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

IN THE MATTER OF THE PROTEST OF
LYNETTE BALDWIN **No. 11-08**
TO ASSESSMENT ISSUED UNDER LETTER
ID NOs. L1690161216 and L0900147264

DECISION AND ORDER

A hearing was held on the above captioned matter on February 17, 2011. Ms. Lynette Baldwin ("Taxpayer") appeared *pro se*. The Taxation and Revenue Department of the State of New Mexico ("Department") was represented by Staff Attorney Ida M. Lujan. Protest Auditor Thomas Dillon appeared as a witness for the Department. In addition to the documents contained in the Administrative File articulated in the beginning of the hearing, Taxpayer #1 (Notice of Limited Scope Audit Resolution of May 11, 2010), and Department A-N are admitted into the record. Additionally, the arguments of the Department filed on February 24, 2011 and March 3, 2011 (and its attached exhibit) are also part of the administrative record in this matter. The Taxpayer submitted a letter on March 14, 2011, which is also part of the administrative record in this matter. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. In tax year 2005 ("TY05") and tax year 2006 ("TY06") Taxpayer was a state-licensed jockey agent. [Department E, Department G, and Taxpayer's admission]

2. As such, Taxpayer derived income from services performed in securing horses—referred to as obtaining a mount—for her jockeys to race in State-sanctioned horse races.

3. Taxpayer's income in TY05 and TY06 resulted solely from a percentage of money paid from her jockey-client's purse earnings.

4. Taxpayer in good-faith believed that she was a "horsemen" for purposes of NMSA 1978, Section 7-9-40 (1989), and consequently believed that her income earned as a percentage from her jockey client's horse-racing purses was exempt from gross receipts taxes in New Mexico.

5. Taxpayer consequently did not file any CRS Reports, and paid no gross receipts tax on income derived from performing services a jockey agent in TY05 and TY06 to the State of New Mexico.

6. Taxpayer did report her income derived from performing services as jockey agent in TY05 and TY06 to the Internal Revenue Service ("IRS") on a Schedule C. [Department L & Department M]

7. As part of the Department's Tape Match Program with the IRS, the Department detected a difference between the Taxpayer's Federal Schedule C reported income and her New Mexico CRS reported income for TY05 and TY06.

8. Because of this mismatch, the Department initiated an audit of Taxpayer to review her TY05 and TY06 tax obligations.

9. According to Protest Auditor Thomas Dillon, it is common in his experience in the ten-years he had worked for the Department for the Tape Match Program to take two-to-three years for the IRS to provide the requisite information and an additional year for the Department to process this information.

10. As a result of this tape-match audit, on December 15, 2009 the Department assessed the Taxpayer for $2,444.98 gross receipts tax, $489.00 penalty, and $1043.43 interest for TY05 under letter ID number L1690161216. [Department B]

11. As a result of this tape-match audit, on December 15, 2009 the Department further assessed the Taxpayer for $2,091.60 gross receipts tax, $418.32 penalty, and $579.61 interest for TY06 under letter ID number L1690161216. [Department A]

12. On January 7, 2010, the Taxpayer protested the imposition of gross receipts principal tax, penalty, and interest for TY05 and TY06, claiming that she qualified for an exemption under NMSA 1978, § 7-9-40 (1989) and therefore owed no tax, penalty, or interest.

13. Taxpayer's protest was assigned to the Department's protest auditor Thomas Dillon.

14. On January 26, 2010, Mr. Dillon consulted with the New Mexico Racing Commission via email to determine what a jockey agent does and whether a jockey agent is considered a jockey or has other duties associated with horse racing. [Department F]

15. The Deputy Director of the New Mexico Racing Commission informed Mr. Dillon via email on January 26, 2010 that a jockey agent is someone employed by a jockey to secure mounts, and that they are paid by negotiating a percentage of their jockey's purse earnings. [Department F]

16. On January 27, 2010, Mr. Dillon wrote the Taxpayer's representative and informed Taxpayer that the Department had concluded that a jockey agent was performing a service that did not qualify for an exemption under the language of NMSA 1978, § 7-9-40 (1989). Mr. Dillon informed the Taxpayer that she could either agree to the Department's

position and pay the assessments or pursue a formal hearing appealing the Department's position. [Department H]

17. On February 10, 2010, the Taxpayer renewed her protest to the two assessments and requested that the matter be set for a formal hearing.

