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

IN THE MATTER OF THE PROTEST OF **No. 05-10**
DePUY, INC. & SUBSIDIARIES; ID NO. 02-182224-00 7
TO 5/24/02 DENIAL OF CLAIM FOR REFUND
OF 1999 CORPORATE INCOME TAX

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on May 4, 2005, before Margaret B. Alcock, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Bruce J. Fort, Special Assistant Attorney General. DePuy, Inc. & Subsidiaries ("DePuy") was represented by Lois Hoelle, Senior Tax Accountant, and Monte Moore, Tax Director. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. For tax years up through 1998, DePuy filed corporate income tax returns with New Mexico on a unitary domestic combined basis.

2. On November 4, 1998, DePuy was acquired by Johnson & Johnson.

3. Johnson & Johnson and its subsidiaries filed their New Mexico corporate income tax returns on a separate entity basis.

4. DePuy did not check with Johnson & Johnson to determine how it reported its New Mexico income, nor did DePuy request a change in its reporting method before filing its 1999 New Mexico corporate income tax return.

5. On September 13, 2000, DePuy filed an original 1999 corporate income tax return on a unitary domestic combined basis, requesting a refund of approximately $80,000.

6. In October 2000, the Department asked DePuy to provide certain information from the company's consolidated federal return.

7. After receiving the Department's letter, DePuy contacted Johnson & Johnson and learned that Johnson & Johnson filed with New Mexico on a separate entity basis. Johnson & Johnson told DePuy that it should also be filing on a separate entity basis.

8. Following this conversation with Johnson & Johnson in October 2000, DePuy made some unsuccessful attempts to contact the Department by telephone, but did not submit a written request for a change in filing status.

9. As of January 11, 2001, which was the 120th day following the day that DePuy filed its original 1999 corporate income tax return, the Department had taken no action on the claim for refund shown on that return.

10. As of April 12, 2001, which was the 210th day following the day that DePuy filed its 1999 corporate income tax return, the Department still had not acted on DePuy's claim for refund, nor had DePuy filed a protest to the Department's inaction.

11. On September 6, 2001, DePuy filed amended returns for the 1999 tax year, reporting its income on a separate entity basis. The return filed for one of the separate entities showed a refund due of $79,241.

12. With its amended returns, DePuy included a letter explaining that it was changing its filing method because it had been acquired in late 1998 by Johnson and Johnson, Inc., and

asserting that its prior election to file using the combined reporting method had been terminated upon its acquisition by Johnson & Johnson.

13. In its September 6, 2001 cover letter, DePuy also requested that the estimated payments made for 1999 be reallocated to the separate entity returns.

14. Because the Department did not accept DePuy's amended 1999 returns, the estimated payments reported on DePuy's original return were not reallocated to the separate entities. As a result, assessments for additional tax were generated for later tax years.

15. On February 1, 2002, DePuy sent the Department a letter explaining that the assessments resulted from a problem with the allocation of estimated payments and stating: "We need New Mexico to recognize the filing change from combined to separate entity and reallocate the payments made by DePuy, Inc. to the separate entities."

16. DePuy's February 1, 2002 letter did not protest, or even mention, the Department's failure to act on the refund claimed on DePuy's 1999 amended returns.

17. On August 7, 2002, after several telephone conversations with Department employees, DePuy sent a letter formally requesting permission to change its filing status from unitary domestic combined to separate entity commencing with the 1999 tax year.

18. DePuy did not receive any response to its request for a change in filing status until March 2003, when Richard Anklam, the Department's Director of Tax Policy, told DePuy he would send out a letter granting its request for a change in filing status.

19. In October 2003, Mr. Anklam again told DePuy that he had approved their change in filing status and would send a confirming letter. DePuy never received the promised letter.

20. In December 2003, DePuy sent a letter directly to Secretary Jan Goodwin requesting formal approval of the change in DePuy's filing status.

21. On February 18, 2004, Lillian Trujillo, a supervisor in the Department's Corporate Income Tax Unit, sent DePuy a letter stating:

> Your request has been reviewed by Mr. Richard Anklam of the Secretary's office.
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> You have been granted permission to file as Separate Corporate Entity beginning with the 1999 tax year and forward.
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> We apologize for the delay in granting this permission Please re-submit the 2000 and 2001 corporate returns that are affected by this decision.

22. DePuy resubmitted its corporate income tax returns for 2000 and 2001 reporting its income on a separate entity basis, and these returns were accepted by the Department.

23. Ms. Trujillo's February 18, 2004 letter limited resubmission of DePuy's corporate income tax returns to the 2000 and 2001 tax years; in a telephone conversation of the same date, she informed DePuy that it would have to go through the protest process to refile its 1999 returns.

24. On March 8, 2004, DePuy resubmitted its amended 1999 corporate income tax returns showing a refund due in the amount of $79,241 and also submitted Form ACD-31094, *Formal Protest*, stating that it was protesting the delay in the Department's approval of DePuy's change in filing status because "[n]ow that we have permission to change our filing status, the 1999 tax year is outside the statute of limitations."

