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

IN THE MATTER OF THE PROTEST OF
CRYSTAL GONZALES **No. 11-13**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0878435392

DECISION AND ORDER

A hearing was held on the above captioned matter on May 17, 2011 before Brian VanDenzen Esq., Hearing Officer, in Santa Fe. Ms. Crystal Gonzales ("Taxpayer") appeared *pro se*. The Taxation and Revenue Department of the State of New Mexico ("Department") was represented by Special Attorney General and Chief Legal Counsel, Nelson Goodin. Protest Auditor Sonya Varela appeared as a witness for the Department. In addition to the documents contained in the Administrative File articulated in the beginning of the hearing, Department Exhibit #1 (2005 Spreadsheet calculating interest and penalty) and Department Exhibit #2 (2006 Spreadsheet calculating interest and penalty) are admitted into the record. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. During Tax Year 2005 ("TY05") and Tax Year 2006 ("TY06"), Taxpayer was a self-employed model.

2. In order to prepare her taxes in TY05 and TY06, Taxpayer consulted with H&R Block.

3. H&R Block prepared TY05 and TY06 federal income tax returns, including Schedule C forms showing self-employment income for both years, for the Taxpayer.

4. Taxpayer did not report or file gross receipts returns for any income reported on the Schedule C forms.

5. Taxpayer did not consult with a certified public accountant or an attorney to determine her potential gross receipts tax liabilities as a self-employed model.

6. Taxpayer did not consult the Department's website for potential gross receipts tax liabilities.

7. Taxpayer consulted only with H&R Block about her tax obligations in preparation of her income taxes.

8. Taxpayer first became aware of her gross receipts tax obligations for TY05 and TY06 upon receipt of notice of audit from the Department, which occurred sometime around October 2008 (neither party could specify the precise date of the commencement of the audit).

9. Taxpayer consulted with H&R Block about her tax obligations after receiving notice of audit. H&R Block could not assist Taxpayer in determining whether she owed gross receipts taxes.

10. Taxpayer called the Department and spoke with an individual named Marie in the office. Marie was unsure what Taxpayer should do about the audit and assessment.

11. Taxpayer also consulted with Power Audit services about her obligations.

12. Although neither party submitted any direct evidence of the date of assessment, it appears in reviewing Department #1 and Department #2 that the Department concluded its audit and assessed the Taxpayer for unpaid gross receipts principal tax, penalty, and interest for TY05 and TY06 on or about December 5, 2008.

13. Taxpayer paid the Department's assessments in this matter.

14. Taxpayer paid the assessment for her TY05 on or about June 15, 2009. The payment included $1,426.59 in interest and $707.96 in penalty.

15. Taxpayer paid the assessment for her TY06 on or about October 25, 2009. That payment included $1,107.32 in interest and $828.69 in penalty.

16. The penalty imposed for TY05 and TY06 was calculated at 2% per month to a maximum amount not to exceed 20% pursuant to NMSA 1978 Section 7-1-69 (2007) rather than NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007).

17. On June 25, 2010, Taxpayer applied for a refund of the TY05 and TY06 gross receipts taxes, penalty, and interest.

18. On July 21, 2010, the Department denied the Taxpayer's claim of refund for the TY05 and TY06 gross receipts taxes, penalty, and interest.

19. On September 23, 2010, Taxpayer protested the Department's denial of her claim for refund for penalty and interest.

20. On December 8, 2010, the Department acknowledged Taxpayer's protest.

21. On April 22, 2011, the Department requested a protest hearing.

22. On April 26, 2011, the Hearing Bureau of the Taxation and Revenue Department sent notice of hearing, setting this matter for hearing on May 17, 2011.

DISCUSSION

Taxpayer protests the denial of refund for interest and penalty she paid under an assessments issued for TY05 and TY06 gross receipts taxes. Taxpayer argues that she relied on H&R Block to prepare her taxes in both years, and assumed that they would know her State tax

obligations. Because H&R Block failed to properly advise her of her gross receipts tax obligations, Taxpayer argues that she should not be liable for penalty and interest.

Presumption of Correctness and Burden of Proof.

Under NMSA 1978, Section 7-1-17(C) (2007), the assessment issued in this case is presumed to be correct. Consequently, the Taxpayer has the burden to overcome the assessment and establish that he or she was not required to pay the assessment. *See Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (NM Ct. App. 1972). This presumption extends to cases involving the denial of a claim for refund. *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 133 N.M. 217, 219-220 (N.M. Ct. App. 2002).

