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

**IN THE MATTER OF THE PROTEST OF** **No. 09-05**
**MARIA AND ROBERT CLOUTIER**
**TO ASSESSMENT ISSUED UNDER LETTER**
**ID NOs. L1384953216 and L1162331520**

## DECISION AND ORDER

A formal hearing on the above-referenced protest was held on July 21, 2009, before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Peter Breen, Special Assistant Attorney General. Maria and Robert Cloutier represented themselves. Robert Cloutier was not present at the hearing. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

## FINDINGS OF FACT

1. Maria and Robert Cloutier ("Taxpayers") were residents of New Mexico during the 2005 and 2006 tax years.

2. Maria G. Cloutier ("Cloutier") has been a resident of New Mexico for 18 years.

3. The Department conducted a limited scope audit of Taxpayers' gross receipts taxes for tax years 2005 and 2006.

4. Taxpayers were assessed by the Department on November 3, 2008, in gross receipts tax in the amount of $2,801.42 in principal, $560.28 in penalty and $1,052.40 in interest for a total of $4,414.10 for tax year 2005.

5. Taxpayers were assessed by the Department on November 3, 2008 in gross receipts tax in the amount of $2,582.46 in principal, $516.50 in penalty and $970.15 in interest for a total of $4,069.11 for tax year 2006.

6. Taxpayers have made a number of payments towards their tax liability: November 2008 - $500.00; January 2009 - $800.00; March 2009 - $400.00; and June 2009 - $400.00. All these payments were applied to the principal tax owed.

7. On November 10, 2008, Cloutier protested the two assessments for tax years 2005 and 2006. The protest letter was addressed to the Department at P.O. Box 25128, Santa Fe, NM.

8. On January 21, 2009, Cloutier sent another protest letter to the Department at P.O. 8575, Santa Fe, NM.

9. In response to the January 21, 2009 protest letter, the Department granted Taxpayers a retroactive extension and acknowledged receipt of the January 21, 2009 protest.

10. When the Department investigated Taxpayers' returns, Taxpayers had not reported or paid gross receipts tax on most of the business income reported on their federal income tax returns, Schedules C.

11. Taxpayers reported $59,985.00 on their federal income tax return, Schedule C for tax year 2005. Department Exhibit A.

12. Taxpayers reported $2,640.00 in gross receipts tax and paid $178.00 in gross receipts taxes to the State of New Mexico for tax year 2005. Department Exhibit A.

13. Taxpayers reported $65,122.00 on their federal income tax return, Schedule C for tax year 2006. Department Exhibit A.

14. Taxpayers reported $11,631.00 in gross receipts tax and paid $791.00 in gross receipts taxes to the State of New Mexico for tax year 2006. Department Exhibit A.

15. For 26 years Cloutier has been a Shaklee representative or distributor. Cloutier bought Shaklee products from Shaklee U.S., Inc., and resold the products from her home.

16. Some of Cloutier's customers purchased Shaklee products on the internet and Cloutier received consideration or business income from Shaklee U.S., Inc. from the internet sales. Shaklee invoiced the sale, processed the sale and shipped the product to Cloutier's customers. Shaklee charged and collected gross receipts tax on the product it sold to the customers.

17. Cloutier received business income from the internet sales and, on the 1099s, this business income was called "member ordering price differential."

18. Cloutier testified that she believed the business income from the internet sales represented the difference between what the Shaklee products cost Shaklee U.S., Inc. and the price charged to the internet customer.

19. Cloutier earned commissions from the volume of Shaklee products she sold. The commissions were based on a point system based on the volume of sales during the month.

20. Some of Cloutier's customers were located in state and some of the customers were located out of state.

21. Based on the volume of sales, Shaklee U.S., Inc. paid Taxpayers different types of business income called "bonus," "fast start bonus" and "prizes and awards." These amounts were commissions paid to Taxpayers.

22. Cloutier testified that she was unsure why she received business income from the "cash allowance program."

23. In 2005, Shaklee U.S., Inc. provided Taxpayers with a 1099 which listed $28,444.80 as a bonus, $240.00 as a fast start bonus, $12,099.85 as a member ordering price differential, and $1,125.00 as a cash allowance program.

