

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

**IN THE MATTER OF THE PROTEST OF  
MARK & DEBRA STANGER  
TO ASSESSMENT ISSUED UNDER LETTER  
ID NOs. L1356897664, L0919297408, L1912100224**

**No. 11-22**

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held on February 18, 2010, before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Ida Lujan, attorney for the Department. Ms. Sylvia Sena appeared and testified as a witness for the Department. Mr. Mark Stanger appeared at the appointed time and was unrepresented by counsel. Mark and Debra Stanger are collectively known as “Taxpayers.” The Department presented no exhibits and Taxpayers presented Exhibits A, B and C which were admitted into the record. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

**FINDINGS OF FACT**

1. On July 23, 2009, the Department assessed Taxpayers in the principal amount of \$9,648.00 in personal income tax, \$1,929.60 in penalty and \$6,171.38 in interest for tax year 2003.
2. On July 23, 2009, the Department assessed Taxpayers in the principal amount of \$6,458.00, in personal income tax, \$1,291.60 in penalty and \$3,164.44 in interest for tax year 2004.
3. On July 23, 2009, the Department assessed Taxpayers in the principal amount of \$7,107.00, in personal income tax, \$1,421.40 in penalty and \$2,413.06 in interest for tax year 2005.
4. On August 4, 2009, Taxpayers filed a protest to the assessments.

5. On August 7, 2009, the Department acknowledged the protest.
6. The Department requested a hearing in this matter on September 15, 2009.
7. On October 1, 2009, the Hearings Bureau mailed a Notice of Administrative Hearing in this matter setting the hearing for February 18, 2010.
8. Biz MD, LLC is a company owned by Taxpayers that was incorporated on or about March 1, 2003.
9. On April 1, 2003, Biz MD, LLC established a defined benefit plan (“plan”) effective April 1, 2003 for the benefit of Taxpayers under I.R.C. Section 412 (2002). The plan was funded with the purchase of an insurance contract pursuant to I.R.C. Section 412(i) (2002). Exhibit C.
10. On February 24, 2005, Biz MD, LLC, received a favorable determination letter from the Internal Revenue Commissioner allowing Biz MD, LLC to deduct its contributions to the plan. Exhibit C.
11. In August 2005, the Internal Revenue Service conducted an audit of Biz MD, LLC for tax years 2003 through 2007. Exhibit C.
12. As part of the audit, the Internal Revenue Service reversed its determination letter as to the plan. Exhibit C.
13. In reversing the determination letter as to the plan, Biz MD, LLC was not allowed to take certain deductions for the contributions it made on behalf of Taxpayers to the plan for tax years 2004 and 2005. Exhibit C.
14. Taxpayers filed timely returns for tax years 2003, 2004 and 2005. By disallowing

certain deductions for tax years 2003, 2004 and 2005, the income tax liability for Taxpayers increased for tax years 2003, 2004 and 2005.

15. As to the 2003 tax year, Mr. Stanger testified that the Internal Revenue Service reversed its position as to the contributions not being deductible. He believed this was true because of an application of an earlier law to the 2003 contributions.

16. On or about September 7, 2006, Taxpayers received a Revenue Agent Report from the Internal Revenue Service that Taxpayers' income tax liability for tax years 2003, 2004 and 2005 was increased due to disallowed deductions. (The page from the Revenue Agent Report showing which specific deductions were disallowed was not tendered.) Exhibit A, page 2.

17. Taxpayers disputed or protested the federal assessment that was based on the Revenue Agent Report from the Internal Revenue Service.

18. Sometime in 2007, the Department received a Revenue Agent Report which set out the federal adjustments the Internal Revenue Service made to Taxpayers' income for tax years 2003, 2004 and 2005. Exhibit C. The Department's 2009 assessments are based on the disallowed deductions stated on the Revenue Agent Report.

19. Taxpayers did not amend their New Mexico returns upon being notified by the Internal Revenue Service through a Revenue Agent Report that their deductions had been disallowed.

20. On January 11, 2010, Taxpayers amended the plan to comply with the Internal Revenue's direction on the funding of the plan. Exhibit C.

21. On or about February 2, 2010, Taxpayers entered into a closing agreement with the

Internal Revenue Service setting out the amount of deductions Taxpayers were allowed to take on the 2004 and 2005 returns.

22. Taxpayers paid the income tax principal on all of the New Mexico assessments as soon as they received the assessments.

23. Taxpayers filed federal claims for refund for tax years 2004, 2005, 2006, 2007 and 2008.

24. Taxpayers' accountant, Rudy Martinez, told Taxpayers to wait until an assessment had been issued before paying the New Mexico liability.

25. At an informal conference, Mr. Stanger and Mr. Martinez met with Ms. Sena and Mr. Breen, attorney representing the Department. Mr. Martinez acknowledged to Ms. Sena and Mr. Breen that he had advised Taxpayers not to amend the return until an assessment had been issued.