Presumption that all receipts of person engaging in business are subject to gross receipts.

Under NMSA 1978, Section § 7-9-4 (2010), any person or entity "engaging in business in New Mexico" is subject to a gross receipts tax. The term "gross receipts" is broadly defined under NMSA 1978, Section 7-9-3.5(A)(1) to include instances of "performing services in New Mexico." Moreover, there is a statutory presumption that all receipts of a person engaging in business in New Mexico are subject to gross receipts tax. *See* NMSA 1978, Section 7-9-5 (2002).

The evidence clearly established that the Taxpayer was engaged in business performing a service as a model during TY05 and TY06, and thus her receipts as a model were subject to gross receipts tax. Taxpayer did not overcome her burden to show that her receipts were not subject to gross receipts. Nor did Taxpayer argue that her receipts were subject to an exemption or a deduction of tax. Consequently, the Department properly denied the Taxpayer's claim for refund for the principal gross tax imposed for TY05 and TY06 under the assessment.

Assessment of Interest

When a taxpayer fails to make timely payment of taxes due to the state, "interest shall be paid to the state on that amount from the first day following the day on which the tax becomes due...until it is paid." NMSA 1978, Section 7-1-67 (2008). Under the statute, the Department has no discretion in the imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory regardless of the explanation provided by a taxpayer. *See State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). The language of the statute also makes it clear that interest begins to run from the original due date of the tax and continues until the tax principal is paid in full. Unlike civil penalty, the assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues.

Here, the Taxpayer failed to pay gross receipts tax due the state for TY05 and TY06. In effect, the Taxpayer had a loan of state funds during the time taxes were owed but not paid. Therefore continuing interest was due from the time Taxpayer failed to timely pay her TY05 and TY06 gross receipts taxes until Taxpayer paid the assessment. Because the imposition of interest is statutorily mandated, the Department properly denied the Taxpayer's claim for refund for interest paid under both assessments.

Assessment of Penalty.

When a taxpayer fails to pay taxes due to the State as a result of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007) requires that

> there *shall* be added to the amount assessed a penalty in an amount equal to the greater of: (1) two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed ten percent of the tax due but not paid. (*italics* added for emphasis)

The statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's failure to act timely meets the legal definition of "negligence" even if a taxpayer's actions or inactions were unintentional.

Regulation §3.1.11.10 NMAC (1/15/01) defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention."

In this case, Taxpayer failed to timely file and pay her TY05 and TY06 gross receipts returns and taxes for services she performed as a model. Taxpayer argued that she was uncertain about her tax obligations in starting her new modeling business and that H&R Block never told her about her gross receipts tax liabilities. Taxpayer acknowledged that she did not consult with either a C.P.A. or an attorney about her possible State tax obligations. Taxpayer acknowledged that she did not consult with the Department's website about her potential gross receipts tax obligations. In order to prepare her federal income tax returns, Taxpayer used H&R Block. Taxpayer assumed that H&R Block would inform her of any potential State gross receipts tax liabilities.

In this case, the Taxpayer's lack of knowledge about her tax obligations constitutes "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention" under the regulation defining negligence. Under New Mexico's self-reporting tax system, every person is

charged with the reasonable duty to ascertain the possible tax consequences of his or her actions. *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). A taxpayer's failure to ascertain their own possible tax obligations amounts to civil negligence. *See id.* While the Taxpayer argues that she made a mistake of law in good faith and on reasonable grounds under NMSA 1978 Section 7-1-69 (B) (2003, prior to amendments through 2007), the only mistake in this instance was the Taxpayer's lack of knowledge of the law, not a good faith dispute as to the application of the law, which does not form a reasonable basis under the case law to excuse civil negligence penalty.

The question remaining is whether the Taxpayer's consulting with H&R Block constituted an instance of nonnegligence under Regulation §3.1.11.11 (D) NMAC (1/15/01) that merits a refund of paid penalty in this protest. Regulation §3.1.11.11 (D) NMAC (1/15/01) allows for abatement of penalty when:

> the taxpayer proves that the failure to pay tax or file a return was caused by reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts; failure to make a timely filing of a tax return, however, is not excused by the taxpayer's reliance on an agent.