18. On June 22, 2010, the Department filed a request for hearing with the Hearing Bureau of the Taxation and Revenue Department.

19. On June 29, 2010, the Hearing Bureau sent Notice of Administrative Hearing, setting a protest hearing on Tuesday, January 25, 2011.

20. On October 26, Taxpayer mailed a letter asking that the matter be set on a day other than a Tuesday. Without objection from the Department, on November 1, 2010 an Amended Notice of Administrative Hearing was sent to all parties changing the date of hearing to Thursday, February 17, 2011.

21. The protest hearing occurred on February 17, 2011.

22. At the Department's request, the record was left open for seven-days to allow the Department to respond to the Taxpayer's proposed Exhibit #1 and also submit any written argument related to the possible retroactive application of the amended penalty provision.

23. On February 24, 2011, the Department submitted a motion related to Taxpayer's Exhibit #1, continuing its objection to the admissibility of that exhibit and objecting to what it perceived to be an order to disclose confidential information about another unrelated taxpayer.

24. On February 25, 2011, the Hearing Bureau issued an order leaving the record open for an additional seven-days for the Department to submit any non-confidential documents or arguments it wished to related to Taxpayer's proposed Exhibit #1.

25. On March 3, 2011, the Department submitted additional written argument related to its objection to Taxpayer's proposed Exhibit #1. Included with that argument was an Affidavit of Thomas J. Dillon, stating that Mr. Dillon reviewed the circumstances surrounding Taxpayer's proposed Exhibit #1, and after the review of that information, was still of the opinion that Taxpayer, as well as any jockey agent, does not qualify for exemption under NMSA 1978, § 7-9-40 (1989).

26. Also included with the Department's March 3, 2011 submission was an argument supporting the Department's position that application of a 20% maximum penalty is permissible application of the amended penalty provision against a liability that predated the effective date of the amended penalty provision. While the Department only had seven-days to submit such an argument related to penalty, and the Hearing Bureau's February 25, 2011 Order Leaving the Record Open specifically extended only the time for submission of argument related to Taxpayer's proposed Exhibit #1, the Department's argument related to penalty is nevertheless accepted into the record as this is an administrative proceeding with relaxed procedural rules designed to give both parties an opportunity to argue the merits of their respective positions.

27. The Taxpayer was also given an opportunity until March 11, 2011 to respond to the Department's positions. The Taxpayer submitted a written letter on March 11, 2011, which was received by the Hearing Bureau the afternoon of March 14, 2011. This letter will also be admitted into the record.

DISCUSSION

The fundamental issue in this case is much more straightforward than the extensive record of filings made after the hearing in this protest suggests: whether the Taxpayer, as an

admitted "jockey agent" qualifies for exemption from payment of gross-receipts taxes under the plain language of NMSA 1978, § 7-9-40 (1989) when her earnings during Tax Year 2005 ("TY05") and Tax Year 2006 ("TY06") came from payment of a percentage of a jockey's purse at a New Mexico horse race track? A plain language reading of the exemption and its accompanying regulations, in conjunction with a reading of the New Mexico Horse Racing Act and its accompanying regulations, establishes that a jockey agent does not qualify for the relevant exemption at issue in this case. Since the Taxpayer was performing a service as a jockey agent, and the exemption does not apply to the facts of this protest, the Taxpayer is liable for gross receipts tax principal, appropriate 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 tax principal, interest, and penalty. *See Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (NM Ct. App. 1972).

Unless exempted, income earned from performance of a service as a jockey agent is subject to gross receipts tax.