## **DISCUSSION**

The issue to be determined is whether penalty and interest should be abated. Taxpayers are not protesting the imposition of principal income tax for tax years 2003, 2004 and 2005.

Taxpayers paid the income tax principal on all the New Mexico assessments.

### **Burden of Proof.**

Section 7-1-17(C) provides that any assessment of taxes made by the Department is presumed to be correct. NMSA 1978, Section 7-1-17(C)(2007). In addition regulation 3.1.11.8(D) provides that "(t)he effect of the presumption of correctness of assessment of civil penalty is that the taxpayer has the burden of coming forward with some evidence showing that

the assessment made by the department is not correct. When not correct, the assessment shall be abated by the secretary or secretary's delegate as provided in Section 7-1-28 NMSA 1978.”

3.1.11.8(D) NMAC (2001).

**Civil Penalty.**

Civil penalty is imposed when a taxpayer is negligent or disregards the department's rules and regulations. Section 7-1-69(A) states that:

(e)except as provided in Subsection C of this section, in the case of failure due to negligence or disregard of department rules and regulations, but without intent to evade or defeat a tax, to pay when due the amount of tax required to be paid, to pay in accordance with the provisions of Section 7-1-13.1 NMSA 1978 when required to do so or to file by the date required a return regardless of whether a tax is due, 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;

NMSA 1978, Section 7-1-69 (A) (2003). The Department took the position at the hearing that 20% penalty applied to the principal amount of tax owed because the assessment had been issued after the effective date of the changes to Section 7-1-69.

The Department's regulation provides that the following type of action is an indication of nonnegligence:

the taxpayer proves that the failure to pay tax or to 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;

3.1.11.11(D) NMAC (2001).

In determining whether Taxpayers were negligent in failing not to pay the entire tax due, the first issue examined is whether at the time the returns were originally due, did Taxpayers reasonably rely on an accountant in preparing their returns. The second issue is whether in September 2006, were Taxpayers negligent in not filing amended returns and not paying the additional income tax due when they received the Revenue Agent Report with the federal adjustments.

Taxpayers' history regarding the Internal Revenue Service's Revenue Agent Report is fairly lengthy and detailed. It all began when Taxpayers' company, Biz MD, LLC, established a defined benefit plan effective April 1, 2003 for the benefit of Taxpayers under I.R.C. Section 412 (2002). The plan was funded with the purchase of an insurance contract pursuant to IRC Section 412(i) (2002). Exhibit C. Taxpayers purchased the plan based on representations by their financial advisor and accountant, Rudy Martinez. In setting up the plan, Biz MD, LLC, requested and received on February 24, 2005, a favorable determination letter from the Internal Revenue Commissioner allowing Biz MD, LLC to deduct its contributions to the plan. Exhibit C. When Taxpayers filed their 2003, 2004 and 2005 New Mexico State returns, Mr. Martinez filed their returns based on amounts, including the itemized deductions, reported on their federal returns.

Payment of New Mexico personal income taxes is governed by the Income Tax Act, Sections 7-2-1, *et seq.*, NMSA 1978. New Mexico is among the majority of states that "piggy-back" or use the federal income tax system as the basis for calculating State income taxes. New Mexico taxable income is calculated by starting with the taxpayer's federal adjusted gross income, deducting the taxpayer's federal personal exemption and itemized deductions, and making certain adjustments

reflected on Schedule A. The amount of tax is taken from the tax rate table or tax schedule. If there is a federal adjustment made, the adjustment impacts the State income tax liability of a taxpayer.

Regulation 3.1.11.11(D) NMAC (2001) defines nonnegligence as when a taxpayer reasonably relies on the advice of an accountant as to his liability after full disclosure of all relevant facts. In this case, Mr. Stanger testified that he relied on Mr. Martinez, an accountant, who introduced Taxpayers to the concept of a defined benefit plan and who encouraged them to establish a defined benefit plan. Mr. Stanger testified that Mr. Martinez assisted Taxpayers in funding the plan.

At the time Taxpayers filed their returns for 2003, 2004 and 2005, Taxpayers believed that the amount of tax due was correctly stated on their returns. Taxpayers took a number of steps to determine whether the contributions and the plan met the requirement of I.R.C. 412(i) (2002). They requested and received a determination letter from the Internal Revenue Service allowing the plan and deductions for the contributions made to the plan. Mr. Martinez was their accountant at the time that they filed their 2003, 2004 and 2005 returns and the amount of itemized deductions, which would have included the contributions to the plan, were amounts calculated by Mr. Martinez. Therefore, when Taxpayers filed their New Mexico State returns for tax years 2003, 2004 and 2005, they relied on an accountant, Mr. Martinez, for the correct amounts of itemized deductions. Therefore, as to the original returns filed, Taxpayers were not negligent in filing those returns.