25. The Department subsequently notified DePuy that the Secretary's delay in approving a change in filing status was not a protestable action.

26. On May 24, 2004, the Department sent DePuy a letter stating that that its refund of 1999 corporate income tax was denied because the Taxpayer's amended returns were resubmitted after expiration of the three-year limitations period set out in NMSA 1978, § 7-1-26.

27. On June 22, 2004, the Taxpayer filed a written protest to the Department's May 24, 2004 denial of its claim for refund.

DISCUSSION

There are two issues to be decided in this protest: whether the Department is required to honor its retroactive permission for DePuy to file its 1999 corporate income tax returns on a separate entity basis, and whether the Department properly denied the $79,241 refund shown on those returns. DePuy argues that: (1) the Department is bound by the oral and written statements of its employees granting DePuy permission to change its filing status retroactive to the 1999 tax year; and (2) the Department should not be allowed to keep money to which it is not entitled. The Department responds that: (1) NMSA 1978, § 7-2A-8.3(B) and Regulation 3.4.10.8 prohibit retroactive approval of changes in filing status; and (2) the refund requested in the 1999 returns DePuy filed in March 2004 is barred by the limitations period set out in NMSA 1978, § 7-1-26.

Retroactive Permission for Change in Filing Status. Section 7-2A-8.3(B) of the Corporate Income and Franchise Act states as follows:

> B. Once corporations have reported net income through a combined return for any taxable year, they shall file combined returns for subsequent taxable years, so long as they remain unitary corporations, unless the corporations elect to file pursuant to Section 7-2A-8.4 NMSA 1978 [providing for filing on a consolidated basis] *or unless the secretary grants prior permission for one or more of the corporations to file individually.* (emphasis added).

The issue in dispute is the meaning of the words "prior permission." There are at least two ways in which these words can be interpreted. The first is set out in Subsection E of Regulation 3.4.10.8 NMAC, which states:

> No retroactive election of a different method for reporting New Mexico state income tax will be permitted. An election to report under a higher-ranked method or a request for permission to file under a lower-ranked method must be made no later than the last day on which the corporate income tax return may be timely filed for the taxpayer's taxable year to which the change in method applies.

In this case, DePuy's 1999 corporate income tax return was due on or before September 15, 2000 (pursuant to an extension of time to file). Based on the Department's regulation, DePuy was required to obtain permission to change to single entity filing prior to this date. Although DePuy maintained that its prior election to file on a combined basis terminated upon its acquisition by Johnson & Johnson, it did not cite any legal authority to support its position. In addition, it should be noted that DePuy filed its original 1999 corporate income tax return on September 13, 2000, almost two years *after* DePuy's acquisition by Johnson & Johnson. Therefore, even if DePuy's prior election to file on a combined basis terminated at the time of the acquisition, DePuy made a new election when it filed its 1999 post-acquisition corporate income tax return on the same basis.

The Department argues that these facts are dispositive, and that Lillian Trujillo's February 2004 letter granting DePuy's request for a filing change retroactive to the 1999 tax year was *ultra vires* and of no effect. The problem with this argument is that while Ms. Trujillo's letter may have been contrary to the Department's regulation, it was not necessarily contrary to the statutory requirements of NMSA 1978, § 7-2A-8.3(B). In actual practice, the Department interpreted Subsection B to mean that once permission to change a filing method was granted, the

taxpayer could amend a previously filed return using the new method, provided the statute of limitations for that year was still open. Although this interpretation is different than that set out in Regulation 3.4.10.8, it is not inherently unreasonable and would not qualify as *ultra vires*.

In February 2004, the Department gave DePuy written permission to file on a separate entity basis beginning with the 1999 tax year. The Department subsequently accepted DePuy's amended returns reporting its income for 2000 and 2001 on a separate entity basis. The Department's current assertion that the hearing officer must invalidate the Department's retroactive permission for a change in filing status for 1999, while the Department continues to honor the retroactive permission granted for the 2000 and 2001 tax years, is clearly untenable. It would be against both logic and fairness to allow the Department to adopt one construction of a statute by regulation, a different construction in practice, and then pick and choose which one to apply in a given situation. Assuming that each construction would qualify as a reasonable interpretation of the statute at issue, any conflict between the two must be resolved in favor of the taxpayer.

In its dealings with DePuy, the Department chose to ignore the interpretation of "prior permission" set out in Regulation 3.4.10.8 NMAC in favor of a more liberal construction allowing amended returns to be filed once permission for a change in filing status has been granted. Having accepted DePuy's amended returns for tax years 2000 and 2001, there is no basis for the Department to reject the amended return for tax year 1999 on the grounds that the Department's retroactive permission to change filing methods was invalid. The issue remaining to be determined is whether the refund requested in DePuy's amended 1999 return was properly denied because it was filed beyond the limitations period set out in NMSA 1978, § 7-1-26.