The Taxpayer fails to overcome the burden of presumption to establish this indicator of nonnegligence under the Regulation for two reasons. First, as the Department persuasively points out, the Taxpayer only went to H&R Block after the end of the year to prepare her personal income taxes. There is no evidence that Taxpayer went to H&R Block for advice about potential gross receipts tax liabilities.

The second reason why Taxpayer fails to persuade is that Taxpayer did not present any evidence indicating that H&R Block advised Taxpayer that she owed no gross receipts tax. To

the contrary, H&R Block told the Taxpayer that they were "uncertain" of her State gross receipt tax liabilities. Without some evidence that H&R Block advised her she had no gross receipts tax obligations, there was no advice for Taxpayer to reasonably rely on in not reporting and paying her TY05 and TY06 gross receipts taxes. Consequently, since there Taxpayer failed to show nonnegligence under the pertinent regulation, Taxpayer was liable to pay civil penalty in this matter.

Computation of Penalty.

The Department imposed a civil penalty of up to 20% under NMSA 1978, § 7-1-69 (2008) rather than under NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007), in effect prior to January 1, 2008. Since the Taxpayer protested the imposition of any penalty, and because the Taxpayer's Bill of Rights requires that an assessment not be "incorrect, erroneous, or illegal," the accuracy of the computation of total penalty amount assessed is an issue for consideration in this protest. NMSA 1978, Section 7-1-4.2 (2003). Even when a Taxpayer is liable for civil negligence penalty, as in here, a Taxpayer is not required to pay a miscalculated or incorrect amount of penalty. *See id.*

The question about which of the civil negligence penalty provisions is applicable to penalty amounts resulting from unpaid tax liabilities predating the effective date of the amended penalty provision is currently subject to numerous appeals before the Court of Appeals. Eventually, this issue will become moot since either there will be no more of these cases because it has been three years since the effective date of the amended penalty statute or because the Court of Appeals will have had reached a decision on one of the appeals. But until such time as the Court of Appeals makes a decision, the issue must still be analyzed for the record.

The only modification in the statute from NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007), in effect prior to January 1, 2008, versus NMSA 1978, § 7-1-69 (2008), effective January 1, 2008, is an increase of maximum possible penalty not exceed amount of 20% from the previous 10% maximum limit. Under both the previous version and the amended version of the penalty provision, the Department was to apply two percent per month penalty from the time the tax was due and not paid until the penalty reached its statutorily prescribed "not to exceed" limit of either 10% under the previous version (which effectively means a five-month period of time from the time the tax was due but not paid) or 20% under the amended version (which effectively means a ten-month period of time from the time the tax was due but not paid). Under both the previous and amended versions of the penalty provision, although factually a tax principal may remain due and not paid, the legislature prohibits the Department from imposing any additional penalty beyond the "not to exceed" limit.

The question of dispute is whether the Department is impermissibly retroactively applying the amended penalty provision without clear legislative intent allowing it to do so. As the New Mexico Court of Appeals recently indicated, "a statute or regulation is considered **retroactive if it**…**affixes new disabilities to past transactions**." *Wood v. State Educ. Ret. Bd.*, 2010 N.M. App. LEXIS 134 (N.M. Ct. App. Nov. 10, 2010), citing *Coleman v. United Eng'rs & Constructors, Inc.*, 118 N.M. 47, 52, 878 P.2d 996, 1001 (1994), [bold for emphasis]. In this case, the past transaction at issue is the Taxpayer's failure to file and pay gross receipts taxes when due, beginning in TY05 and continuing through the final TY06 due date of January 25, 2007. *See* NMSA 1978, Section 7-9-11. Under the old penalty statute, the disability for this transaction terminated at a 10% penalty in June 2007, five months after the final TY06 monthly gross receipts tax was due but not paid. The amended penalty provision affixes a new disability (an additional

10% of penalty) against a transaction that both predates the effective date of the amended penalty provision and had already reached the former statutory limit for imposition of penalty. Consequently, since the amended penalty provision would affix a new disability against a past transaction, a transaction that had already reached its maximum disability under the previous penalty provision, to apply the amended penalty provision in this situation would be a retroactive application.