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 in this case clearly establishes that the Taxpayer was engaged in business in New Mexico as a licensed jockey agent during TY05 and TY06. As a jockey agent, Taxpayer was responsible for marketing her jockey clients to perspective horse owners and trainers, arranging meetings between her jockey clients and horse owners and trainers, securing horse mounts appropriate for the skill, experience, and prestige of her respective jockey clients, securing better horse mounts that might increase her jockey client's opportunity to win larger purses, and for taking care of the administrative needs of her jockey clients. Indeed, in performing her services as a jockey agent, Taxpayer could significantly increase a jockey's ability to earn income from purses. That possibility of maximizing her jockey client's income is in itself a service, akin to the services provided by an accountant, attorney, investment banker, realtor, etc, all of whom are generally subject to gross receipts tax. By any definition, there is no dispute that Taxpayer was performing a service for her jockey clients here in New Mexico in executing these various aspects of her job.

Further, considering that the Taxpayer never disputed that she was performing a service in New Mexico subject to gross receipts tax, and instead only claimed a specific exemption from imposition of gross receipts tax to her particular service as a jockey agent, the presumption of taxability and basic logic (why claim an exemption if you don't otherwise believe your income was subject to the gross receipts tax?) hold that Taxpayer is subject to gross receipts as a person engaged in business in New Mexico.

A jockey agent does not qualify for exemption under the plain language of §7-9-40.

Taxpayer claims that her income earned as a jockey agent came as a percentage of jockey purse earnings, and therefore is exempted from gross receipts taxes under NMSA 1978, § 7-9-40 (1989). In the alternative, Taxpayer argues that she is "horseman" in every sense of that word,

and therefore also is exempted by NMSA 1978, § 7-9-40 (1989) because that statute states that horseman are not subject to gross receipts. In support of this claim, Taxpayer argues that the Department has granted the exemption to other jockey agents in the past. Finally, Taxpayer expresses frustration with the length of the process and the delay between TY05 and TY06 and the assessment.

a. Taxpayer is not a horseman, jockey, or trainer for the purposes of the exemption.

"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 & Revenue Dep't, 111 N.M. 735, 740 (N.M. Ct. App. 1991)*; *see also Security Escrow Corp. v. Taxation and Revenue Department,* 107 N.M. 540, 543, 760 P.2d 1306, 1309 (Ct. App. 1988). An exemption provision must be narrowly yet reasonably construed. *See id.* The Taxpayer must show that the claimed exemption is both within the letter and the spirit of the law. *See id.*

The *Security Escrow Corp.* court is particularly insightful on how to best interpret a statute, like the exemption at issue in here:

> In construing the meaning of a particular statute, a reviewing court's central concern is to determine and give effect to the intention of the legislature. *State ex rel. Klineline v. Blackhurst*, 106 N.M. 732, 749 P.2d 1111 (1988). In determining this intent, we look primarily to the language of the act and the meaning of the words, and when they are free from ambiguity, we will not resort to any other means of interpretation. *See State v. Pitts*, 103 N.M. 778, 714 P.2d 582 (1986); *New Mexico Beverage Co. v. Blything*, 102 N.M. 533, 697 P.2d 952 (1985).

> When a term is not defined by the statute, a court may interpret the word in accordance with its ordinary meaning. *United States v. State of New Mexico*, 536 F.2d 1324 (10th Cir.1976). Unless the legislature indicates a different intent, we must give statutory words their ordinary meaning. *State ex rel. Klineline v. Blackhurst*. Although we cannot add a requirement that is not provided for in the statute or read into it language that is not there, we do read the act in its entirety and construe each part in connection with every other part to produce a harmonious whole. *Id*. *Security Escrow Corp. v. State Taxation & Revenue Dep't*, 107 N.M. 540, 543 (N.M. Ct. App. 1988).

In sum, any question of statutory construction/interpretation must begin with a review of the plain language of the act, and where the words are free from ambiguity, no others means of interpretation are necessary.