24. The total amount of nonemployee income to Taxpayers for 2005 from Shaklee U.S., Inc. was $41,909.65.

25. Cloutier received a 1099 from R. Norman Dominguez for tax year 2005 for performing networking services in New Mexico. The business income earned from performing these services was $5,288.28. Cloutier does not dispute that this amount is taxable as gross receipts.

26. In 2006, Shaklee U.S., Inc. provided Taxpayers with a 1099 which listed $33,550.36 as a bonus, $100.00 as a fast start bonus, $14,298.78 as a member ordering price differential, and $140.41 as a prizes and awards.

27. The total amount of nonemployee income to Taxpayers for 2006 from Shaklee U.S., Inc. was $48,089.55.

28. Taxpayers were not employees of Shaklee U.S., Inc.

29. For both 2005 and 2006 tax years, in determining the gross receipts tax due, the Department, through the Compliance Bureau credited or subtracted the out of state sales at a rate of 22.5%. Department Exhibit A.

30. Cloutier provided a Department employee with around 100 receipts of sales for one month for both 2005 and 2006. The Department employee determined that based on the receipts 22.5% of sales were out of state sales.

31. The Department credited or subtracted the out of state receipts based on the total receipts reported on the Schedule C, less the gross receipts reported and less the gross receipts tax paid. Department Exhibit A.

32. For tax year 2005, the difference in amount between what was reported on Schedule C and the amounts listed on the 1099s is $12,788.00. Department Exhibit A.

33. For tax year 2006, the difference in amount between what was reported on Schedule C and the amounts listed on the 1099 is $17,033.00. Department Exhibit A.

34. Taxpayers' federal income tax returns, Schedules C were not introduced into the record.

35. Taxpayers employed a certified public accountant, William Zeidenberg, from the ILZ Group, LLC to prepare and file their income tax returns.

36. Cloutier provided Mr. Zeidenberg with all of her sales information and she filled out the questionnaire he provided to her regarding all of her income from all sources. She also provided him with Taxpayers' 1099s.

37. Taxpayers prepared and filed their gross receipts tax returns.

38. Cloutier never researched whether her commissions were taxable either by reviewing the information on the Department's website or by attending any of the seminars offered by the Department.

39. Cloutier reported gross receipts on the sale of Shaklee products to her customers for tax years 2005 and 2006.

40. Taxpayers failed to report and pay gross receipts taxes on business income called "bonus," "fast start bonus," "member ordering price differential," "cash allowance program," and "prizes and awards" for tax years 2005 and 2006.

41. Taxpayers failed to report and pay gross receipts taxes on business income Cloutier received from R. Norman Dominguez for tax year 2005.

## DISCUSSION

The issues to be decided are (1) whether all of Taxpayers' business income is gross receipts and (2) whether Taxpayers are liable for penalty and interest.

**Burden of Proof**. There is a statutory presumption that any assessment of tax made by the Department is correct. NMSA 1978, §7-1-17(C) (2007); *MPC Ltd. v. New Mexico Taxation & Revenue Department*, 2003-NMCA-21, ¶ 13, 133 N.M. 217, 62 P.3d 308. There is also a presumption that all receipts of a person engaging in business in New Mexico are subject to gross receipts tax. NMSA 1978, §7-9-5 (2002); *Grogan v. New Mexico Taxation and Revenue Department*, 2003-NMCA-033, ¶ 11, 133 N.M. 354, 62 P.3d 1236, *cert. denied*, 133 N.M. 413, 63 P.3d 516 (2003). A statutory presumption exists that all of a person's receipts are subject to the gross receipts tax. Accordingly, it is the Taxpayers' burden to present evidence and legal arguments to show that the Department's assessment is incorrect.

*See*, *Proficient Food Co. v. New Mexico Taxation and Revenue Department*, 107 N.M. 308, 393, 758 P.2d 806, 807, *cert. denied*, 107 N.M. 308, 756 P.2d 1203 (1988).