A statute may only be applied retroactively if there is a clear, unambiguous legislative intent to do so. *See Psomas v. Psomas*, 99 N.M. 606, 609, 661 P.2d 884, 887 (1982). Absent such clear intent for a retroactive application, a statute only applies prospectively. *See id.* The Department has never presented any evidence, nor does the plain language of the statute contain any evidence, that the legislature intended NMSA 1978 Section 7-1-69 (2007) to apply retroactively to obligations that originated before the January 1, 2008 effective date of that revision. Given the legislature's silence on the question of retroactivity of NMSA 1978 Section 7-1-69 (2007), case law suggests that the amended statute should only apply prospectively. *See Psomas*; *See also N.M. Elec. Serv. Co. v. Jones*, 80 N.M. 791, 793, 461 P.2d 924, 926 (Ct. Appl. 1969) ("where an ambiguity or doubt exists as to the meaning or applicability of a tax statute, it should be construed most strongly against the taxing authority and in favor of those taxed"). Moreover, the New Mexico Supreme Court has also found that the Department may not retroactively apply a modified penalty regulation against a taxpayer for an obligation that predates the effective date of the modified regulation. *See Kewanee Industries, Inc. v. Reese*, 114 N.M. 784, 845 P.2d 1238 (1993).

Mechanically in this case, the Taxpayer paid penalty for unpaid gross receipts taxes for TY05 and TY06. For the December reporting period in each respective year (which is the last required reporting period for each respective year), the gross receipts taxes were due but not paid on

January 25, 2006 for TY05 and January 25, 2007 for TY06. *See* NMSA 1978, Section 7-9-11. The penalty for failure to pay TY05 gross receipts tax reached its "not to exceed" maximum limit in June of 2006, well before the January 1, 2008 effective date of the amended penalty provision. After that June 2006 date, the Taxpayer's gross receipts tax principal still remained factually due but not paid; yet, the legislature had prohibited the Department from imposing any more penalty after that date because the penalty had reached its "not to exceed" limit of 10%. Likewise, the penalty for failure to pay TY06 gross receipts tax reached its "not to exceed" maximum limit in June of 2007, six-months before the January 1, 2008 effective date of the amended penalty provision. After that June 2007 date, the Taxpayer's gross receipts principal still remained factually due but not paid; yet, the legislature had prohibited the Department from imposing any more penalty after that date because the penalty had reached its "not to exceed" limit of 10%.

Respectfully, the fact that the Department points to in all these cases, including this one—that the tax remains due and not paid at the time of the effective date of the amended statute—*is of no consequence* because under either version of the statute at question, penalty is being applied month-to-month beginning from a very specific past moment in time: the moment the tax was due but not paid; once the penalty has reached the specified maximum cap, no more penalty may be added under the "not to exceed" language even though the following month the tax still may factually remain due and not paid. In other words, the significance of the due and not paid language of the penalty statute ends once the "not to exceed" condition has been met, because no matter how many more months the principal tax may be due and not paid, no additional penalty may be assessed against a taxpayer.

Nothing in the plain language of the amended penalty provision, NMSA 1978, Section 7-1-69 (2008) indicates that the Department may re-open an exhausted penalty calculation once that

penalty has met its "not to exceed" condition. As mentioned before, without clear evidence of legislative intent for retroactive application of NMSA 1978, Section 7-1-69 (2008), the outstanding tax due for TY05 and TY05 were subject to a penalty "not to exceed" 10% pursuant to NMSA 1978, Section 7-1-69 (2003) because that was the provision in effect at the time the tax was due and the "not to exceed" condition had been met before the effective date of the amended penalty provision. *See Kewanee Industries, Inc.*; *See also Psomas*; *See also N.M. Elec. Serv. Co.*

While the Department was right to deny the Taxpayer's claim of refund for civil negligence penalty because of the Taxpayer's negligence in this matter, the Taxpayer is entitled to a 10% refund on the amount of penalty she paid the Department for TY05 and TY06 for the reasons discussed above.

CONCLUSIONS OF LAW

1. Taxpayer filed a timely, written protest of the denial of a claim for refund of penalty and interest under Letter No. # L2050148480, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer is liable for gross receipts tax principal, interest, and penalty in TY05 and TY06, and thus the Department properly denied her claim for refund.

3. However, the amount of civil penalty added to the principal tax should not have exceed ten percent as provided in §7-1-69(A)(1)(2003, prior to amendments through 2007) and any amounts added or assessed in excess of the ten percent (10%) should be refunded to the Taxpayer .

For the foregoing reasons, the Taxpayer's protest **IS GRANTED IN PART AND DENIED IN PART:** the Department is ordered to refund ten percent of the penalty amount for tax year 2005 and tax year 2006 for a total refund of overpaid penalty of $768.33.

DATED: June 10, 2011.