The relevant statute at issue here is NMSA 1978, § 7-9-40 (1989). NMSA 1978, § 7-9-40 (1989) is titled "Exemption; gross receipts tax; purses and jockey remuneration at New Mexico racetracks; receipts from gross amounts wagered." In pertinent part, NMSA 1978, § 7-9-40 (A) (1989) reads "receipts of *horseman*, *jockeys* and *trainers* from race purses at New Mexico horse racetracks subject to the jurisdiction of the state racing commission" are exempt from imposition of a gross receipts tax. *Italics added for emphasis*. At no point does the NMSA 1978, § 7-9-40 (1989) use the term "agent" or the phrase "jockey agent." The statute seems to be free of ambiguity in that it applies solely to horseman, jockeys, and trainers, and specifically does not include jockey agents.

The only term in the statute without immediate clarity as to its ordinary meaning is the term "horseman." While the Taxpayer argues that she qualifies as a "horseman" in every sense within the horse racing community, Regulation 3.2.128.7 NMAC [5/15/01] specifically defines a "horseman" under the exemption to mean "the *owners* of race horses that win purse money in

races held at New Mexico horse racetracks." *Italics added for emphasis*. The letter of the law, at least with how the regulation defines "horseman", does not include a jockey agent as a horseman. Under the regulation, the Taxpayer does not qualify as a "horseman" because there is no evidence that she was an owner of a race horse in TY05 or TY06.

Further, the evidence in this case clearly established that a jockey agent is different then a jockey or a trainer. The Taxpayer indicated that her role was specifically to work with a jockey to secure mounts from horse owners and/or horse trainers. Taxpayer did not own any horses, did not train any horses, and did not ever ride any horses during a race. In fact, Taxpayer said that a jockey agent can only hold one license at a time, and therefore as a jockey agent, any additional licenses held concurrently with her jockey agent license, such as a jockey, trainer, or any other licensed position associated with a horse racing track, would be void. In other words, a jockey agent license is entirely unique and distinct from being a horse owner, horse trainer, or jockey because a jockey agent's license requires surrender of any other licenses as a horse owner, trainer, or jockey.

Indeed, a review of both the Horse Racing Act and its accompanying regulations clearly show that a "jockey agent" is a legally distinct entity from a horse owner, horse trainer, or horse jockey. In defining "occupational license" under the Horse Racing Act, the legislature separately listed "a horse owner, trainer, jockey, agent…" NMSA 1978, Section 60-1A-2(Q) (2010). Although all may qualify for an occupational license, by separately listing each respective title, it is clear that the legislature believed the each respective function listed had a unique and distinct role/purpose under the Horse Racing Act. Since the legislature was aware of a jockey agent's distinct purpose, yet choose not to include a jockey agent under the exemption, the legislature must have not intended to exempt a jockey agent from the payment of gross receipts taxes.

Under the regulations associated with the Horse Racing Act, a jockey agent is also consistently addressed distinctively from a horse owner, horse trainer, or a horse jockey. Under Regulation 16.47.1.8(A)(2) NMAC [09/15/09], there is separate licensing fee listed for jockeys (between $80-100 depending on length), trainers (again between $80-100 depending on length), and jockey agents ($55 per year). In discussing the specific license requirements and duties of each respective licensee, the regulations place "owners", "trainers", "jockeys", and "jockey agents" into separate, dedicated subsections: Regulation 16.47.1.9 NMAC [07/15/2003] addresses "owners"; Regulation 16.47.1.10 NMAC [09/15/09] addresses "trainers"; Regulation 16.47.1.12 NMAC [06/15/09] addresses "jockeys"; and Regulation 16.47.1.13 NMAC [08/14/08] addresses "jockey agents." Whether or not the Horse Racing Commission in practice strictly comports with its own regulations and definitions, or rather as Taxpayer suggests loosely considers everyone licensed as a "horseman", does not change the legislature's intent to give each respective position a distinct application from the other, which is supported by the language of the Horse Racing Act and the regulatory definitions.