**Taxpayers' Business Income.** NMSA 1978, Section 7-9-4 (1990) imposes an excise tax on the gross receipts of any person engaging in business in New Mexico. The definition of "engaging in business" is quite broad and includes "…carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit..." NMSA 1978, § 7-9-3.3 (2003). The term "gross receipts" encompasses receipts from performing services in New Mexico and is specifically defined to include:

> the total commissions or fees derived from the business of …selling or promoting the …sale ...of any property, service, stock, bond or security;

NMSA 1978, § 7-9-3.5(A)(2)(b). In addition, regulation 3.2.1.18(HH)(3) provides that:

> the commissions received by the independent contractors engaging in business in New Mexico with respect to merchandise sold in new Mexico are gross receipts subject the gross receipts tax.

Regulation 3.2.1.18(HH)(3) NMAC.

Cloutier does not dispute that the business income she identified as commissions were gross receipts. She said that until she received a letter from the Department indicating that it was conducting a limited scope audit, and she began investigating whether she owed any money, she was unaware that the commissions she received from Shaklee U.S., Inc were taxable. Audio Recorder 10:00-10:10; and protest letter. Cloutier acknowledged that the receipts for the bonuses, the fast start bonuses, cash allowance program, prizes and awards are commissions and therefore taxable as gross receipts. See Protest Letter. Cloutier does not remember why the cash allowance was given to her but she does not dispute that it is a

commission. Audio Recorder 15:20-15:41; Protest Letter. Cloutier also does not dispute that the business income she received from R. Norman Dominguez is taxable as gross receipts. Audio Recorder 16:15-17:32; protest letter.

Cloutier's main dispute with the Department is the characterization of the business income received for "member ordering price deferential" in the amounts of $12,099.85 for tax year 2005 and $14,298.78 for tax year 2006. Cloutier argues that these amounts are not gross receipts and should not be included in the calculation of the amount of gross receipts tax owed. Cloutier maintained that the business income was derived from internet sales which represented the difference between what the Shaklee products cost Shaklee U.S., Inc. and the price charged to the internet customer. Cloutier argued that Shaklee U.S., Inc. paid gross receipts tax on these amounts and therefore these amounts should be excluded from the calculation of how much she owes the Department. The Department took the position that all the business income reported on the 1099s were commissions from sales and that it excluded the out of state sales by applying a rate of 22.5% to all of the business income reported on the Schedules C, less the gross receipts reported and less the gross receipts tax.

Cloutier's argument fails because the transaction that is in dispute is the transaction between Shaklee U.S., Inc. and Taxpayers, and not the transaction between Shaklee U.S., Inc. and Cloutier's internet customers. In addressing a transaction where there is a product sold by an independent contractor and the independent contractor receives consideration or business income from the product being sold, there are two separate transactions. The first transaction is the sale of the product, for which Shaklee U.S., Inc. charged and collected gross receipts tax. The second transaction is the consideration or business income received by the sales

representative for providing the customer to Shaklee U.S., Inc. and assisting in the sale of the product. It is the second transaction for which Taxpayers received business income. The first transaction is the sale of the products to New Mexico customers. The second transaction is the commission received on the sale of the product to the customer.

Regulation 3.2.1.18(HH)(1) NMAC specifically addresses these types of transactions. It provides, in part, that:

> (c)omissions and other consideration received by an independent contractor from performing a sales service in New Mexico with respect to the tangible or intangible personal property of other persons are gross receipts whether or not the other person reports and pays gross receipts tax with respect to the receipts from the sale of the property. The receipts from the sale of the property are gross receipt of the person whose property was sold. Receipts, whether in the form of commissions or other remuneration, of the person performing a sales service in New Mexico are gross receipts of the person performing the sales service.

Regulation 3.2.1.18(HH)(1) NMAC.

The consideration or business income from Shaklee U.S., Inc. for the "member ordering price differential" are gross receipts. The business income from the internet sales cannot possibly be the difference between what the Shaklee products cost Shaklee U.S., Inc. and the price charged to the internet customer. If this characterization of the sale is correct, then there is no profit to Shaklee U.S., Inc. to cover its costs related to the making, processing or shipping of the product. While Cloutier testified that Shaklee U.S., Inc. processed these internet sales on her behalf, Shaklee U.S., Inc. is an independent company and there was no evidence presented that Shaklee U.S., Inc. was acting on her behalf or agreed to no profit to cover its costs in processing the sale of the product. In addition, there was no evidence

offered that Taxpayers purchased any of these products that were sold on the internet to Cloutier's customers.

