The second page of Exhibit 5 is a set of figures showing how Component Building Corporation calculated the fee it paid to Mr. Thompson for his services in drawing up the contract proposal. The figures indicate that Mr. Thompson was paid $1,440.75. The legal incidence of the gross receipts tax on this transaction was on Mr. Thompson. Component Building Corporation had no liability for reporting or paying gross receipts tax on Mr. Thompson's receipts from negotiating the contract

between Component Building Corporation and Mr. G. Under the facts presented, there is no "double taxation."

IV PENALTY.

The Thompsons' 1993 federal income tax return was prepared by the same accountant who had prepared their taxes for twenty years. Mr. Thompson testified that given the long-standing nature of the relationship, he expected his accountant to advise him if additional taxes were due. This testimony raises a question as to whether Mr. Thompson should be held liable for the 10 percent negligence penalty imposed by under Section 7-1-69 NMSA 1978.

Section 7-1-69 NMSA 1978 (1993 Repl.Pamp.) governs the imposition of penalty during the period at issue in this protest. Subsection A imposes a penalty of two percent per month, up to a maximum of 10 percent:

> [i]n 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...

Taxpayer "negligence" for purposes of assessing penalty is defined in Regulation GR 69:3 (now 3 NMAC 1.11.10) as:

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

Regulation GR 69:4 (now 3 NMAC 1.11.11) sets out several situations that may indicate a taxpayer has not been negligent, including "reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts...."

The Thompsons' failure to report and pay gross receipts tax was not based on advice received from their accountant, but on Mr. Thompson's inattention to the requirements of New Mexico law. Mr. Thompson was well aware of New Mexico's gross receipts tax, having reported and paid the tax on receipts from his previous businesses. Mr. Thompson was also aware of the use of NTTCs to support deductions from gross receipts. He testified that he had obtained NTTCs to use in purchasing materials and supplies for his stucco business. Although Mr. Thompson reported his receipts from services performed during 1993 as business income on his federal tax returns and also paid self-employment taxes to the government, he testified that it never occurred to him that his income was subject to New Mexico gross receipts tax. This inattention to his state tax obligations meets the definition of negligence.

Mr. Thompson believes his accountant should have advised him of his liability for gross receipts tax on his 1993 income. Mr. Thompson acknowledges, however, that he never asked the accountant whether there might be other taxes due in connection with the business income reported on his 1993 federal income tax return. Nor did Mr. Thompson discuss the applicability of the gross receipts tax or the use of NTTCs with his accountant at the time Mr. Thompson began performing services for Component Building Corporation, Superior Exteriors & Supplies, Inc. and Humberto Hernandez Construction. Although reliance on the advice of a competent tax advisor may be a defense to the imposition of penalty under Regulation GR 69:4, there is no evidence that Mr. Thompson either sought or received advice concerning his gross receipts tax liability on income earned during 1993.

The application of Regulation GR 69:4 has been addressed in at least two decisions of the New Mexico Court of Appeals. In *Vivigen, Inc. v. Minzner*, 117 N.M. 224, 231-232, 870 P.2d 1382, 1389-1390 (Ct. App. 1994), the court of appeals rejected Vivigen's argument that it reasonably relied on the

accountants auditing its annual financial statements to alert Vivigen of its liability for payment of compensating tax:

> This response is not persuasive.... Vivigen offered no evidence that the outside auditors reviewed Vivigen's monthly state tax returns and does not explain why the audit for the annual reports should have uncovered failure to pay compensating tax, nor does it explain why the failure of the auditors to discover the error would excuse Vivigen's failure to comply with clear state law.

Similarly, in *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 797, 779 P.2d 982, 984 (Ct. App. 1989) , the court found that the taxpayer could not have reasonably relied on the erroneous gross receipts tax reports prepared by its accountant:

> According to the accountant's testimony, taxpayer reviewed the monthly reports and failed to inquire about the reporting of the payments as cost reimbursements. Taxpayer should have known that it had received large payments, especially in November 1984, no different in character than the Medicaid income received monthly throughout the year and reported monthly as gross receipts,.... Given taxpayer's knowledge of the character and size of the income payments in question, taxpayer cannot be said to have reasonably relied on the incorrect reports as advice of its accountant.

In this case, Mr. Thompson should have realized that the income he earned from performing services as an independent contractor was subject to gross receipts tax, just as the income he earned in his previous businesses had been subject to tax. Under the circumstances, Mr. Thompson cannot argue that he reasonably relied on his accountant, whose advice on gross receipts tax was never specifically solicited, in failing to report and pay this tax. The negligence penalty was properly imposed.

CONCLUSIONS OF LAW

1. The Thompsons filed a timely written protest to Assessment No 2093538 pursuant to Section 7-1-24 NMSA 1978, and jurisdiction lies over the parties and the subject matter of this protest.

2. Mr. Thompson did not have a partnership relationship with either Component Building Corporation or Superior Exteriors & Supplies, Inc.

3. During 1993, Mr. Thompson was engaging in business as defined in Section 7-9-3(E) NMSA 1978 and is liable for gross receipts tax on his receipts from performing services in New Mexico.

4. Mr. Thompson is not entitled to claim the deduction from gross receipts provided in Section 7-9-52 NMSA 1978.

5. Mr. Thompson was negligent in failing to report gross receipts tax on business income earned during 1993 and is liable for the negligence penalty imposed pursuant to Section 7-1-69 NMSA 1978.

For the foregoing reasons, the Thompsons' protest IS DENIED.

DONE, this 14th day of April 1998.