While there is no doubt that the Taxpayer genuinely believes she is "horseman" in the broader horse racing community, with respect to the limited tax liability considerations articulated by statute and regulation, the Taxpayer does not qualify as horseman, trainer, or jockey under the pertinent exemption, NMSA 1978, § 7-9-40 (1989) because she does not meet the regulatory definition of a horseman and because by statute and regulation a jockey agent is a separate and distinct occupation then a horse owner, trainer, or jockey.

b. Taxpayer's Exhibit #1 and its admissibility.

Over the Department's strong and continuing objections, the Taxpayer tendered Exhibit #1 into the record, claiming that it was evidence that the Department had granted an exemption under NMSA 1978, § 7-9-40 (1989) previously to a similarly situated jockey agent. The Department objected on relevancy grounds, on hearsay grounds, and legal residuum grounds. During the hearing, the hearing officer reserved ruling on the Department's objections and the admission of Taxpayer's Exhibit #1.

The Department's hearsay and legal residuum grounds are easily dismissed. During an informal administrative hearing, the formal rules of evidence, including the hearsay rules, do not strictly apply. Even if the hearsay rules did apply, Taxpayer's Exhibit #1 appears to be a copy of a regularly maintained business record of the Department, and as such, would likely be a recognized exception to the hearsay rule under either the regularly maintained business records exception or under the catch-all exception as having sufficient indicia of reliability.

Under the legal residuum principle, the Department's argument seems to be that *every* piece of evidence submitted during an administrative hearing must be supported by a residuum of legally competent and admissible evidence. Respectfully, this position is an over reading of the legal residuum principle, and if applied as the Department argues in this specific case would be contrary to the Department's position in other administrative hearings held in the Hearing Bureau and even contrary to the evidence that the Department tendered in this specific case.

The legal residuum rule requires that an agency's administrative decision be "supported by some evidence that would admissible under the rules" of evidence. *Chavez v. City of Albuquerque*, 124 N.M. 239, 241, 1997 NMCA 111, 947 P.2d 1059, 1061 (N.M. Ct. App. 1997).

As the New Mexico Court of Appeals explained in *Anaya v. New Mexico State Personal Board*, 107 N.M. 622, 626, 762 P.2d 909, 913 (N.M. Ct. App 1988),

> [t]he legal residuum rule does not require that all evidence considered by the administrative agency be legally admissible evidence, but only "that an administrative action be supported by *some* evidence that would be admissible in a jury trial" *Duke City Lumbar Co. v. New Env'tl Improvement Bd., 101 N.M. at 295, 681 P.2d at 721*.

As mentioned above, Taxpayer Exhibit #1 would survive a hearsay objection as one of two possible exceptions to the hearsay rules, and thus would be admissible in a jury trial, satisfying the *Duke City* and *Chavez* standard. And even if Taxpayer Exhibit #1 would not survive a hearsay objection, it is hardly the only piece of evidence supporting an administrative decision in this case, nor does it relate to an essential element at issue during the protest hearing.

What is striking is that Taxpayer's Exhibit #1 is no different than over half of the exhibits tendered by the Department in this case: to exclude the Taxpayer's Exhibit #1 on hearsay grounds or under the Department's theory of the residuum principle would necessitate excluding most of the Department's exhibits (A, B, E, F, G, H, L, M, N) on those same grounds. Considering that the Department apparently has no problem relying on hearsay as part of its case during an informal administrative hearing where the rules of evidence are relaxed, aside from its legitimate confidentiality concerns, it is a bit perplexing why the Department spent so much energy trying to exclude a pro-se Taxpayer's attempt to produce a single solitary exhibit that is on its face a Department document produced in the regular course of the Department's business.