There is a difference in the business income between the 1099s and the amount reported on Schedule C of Taxpayers' returns for tax years 2005 and 2006. For tax year 2005, the difference in amount between what was reported on Schedule C and the 1099s is $12,788.00. For tax year 2006, the difference in amount between what was reported on Schedule C and the 1099 is $17,033.00. Taxpayer offered no explanation as to what these amounts represented and therefore, the assessment is presumed to be correct as to these amounts.

**Method of Calculating Percentage of Taxable Receipts**

For both 2005 and 2006 tax years, in determining the gross receipts tax due, the Department, through the Compliance Bureau credited or subtracted the out of state sales at a rate of 22.5% from the total amount of business income reported on Schedule C of Taxpayers' federal returns, less the gross receipts reported and the gross receipts taxes paid. The Department arrived at this rate by analyzing the information provided by Taxpayers. Cloutier provided a Department employee, Libby Martinez, with around 100 receipts of sales for 2005 and for 2006. The Department employee determined that based on the receipts, 22.5% of sales were out of state sales. It should be noted that this rate was applied to the receipts from R. Norman Dominguez and was applied to the total receipts on Schedule C (less the gross receipts reported and the gross receipts taxes paid). The rate was not just applied to the receipts from Shaklee U.S., Inc. Taxpayers provided no evidence that this rate is incorrect, and therefore have not rebutted the presumption. Section 7-1-17(C) states that any assessment

of tax by the Department is presumed to be correct, and it is the burden of the taxpayer protesting an assessment to overcome this presumption. *Tipperary Corp. v. New Mexico Bureau of Revenue*, 93 N.M. 22, 24, 595 P.2d 1212, 1214 (Ct. App. 1979); *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). As illustrated by the court's decision in *Torridge Corp. v. Commissioner of Revenue*, 84 N.M. 610, 613, 506 P.2d 354, 357 (Ct. App. 1972), *cert. denied*, 84 N.M. 592, 506 P.2d 336 (1973), the presumption of correctness encompasses the audit methods employed by the Department to determine the amount of tax assessed.

**Complexity of the Tax Laws**.

Cloutier contends that the penalty and interest should be waived because she took every precaution in filing her gross receipts tax returns and in addition, the tax laws are too complex to understand.

**Civil Penalty**. NMSA 1978, Section 7-1-69 (2003, prior to amendments through 2007), governs the imposition of penalty. Sub-sections A and A(1) of the statute imposes a civil penalty of two percent per month, up to a maximum of ten percent, if a taxpayer fails due to negligence or disregard of rules and regulations to pay taxes in a timely manner. The Department's regulation defining negligence for purposes of assessing penalty is Regulation 3.1.11.10 NMAC. It states as follows:

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

Regulation 3.1.11.10 NMAC.

Whether a taxpayer has acted negligently for purposes of the civil penalty imposed by §7-1-69 (2003, prior to amendments through 2007), is determined as of the date the taxes were due. At the time the gross receipts taxes were due, Taxpayers had an erroneous belief that gross receipts taxes were not due on commissions, only on the sale of Shaklee products sold from their house. This falls within the definition of negligence.

Cloutier maintained that the tax laws were too complex for her to understand. There was no evidence presented, however, to explain exactly what efforts Cloutier made in the 18 years she has resided in New Mexico to determine the extent of her tax obligations. She did not avail herself of the Department's website or avail herself of the Department's free seminars on gross receipts tax. There is no evidence the Taxpayers had any discussions with Department employees prior to the audit. Although Cloutier testified that her accountant, William Zeidenberg, from the ILZ Group, LLC, prepared her income tax returns, there is no evidence the Taxpayers had any specific discussions with their accountant concerning their gross receipts taxes. Mr. Zeidenberg only prepared and filed Taxpayers' income tax returns.