Statutory Limitation on Granting of Refunds. With some exceptions not applicable here, NMSA 1978, § 7-1-26(D) limits the time within which a claim for refund may be filed to three years from the end of the calendar year in which the payment of tax was originally due, stating:

> [N]o credit or refund of any amount may be allowed or made to any person unless as the result of a claim made by that person as provided in this section:
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> (1) within three years of the end of the calendar year in which:
>
> (a) the payment was originally due or the overpayment resulted from an assessment by the department pursuant to Section 7-1-17 NMSA 1978, whichever is later;

In this case, the original due date for payment of DePuy's 1999 corporate income taxes was March 15, 2000. The time within which DePuy could claim a refund of these taxes expired December 31, 2003. The amended 1999 corporate income tax return DePuy filed on March 8, 2004 showing a refund due of $79,241 was filed beyond the limitation period set out in § 7-1-26 and was not timely. For this reason, the refund was properly denied.

Although DePuy argues that it was entitled to rely on the representations of the Department's employees, there is no evidence that any representations were made concerning DePuy's right to refile its claim for refund of 1999 taxes. Lillian Trujillo's February 18, 2004 letter specifically limited resubmission of DePuy's corporate income tax returns to the 2000 and 2001 tax years. In a telephone conversation, Ms. Trujillo advised DePuy that the statute of limitations had run on the 1999 tax year and returns for that year could only be accepted through the protest process. In this case, however, the 18-month delay between DePuy's request for a change in filing status and the Department's letter granting the change does not provide a basis for waiving the statute of limitations. While NMSA 1978, § 7-2A-8.3 allows a taxpayer to seek

permission to change its filing status, the statute does not guarantee that permission will be granted, nor does it set a time limit within which the Department is required to act on such requests.

An additional consideration is the fact that DePuy bears as much responsibility for the delay as does the Department. At the time DePuy was acquired by Johnson & Johnson in November 1998, DePuy failed to inquire as to the filing method Johnson & Johnson used to report its New Mexico income. As a result, DePuy did not apply for a change in its reporting method, but elected to file its original 1999 returns on a unitary domestic combined basis. Even after discovering its error in October 2000, DePuy took no steps to obtain the Department's permission to change to separate entity filing. Although Lois Hoelle, DePuy's senior tax accountant, testified that she was not initially aware of this requirement, there was no explanation given for this lack of knowledge. In addition to being set out in New Mexico's tax statutes and regulations, the instructions to New Mexico's corporate income tax returns—including instructions for the 1999 tax year—clearly advise taxpayers that a corporation wishing to change to a lower-ranked reporting method "must obtain written permission PRIOR TO the start of the tax year…." (emphasis in the original).[1] By the time DePuy submitted its written request for a change in filing status in August 2002, more than three-and-a-half years had passed since DePuy's acquisition by Johnson & Johnson and almost two years had passed since the extended due date of DePuy's 1999 corporate income taxes. If DePuy had filed its request in a more timely manner, approval would have been received before the statute of limitations for the 1999 tax year had run.

At the administrative hearing, DePuy's tax director stated that his real concern was the Department's failure to grant the refund requested in DePuy's original 1999 corporate income tax return, which was filed in September 2000. This issue was not preserved for review, however, because DePuy failed to file a timely protest to the Department's inaction. The Department's authority to grant refund claims—and the remedies available to a taxpayer whose refund has not been granted—are set out in NMSA 1978, § 7-1-26. Subsection B(2) states as follows:

> (2) If the department has neither granted nor denied any portion of a claim for refund within one hundred twenty days of the date the claim was mailed or delivered to the department, the person may refile it within the time limits set forth in Subsection C of this section or may within ninety days elect to pursue one, but only one, of the remedies in Subsection C of this section [filing a protest or filing suit in district court]. *After the expiration of the two hundred and ten days from the date the claim was mailed or delivered to the department, the department may not approve or disapprove the claim unless the person has pursued one of the remedies under Subsection C of this section*. (Emphasis added).

In *Kilmer v Goodwin, Secretary, New Mexico Taxation and Revenue Department*, 2004 NMCA 122, ¶ 16, 99 P.3d 690, the court found that the purpose of the time deadline in § 7-1-26 is to avoid stale claims, and that "[t]he time deadline places the burden of maintaining an active claim on the taxpayer and makes it the taxpayer's responsibility to confront the Department inaction."

In this case, DePuy filed its original 1999 corporate income tax return on September 13, 2000, showing a refund due. The Department did not take action to either grant or deny the refund. Beginning on January 11, 2001, which was the 120th day from the date of filing, DePuy had 90 days to either file a protest or file a suit in district court to protect its claim. It failed to do

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[1] The instructions to New Mexico's corporate income tax returns are public records of the Department that are available in paper form or through the Department's web site.

so, and as of April 12, 2001, which was the 210th day from the date of filing, the Department (and the Department's hearing officer) lost jurisdiction to consider the taxpayer's claim.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely, written protest to the Department's denial of its claim for refund of 1999 corporate income taxes, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Department's February 18, 2004 letter giving DePuy retroactive permission to change to separate entity filing was effective for all years still within the statutory limitations period set out in NMSA 1978, § 7-1-26.

C. The amended 1999 corporate income tax returns DePuy filed on March 8, 2004 were beyond the statutory limitations period, and the refund requested in those returns was properly denied.

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

DATED May 12, 2005.