Whether Taxpayer's Exhibit #1 is relevant is a much more difficult analysis. The Department is correct that on the face of the document, Taxpayer Exhibit #1 does not provide enough information either way to substantiate the Taxpayer's claim that the Department granted another similarly situated jockey agent the pertinent exemption. Even if, as Taxpayer credibly

testified she believed, another jockey agent in the past was granted in exemption, that is not dispositive of whether the Taxpayer is legally entitled to such an exemption during this protest. It is possible that, although Taxpayer has a good faith belief that the taxpayer referenced in Exhibit #1 was similarly situated to Taxpayer in this protest, there are other unknown facts and circumstances involved in that case that distinguish that other taxpayer from the Taxpayer involved in this protest. Additionally, even for the sake of argument that Taxpayer is correct that the Department previously granted an exemption to a similarly situated jockey agent, it is possible that the Department's decision was made for strategic reason, or was just simply made in error in interpretation of the law. A past error in the law made to an unrelated taxpayer does not prevent the Department from correcting its interpretation of the law in a future case involving an unrelated Taxpayer. Since this appears to be question of first impression, there is no clear legal precedent determining whether a jockey agent qualifies for the exemption, and consequently, the Department's own legal analysis of the issue may have legitimately changed over time.

That being said, the structure and purpose of an administrative hearing is to give each party—both the administrative agency and the member of public for whom the agency works—a reasonable opportunity to present their case on the merits in a relaxed procedural setting. Considering that Taxpayer's Exhibit #1 is this pro se Taxpayer's only exhibit in a relaxed administrative proceeding, it strikes the undersigned hearing officer as particularly draconian to exclude it on narrow relevancy grounds when there is at least some arguable relevancy in the question of whether the Department may have previously had a different view of the exemption at issue in this protest. The document is relevant to the presentation of the Taxpayer's argument, even if the document by itself lacks the necessary weight to carry Taxpayer's factual burden.

Taxpayer's Exhibit #1 is admitted over objection, with the caveat that it is of limited weight and any confidential information identified on that Exhibit will be redacted.

In the Taxpayer's March 14, 2011 filing, Taxpayer argued for the admission of the Exhibit #1. Taxpayer also argued that the Department's failure to squarely address whether the other taxpayer referenced in Exhibit #1 was similarly situated and was given the exemption meant that the Department either did not act with diligence to research the issue or that the other taxpayer was indeed granted the exemption in a similar situation. However, even if Taxpayer is correct that the Department had previously granted the exemption to a jockey agent, that does not change that fact that under the clear language of the exemption in conjunction with its accompanying regulations, as wells as the Horse Racing Act and its accompanying regulations, that a jockey agent does not legally qualify for the exemption. While the Department should strive to treat all taxpayers equally, the Department's action must also comport with the law. To say simply that a possibly similarly situated taxpayer in the past *may* have been granted an exemption, and therefore this Taxpayer is entitled to the exemption, fails to address whether such exemption is legally permissible.

c. Taxpayer's timeliness concerns.

The Taxpayer expressed frustration that it took so long for the Department to assess her for TY05 and TY06. Mr. Dillon explained the delays that occurred in this case were not unusual given the regular course of events in the Tape Match program, the protest office review, the Department's legal staff review, and the scheduling of the hearing by the hearing bureau. The hearing was scheduled within days of receipt of a request for hearing, and the setting was made in approximately six-months of the initial request for hearing, only to be continued an additional

month for the Taxpayer's request to conduct a hearing on a day other than a Tuesday. Moreover, the Department's assessments in this case comply with the statute of limitations requirements expressed by the Tax Administration Act for a non-filer. *See* NMSA 1978, Section 7-1-18(C) (1994).

The Taxpayer was also uncomfortable allowing the Department additional time to submit argument in her case because she had concerns about the continuing accrual of interest. As part of this concern, the Taxpayer expressed reluctance in allowing the Department any additional time to submit argument about Taxpayer #1 because of her overall concerns about the timeliness of the process, the accrual of interest, and the timeliness of the decision. However, by regulation 3.1.8.9 NMAC [8/30/01], the hearing officer has the authority to allow submission of legal arguments after the conclusion of a hearing. The Taxpayer was notified by the Department that she could stop the accrual of interest by paying the principal amount of tax. See Department Exhibit D.