While the civil penalty was correctly imposed on Taxpayers' liability, the Department's calculation of the penalty is erroneous. The Department imposed a twenty percent (20%) civil penalty on the principal of the gross receipts tax. See Assessment dated November 3, 2008. The amount of negligence penalty added to the underlying principal tax liability by the Department is not in accordance with the meaning of §7-1-69 (2003, prior to amendments through 2007). §7-1-69(A)(1) provides that if the tax required to be paid when due is not paid, the Department may add civil penalty in an amount "…**not to exceed** ten percent of the tax due but not paid." (Emphasis added). While the Legislature in 2007 amended §7-1-69(A)(1) to allow an amount "…not to exceed

twenty percent of the tax due and not paid," this amendment was not effective until January 1, 2008, well after the due date of gross receipts tax being due. There was no retroactivity provision within this statute allowing for an additional civil penalty of ten percent (10%) to be applied to past due principal tax balances due as of January 1, 2008 that had already exceeded the maximum rate applied. In *Phelps Dodge Corp. v. Revenue Division of the Dept. of Taxation and Revenue State of New Mexico,* 103 N.M. 20, 24, 702 P.2d 10, 14 (Ct. App. 1985), which following *Worman v. Echo Ridge Homes Cooperative, Inc.* 98 N.M. 237, 647 P.2d 870 (1982) the court held that "new legislation must not alter the clear language of a prior statute if it is to be applied retroactively." Additionally, in *State v. Padilla,* 78 N.M. 702,703, 437 P.2d 163, 164 (Ct. App. 1968), affirmed in *Psomas v. Psomas,* 99 N.M. 606, 609, 661 P.2d 884, 887 (1982), the court stated, "it is presumed that statutes will operate prospectively only, unless an intention on the part of the legislature is clearly apparent to give them retroactive affect." See also *Karpa v. Commission of Internal Revenue,* 909 F.2d 784 (1990) and *Bradbury Stamm Construction v. Bureau of Revenue,* 70 N.M. 226, 373 P.2d (1962).

While Taxpayers owed principal tax on January 1, 2008, no additional civil penalty for failure to pay tax or file a return could be added to the principal amount since the maximum amount of the civil penalty had already been applied. Therefore the civil penalty added to Taxpayers' principal tax can be no more than ten percent (10%). (This issue has been briefed by the Department in prior tax cases before the Hearings Bureau.)

**Interest.** NMSA 1978, Section 7-1-67 (2007) governs the imposition of interest on late payments of tax and provides, in pertinent part:

> If any tax imposed is not paid on or before the day on which it becomes due, ***interest shall be paid*** to the state on such amount from the first day following the day on which the tax becomes due, without regard to any

> extension of time or installment agreement, until it is paid... (emphasis added).

The Legislature's use of the word shall indicates that the assessment of interest is mandatory rather than discretionary. *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. The Legislature has directed the Department to assess interest whenever taxes are not timely paid and has provided no exceptions to the mandate of the statute. The reason for a late payment of tax does not mitigate the imposition of interest.

In this case, the Taxpayer failed to pay gross receipts taxes due on the commissions and other sources of income reported on her Schedule C. Although it is clear that Cloutier did not intend to make a mistake in not reporting her gross receipts, it is apparent that the taxes were due and owing. Under the provisions of §7-1-67 (2007), imposition of interest is mandatory and cannot be waived or abated.

## CONCLUSIONS OF LAW

A. Maria and Robert Cloutier filed a timely protest to the assessments of gross receipts tax issued under Letter ID Nos. L1162331520 and L1384953216, and jurisdiction lies over the parties and the subject matter of this protest.

B. Maria and Robert Cloutier failed to meet their burden of proving that their income reported as business income on Schedules C of their 2005 and 2006 federal income tax returns is not subject to New Mexico gross receipts tax; accordingly, the amounts of $59,985.00 and $65,122.00, respectively, are subject to New Mexico gross receipts tax.

C. The amount of civil penalty added to the principal tax shall not exceed ten percent (10%) 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 abated.

D. Interest was correctly added and assessed to the principal amount of tax, and continues to be applied until the principal tax is paid in full.

For the foregoing reasons, the Taxpayers' protest IS GRANTED IN PART AND DENIED IN PART: the Department is ordered to abate ten percent (10%) of the penalty amount for tax years 2005 and 2006 unless it has already done so.

Dated October 28, 2009.