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

IN THE MATTER OF THE PROTEST OF
AURELIA SHORTY **No. 11-17**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0089824640

DECISION AND ORDER

A hearing was held on the above captioned matter on July 21, 2011 before Brian VanDenzen Esq., Hearing Officer, in Santa Fe. Ms. Aurelia Shorty ("Taxpayer") appeared along with attorney Claudia Crawford. The Taxation and Revenue Department of the State of New Mexico ("Department") was represented by Staff Attorney Peter Breen, Taxation and Revenue Department. Protest Auditor Thomas Dillon appeared as a witness for the Department. In addition to the documents contained in the Administrative File articulated during the beginning of the hearing, Taxpayer #1-6 and Department A, B, C, E, and H are admitted into the record. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Taxpayer is an enrolled tribal member of the Navajo Nation. [Taxpayer #2 & Taxpayer #3].

2. Taxpayer is a member of the Kinlichee Chapter near Ganado, Arizona.

3. Taxpayer is a registered voter only at Kinlichee Chapter on the Navajo Nation.

4. Taxpayer has only voted on the Navajo Nation.

5. Taxpayer has family in Ganado, Arizona.

6. Taxpayer's parents, whom are both deceased, had a home site lease in the Navajo Nation near Wood Springs, Arizona, which is some 8-miles northeast of Ganado, Arizona.

7. Since Taxpayer is the only surviving immediate family member, Taxpayer is the only person with an interest in this home site lease.

8. At the home site lease, there is a Hogan, a burnt-down mobile home, and a permanently fixed physical home.

9. Because of vandalism over the years, the mobile home and the permanently fixed physical home are not habitable, as least without significant rebuilding.

10. Because of cultural tradition, even if the permanently fixed physical home was habitable, Taxpayer would likely rebuild the home because it is the location where her mother passed on.

11. Under Navajo cultural tradition, Taxpayer considers her home site lease on the Navajo Nation in Wood Springs, AZ her permanent home because her umbilical cord is buried at that location.

12. The Hogan on the home lease site remains in good condition, and because of the limited access into the Hogan, Taxpayer is able to maintain many of her most important cultural possessions in the Hogan.

13. Taxpayer intends to retire to her family's home site lease. However, before she can do so, Taxpayer will need to rebuild a structure there as both the mobile home and the fixed residential home are not inhabitable as is.

14. In order to save money, Taxpayer pays no utility bills at the home site lease in Wood Springs, AZ.

15. Taxpayer regularly returns to Ganado for family and ceremonial purposes.

16. However, when Taxpayer returns to the Ganado area, she stays with extended family near the Kinlichee Chapterhouse rather than at her home site lease in Wood Springs.

17. Taxpayer owns no other real property outside of the borders of the Navajo Nation and has no intention to ever buy any real property in New Mexico.

18. Taxpayer was and is a teacher working for the United States Department of the Interior, Bureau of Indian Education.

19. As part of her employment, Taxpayer has traveled to different schools across the Navajo Nation as required, including schools in both Arizona and New Mexico.

20. Beginning in 2001, and continuing through tax year 2005, Taxpayer was employed exclusively as an educator at Mariano Lake Community School in Crownpoint, New Mexico. [Taxpayer #1]

21. Mariano Lake Community School is located on the Navajo Nation and is administered by the United States Department of the Interior, Bureau of Indian Education. [Taxpayer #1]

22. All of Taxpayer's income in 2005 came from her work performed within the Navajo Nation for the Mariano Lake Community School.

23. Taxpayer worked year-round at Mariano Lake Community School.

24. Mariano Lake Community School had insufficient on-campus housing available for staff rental. Consequently, about half the staff lived outside of Crownpoint.

25. Since 2003, including Tax Year 2005, Taxpayer rented a 2-bedrooom, 1-bath apartment at 1013 E. Mesa Ave. #1 in Gallup, New Mexico.

26. Taxpayer's apartment at 1013 E. Mesa Ave. #1 in Gallup, New Mexico is a separately metered apartment for utility purposes.

27. In 2005, Taxpayer paid for a water bill, a cable bill, and a phone bill for utilities at her apartment at 1013 E. Mesa Ave. #1 in Gallup, New Mexico.