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. 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. In effect, the Taxpayer had a loan of state funds during the time taxes were owed but not paid. Therefore continuing interest is due until such time as the principal tax due is paid. While Taxpayer believes that interest rates charged to her were exorbitant, those rates were set in statute by the legislature and are beyond the control of the Department.

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, NMSA 1978, Section 7-1-69(A) (2003) imposes a penalty of two percent per month "from the date the tax was due," not to exceed ten percent of the outstanding tax liability. Again, 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." The term "negligence" is defined in Regulation §3.1.11.10 NMAC (1/15/01) to include "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention."

In this case, due to her erroneous belief that she legally qualified as a "horseman" for purposes of the exemption, Taxpayer did not file and pay the appropriate gross receipts tax for TY05 and TY06 when due. While certainly not an intentional error or omission, erroneous belief, inadvertent error or inattention meets the legal definition of "negligence" under the penalty statute. *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 799, 779 P.2d 982, 986 (Ct. App. 1989). Taxpayer presented no evidence under Regulation §3.1.11.11 NMAC (1/15/01) to demonstrate nonnegligence. As such, the Department is required by statute to impose penalty.

Computation of Penalty.

On both of the assessments issued in this matter, the Department seeks to impose a 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. *See* 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.*

As the Department is well aware, the four hearing officers in the hearing bureau who hear tax cases have considered whether the Department may apply the amended penalty provisions against unpaid tax liabilities that had reached their statutory cap before the effective date of the amended penalty provision have ruled against the Department. The Department has appealed the Hearing Bureau's ruling on this penalty issue to the Court of Appeals seven times, and those appeals remain pending as of the date of this decision. In an eighth case, *In the Matter of the Pretest of GEA Integrated Cooling Technology*, which was cited by the Department in its brief, a contract hearing officer with the Department ruled in favor of the Department. The Taxpayer in that case has appealed that decision to the Court of Appeals, and that appeal also remains pending as of the date of this decision. This matter is a legal issue where there is a dispute as to the meaning of the application of Section 7-1-69 to cases where the tax or return due predates the effective date of January 1, 2008. Eventually, rather than continuing to be a source of contention, this issue will become moot since either there will be fewer of these cases because it has been three

years since the effective date of this statute or because the Court of Appeals will have had reached a decision on one of the appeals.

NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007), in effect prior to January 1, 2008 states,

> A. 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 t ax 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 (2007) states,

> A. 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 twenty percent of the tax due but not paid.

The only modification in the statute from the 2003 version as compared to the 2007 version is simply the increase in penalty from 10% to 20%. The effective date of this amended penalty provision was January 1, 2008.

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 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 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). Interestingly, rather than address the New Mexico Supreme Court's much more recent holding on retroactive application of a penalty regulation, the *GEA* case that the Department relies so heavily on focused on a less relevant and older case [*Bradbury & Stamm Construction Co. v. Bureau of Revenue*, 70 N.M. 226, 372 P.2d 808 (1962)] dealing with the interest statute, which as will be discussed below, is separate and distinct from the penalty statute at issue here.

Of course, the Department takes a different position in this matter. Citing the *GEA* decision, the Department argues that because NMSA 1978, §7-1-69 uses the phrase "there shall be added to the amount assessed a penalty in an amount…", that the word "assessed" has to mean

"assessment" as defined by NMSA 1978, §7-1-17, and therefore any formal notice of assessment issued on or after the January 1, 2008 effective date of NMSA 1978, § 7-1-69 may apply up to a 20% maximum penalty against any unpaid principal tax, even if that unpaid principal tax predates the effective date of the amended statute and even if the penalty had already reached the previous 10% penalty cap. The Department argues that penalty does not get charged to a taxpayer until the Notice of Assessment is issued or until a taxpayer self-reports pursuant to NMSA 1978, § 7-1-17.