The Department argued that Taxpayers were negligent because they failed to file amended returns and pay the adjusted income tax after receiving the Revenue Agent Report in September

2006. The Department argued that regulation 3.1.11.11(D) NMAC (2001) provides that the indications of nonnegligence do not apply to taxpayers who fail to file a return or an amended return, even if the accountant told them not to file the return. The Hearing Officer agrees that regulation 3.1.11.11(D) does not apply to taxpayers who fail to file returns. The Hearing Officer also agrees that an amended return must be filed and additional taxes to the State of New Mexico must be paid, in almost all situations when a Revenue Agent Report is issued. (Taxpayers had the option of amending their returns, paying the additional tax and then filing a claim for refund under Section 7-1-26. In this case, Taxpayers paid the principal income taxes but did not file the returns.) However, if a taxpayer does not file an amended return and pay the additional tax based on a “good faith” belief and based on “reasonable grounds” that he correctly reported and deducted, then the Department shall not assess penalty.

Section 7-1-69(B) provides that:

(n)o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds.

NMSA 1978, Section 7-1-69(B) (2003). In Taxpayers’ case, they had a “good faith” belief based on “reasonable grounds” that they were complying with the federal law. They did not pay the additional taxes and file amended State returns because they were embroiled in litigation in which they were arguing with the Internal Revenue Service whether the contributions were deductible. The reasonable grounds relied on by Taxpayers were that they believed that the plan and the funding of the plan were in compliance with the requirements of the Internal Revenue Service since they had received a favorable letter of determination from the Internal Revenue Service.

They had consulted with a lawyer, Kathleen Barrow, from the Jackson Lewis law firm, to determine whether the plan was in compliance or not. Mr. Stanger testified, extensively, on the steps he took to make sure that he was following the federal law. In September 2006, Taxpayers made a mistake of law, but believed they had paid the correct amount of income tax to the State. Eventually, they paid the correct amount of income tax due to the State.

It wasn't until January and February 2010 that Taxpayers acknowledged that the plan was not in compliance with the federal law and that not all the contributions taken were deductible. Taxpayers have met their burden in proving that at the time they received the Revenue Agent Report in September 2006, that they failed to pay the adjusted income tax amounts for tax years 2003, 2004 and 2005 based on "reasonable grounds" and a "good faith" belief that the original returns were accurate and that they did not need to file amended returns. For this reason, penalty was not properly imposed.

While it was not argued that Taxpayers should have been on notice that they needed to pay the State income tax amounts, the Hearing Officer notes that the Revenue Agent Report states that "(t)he Internal Revenue Service has agreements with state tax agencies under which information about federal tax, including increases or decreases, is exchanged with states. If this change affects the amount of your state income tax, you should amend your state return by filing the necessary forms." Exhibit A, page 2.

**Interest.**

At the hearing, the Hearing Officer explained to Mr. Stanger that once a taxpayer agrees to the amount of principal tax due, then interest must be assessed. In this case, since Taxpayers paid

the principal tax due, interest must be assessed and is only accrued through the date of the final payment of the principal amount of tax due. Interest “shall be paid” on taxes that are not paid on or before the date on which the tax is due. NMSA 1978, § 7-1-67 (A). The word “shall” indicates that the assessment of interest is mandatory, not discretionary. *See State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). The assessment of interest is not designed to punish Taxpayers, but to compensate the State for the time value of unpaid revenues. Because the principal amount of tax was not paid when it was due, interest was properly assessed.

#### CONCLUSIONS OF LAW

A. Mark and Debra Stanger filed a timely written protest to the penalty and interest assessed under Letter ID Nos. L1356897664, L0919297408, and L1912100224 and jurisdiction lies over the party and the subject matter of this protest.

B. Mark and Debra Stanger reasonably relied on an accountant to prepare their returns for tax years 2003, 2004 and 2005. Mark and Debra Stanger were not negligent in claiming certain deductions for the funding of their defined benefit plan for tax years 2003, 2004 and 2005.

C. Mark and Debra Stanger had reasonable grounds and a good faith belief that at the time they received the Revenue Agent Report in September 2006 that they had filed their returns for 2003, 2004 and 2005 in accordance with the law. Penalty shall not be assessed on any of the tax years in protest.

D. Mark and Debra Stanger made a mistake of law in taking certain deductions on their personal income tax returns.

E. Mark and Debra Stanger owe the interest amount calculated by the Department

until the date that the final payments were made by Mark and Debra Stanger.

F. Interest should be applied to the principal amount of tax due in accordance with this Decision and as calculated by the Department.

For the foregoing reasons, Mark and Debra Stanger's protest is GRANTED IN PART AND DENIED IN PART.

DATED: September 20, 2011.