28. In tax year 2005, Taxpayer had a bank account with Bank of America listing her address as 1013 E. Mesa Ave. #1 in Gallup, New Mexico. [Department H]

29. In tax year 2005, Taxpayer filed her federal income tax returns listing her address as 1013 E. Mesa Ave. #1 in Gallup, New Mexico. [Department H]

30. Beginning in tax year 2006, Taxpayer filed and paid her personal income taxes in New Mexico, self-identifying herself as a New Mexico resident and listing her address as 1013 E. Mesa Ave. #1 in Gallup, New Mexico. [Department B]

31. Because of the close proximity to her Gallup apartment, Taxpayer maintains a P.O. Box address in Window Rock, Arizona rather than in Ganado, Arizona.

32. Taxpayer presented one letter she received from Benjamin Curley on July 3, 2009 at her P.O. Box address in Window Rock, Arizona, [Taxpayer #6]

33. In 1995, Taxpayer, whom had previously been licensed in Arizona, applied for a New Mexico driver's license, a license she maintained in 2005.

34. Beginning in 2003, and including tax year 2005, Taxpayer had registered her primary vehicle, a Nissan, in New Mexico.

35. Taxpayer also has a 1964 Volkswagen Bug registered in New Mexico.

36. Taxpayer registered her father's former 1979 Ford pick-up truck, which had previously been registered in Arizona, in New Mexico. Taxpayer had this truck towed from the home site lease in Wood Springs, AZ to her apartment in Gallup, where the vehicle remains.

37. After tax year 2005, the Taxpayer registered in her name a truck and a traveler trailer in New Mexico rather than Arizona. Taxpayer, however, indicated that both of these vehicles are paid for and used by her long term friend Clinton Trujillo. When Clinton Trujillo is not working as union oil pipeline worker at various locations across the west, the truck and travel trailer are parked at Taxpayer's apartment in Gallup.

38. On August 12, 2009, the Department assessed Taxpayer for unfiled and unpaid tax tear 2005 personal income tax, penalty, and interest.

39. On September 2, 2009, Taxpayer through attorney Linda Quezada filed a written request for an extension of time to file a protest of the assessment.

40. On September 21, 2009, the Department granted the Taxpayer's request for an extension of time to file a formal protest, giving the Taxpayer until November 10, 2009 to file such a protest.

41. On November 6, 2009, Taxpayer filed a formal written protest to the assessment.

42. On November 17, 2010, the Department requested a protest hearing.

43. On November 24, 2010, the Hearing Bureau of the Taxation and Revenue Department sent notice of hearing, setting this matter for hearing on July 21, 2011.

44. As of the date of the scheduled hearing, Taxpayer owed $3,061.00 in unpaid principal tax, $612.20 in penalty (calculated at the maximum 20%), and $1277.99 in unpaid interest (accumulating at $0.34 per day).

DISCUSSION

At issue in this matter is whether for Tax Year 2005 ("TY05"), the Taxpayer's personal income was exempt from New Mexico Personal Income tax pursuant to NMSA 1978, §7-2-5.5

(1995). Taxpayer and the Department are in agreement that the Taxpayer was an enrolled member of the Navajo Nation in TY05, and earned all of her personal income while working under contract for the United States Department of the Interior, Bureau of Indian Education at Mariano Lakes Community School on the Navajo Nation in TY05. The only issue in dispute is whether under NMSA 1978, §7-2-5.5 (1995), Taxpayer "lived within the boundaries" of the Navajo Nation or lands held in trust for the Navajo Nation during TY05.

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).

Personal Income Tax and the Exemption.

Payment of New Mexico personal income tax is governed by NMSA 1978, §§ 7-2-1, *et seq*. Unless otherwise exempted by law, a tax is imposed "upon the net income of every" New Mexico resident. NMSA 1978, §7-2-3 (1981).

Under NMSA 1978, §7-2-5.5 (1995), "Exemption; earnings by Indians, their Indian spouses and Indian dependants on Indian lands,"

> Income earned by a member of a New Mexico federally recognized Indian nation, tribe, band or pueblo, his spouse or dependent, who is a member of a New Mexico federally recognized Indian nation, tribe, band or pueblo, is exempt from state income tax if the income is earned from work performed within and the member,

> spouse or dependent lives within the boundaries of the Indian member's or the spouse's reservation or pueblo grant or within the boundaries of lands held in trust by the United States for the benefit of the member or spouse or his nation, tribe, band or pueblo, subject to restriction against alienation imposed by the United States.

If Taxpayer can demonstrate that she was entitled to the exemption under NMSA 1978, §7-2-5.5 (1995) in TY05, then income attributable to Taxpayer in TY05 would not be subject to New Mexico personal income tax.