This interpretation of the word "assessed" renders portions of NMSA 1978, § 7-1-69 (A)(1) meaningless because it ignores the remaining provisions of that statute that require precise accounting of the past months starting from the moment when the tax was due and not paid. The calculation of penalty begins from the point where the failure of a taxpayer occurred, either the failure to file or the failure to pay, not from the time a taxpayer is assessed. That is, the critical triggering date or event under the penalty statute is the time that the tax was due and not paid rather than the date assessed because that is the day a taxpayer is negligent and thus subject to civil negligence penalty.

All portions of a statute have to be read together for meaning. *See Security Escrow Corp*, 107 N.M. 540, 543. In the context of the Tax Administration Act, the word "assessed" as used in the NMSA 1978, § 7-1-69 has a different meaning because to interpret "assessed" in the way the Department does would make "the not to exceed" language meaningless. Moreover, the Department's interpretation of the word "assessed" also renders NMSA 1978, Section 7-1-30 meaningless. Contrary to the Department's theory that penalty only exists when "assessed," NMSA 1978, Section 7-1-30 provides that the Department need not issue an assessment to collect penalty and interest. Since the Department's interpretation would render portions of both NMSA 1978, §

7-1-69 and the Tax Administration Act meaningless, the Department's interpretation violates basic principles of statutory construction, as expressed by *Security Escrow Corp.*

Mechanically in this case, the two assessments were 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%.

The fact that the Department continually 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.*

The Department finally argues that since the interest provision was amended at the same time as the penalty provision, the hearing bureau ought if it really believes that the penalty provision is being improperly retroactively applied, also order the Department to impose the previous interest provision against the Taxpayer. Unlike the provisions on the civil negligence penalty, the Legislature did not impose either a cap in the cumulative interest or in the length of time interest is too accrue under NMSA 1978, §7-1-67 (2008), other than that interest may not accrue against interest or accrue against penalty. The critical distinction being that unlike penalty, the interest provision does not contain any concept of expiration of a time period or any "not to exceed" condition that stops further accrual of interest. Thus, when the new interest provision took affect on January 1, 2008, since no maximum cap had already been reached and because no such conceptual cap exists under the interest provision, the Department was mandated to continue to

impose interest at the legislatively specified rate against any unpaid tax liability at the percentage specified by the amended statute until the principal tax is paid in full.

Both before and after the 2008 changes of law to the interest and penalty provisions, the legislative purpose of the interest statute and the civil penalty statute are entirely different, and the manner in which they are calculated is also entirely different. The legislative purpose for imposing interest is to recoup the time value of money. The legislative purpose for imposing a civil penalty is for a taxpayer's failure to act—either to pay or to file. Interest is calculated on a daily basis until the unpaid principal tax is paid in full, while penalty is calculated on a monthly basis for a limited period of time before being capped even if the principal tax remains due and not paid. If the legislature wanted the penalty to accrue just like interest so long as the outstanding tax remained unpaid, then it would have expressly so stated in the penalty statute. Because there is a difference between the two provisions, the hearing officer has to conclude that the legislature intended that each provision have a distinct application. Under those distinct applications, the penalty is capped at a maximum of 10% as provided in §7-1-69(A)(1) (2003, prior to amendments through 2007), while the interest was appropriately calculated in this case.

CONCLUSIONS OF LAW

1. Taxpayer filed a timely, written protest to the assessment of gross receipts principal tax, interest and penalty under Assessment Nos. # L1690161216 and L0900147264, 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 for income earned as a jockey agent in TY05 and TY06 because she does not qualify for exemption

pursuant to NMSA 1978, § 7-9-40 (1989), and because her erroneous belief that she qualified under this exemption was negligent and subject to civil penalty.

3. The Department correctly assessed interest, pursuant to NMSA 1978, §7-1-67, and the Taxpayers owe the amount of interest accrued until the principal tax is paid in full.

4. The amount of civil penalty added to the principal tax shall not 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%) shall be abated.

For the foregoing reasons, the Taxpayer's protest **IS GRANTED IN PART AND DENIED IN PART:** the Department is ordered to abate ten percent of the penalty amount, **a total of $453.66**, for tax year 2005 and tax year 2006.

DATED: March 15, 2011.