The exemption under NMSA 1978, §7-2-5.5 (1995) can be broken down further into three elements. First, there must be earned income by a member of a New Mexico federally recognized Indian nation. *See id*. In this case, the evidence clearly established—and the Department does not dispute—that the Taxpayer is a member of a federally recognized Indian Nation, the Navajo Nation.

The second element under NMSA 1978, §7-2-5.5 (1995) is that the earned income derived from work performed within the boundaries of the Indian member's or spouses' land. *See id*. The statute and the accompanying regulation are silent on how income should be attributed under this derived from element. The seminal federal case on the prohibition of state personal income taxes on tribal members from income derived from within tribal territory is *McClanahan v. Arizona State Tax Commission*, 411 U.S. 164 (1972). In *McClanahan*, the United States Supreme Court held that Arizona could not impose a state personal income tax on a tribal member whose income "derived wholly from reservation resources." *id*. at 179. Since there is no clear State standard to analyze the term "work performed within", and the regulation recognizes the limitations imposed by federal law, the standard articulated by *McClanahan* that

the income must be "derived wholly from reservation resources" is controlling in determining when a tribal member's income is exempt from state income tax.

Again, the evidence is clear in this case that in TY05, Taxpayer derived her income wholly from reservation resources from work performed within the boundaries of the Navajo Nation as a teacher at Mariano Lakes Community School in Crownpoint, New Mexico. The Department does not contest this portion of the Taxpayer's claim for exemption. This work activity as a teacher satisfies both the statutory and regulatory requirements that the income derive "from… activities on the tribal territories". *See* 3.3.4.12(C) NMAC (5/15/2001).

The third element under NMSA 1978, §7-2-5.5 (1995) presents the controversy in this matter: the "member, spouse or dependent" claiming the exemption "lives within the boundaries" of the applicable tribal land. Neither the statute nor the regulation interpreting the statute provide a definition, standard, or test to determine what is meant to "live within the boundaries" of tribal land. Implicit in the presentation of the Taxpayer's case is an argument for the application of NMSA 1978, § 7-2-2 (S) (2003) and Regulation 3.3.1.7 NMAC (4/29/2005), which collectively addresses residency and domicile factors, in order to determine whether Taxpayer "lived within the boundaries" of tribal land during TY05. The Department did not contest the Taxpayers' position that the residency and the application of the domicile factors listed by regulation is the appropriate method to determine whether Taxpayer "lived within" Navajo Nation during the relevant time frame.

However, before even turning to Taxpayer's domicile argument, a close reading of the exemption does not necessarily support the Taxpayer's contention that domicile is the appropriate method of analysis to determine living within. The exemption never uses the words "residency" or "domicile." Nor does the exemption statue NMSA 1978, §7-2-5.5 (1995) cross

reference the New Mexico statutes and regulations on residency and domicile, NMSA 1978, § 7-2-2 (S) (2003) and Regulation 3.3.1.7 NMAC (4/29/2005). Despite the fact that the legislature was aware of the meaning of "residency" and "domicile" given NMSA 1978, § 7-2-2 (S) (2003) and could have chosen to use either term under the exemption, the legislature choose to use the distinct phrase "lives within." The accompanying regulation under the exemption, Regulation 3.3.4.12 NMAC (5/15/01), neither defines what is meant by "lives within" nor references the words "residency" or "domicile."

Unlike "domicile", which deals a great deal with a person's intent, the term "lives within" suggests a continuing physical presence inside a defined geographical boundary. At the very least, the value of physical presence within a boundary as opposed a person's intent is elevated by the legislature's use of the phrase "lives within." Under that standard—continuing physical presence inside a defined geographical boundary—the Taxpayer fails to carry her burden of proof. Because Taxpayer indicated that her job as a teacher a Mariano Lake Community School is a year-round position and that while working, she resided at her apartment in Gallup for convenience sakes, there is little doubt that the Taxpayer was physically present in Gallup, New Mexico and not the Navajo Nation during TY05 for at least 185-days, and likely significantly more time than 185-days. If the Taxpayer lived within the boundaries of Gallup, New Mexico during TY05 for at least 185-days, the Taxpayer could not have "lived within" the Navajo Nation during that period of time even if she believed and intended her home to be in Wood Springs, Arizona. Consequently, under the plain language of the exemption, the Taxpayer failed to establish that she "lived within" the Navajo Nation during TY05.

Residency and Domicile.

Although Taxpayer failed to establish that she "lived within" the Navajo Nation under the plain language of the exemption statute, because residency and domicile were essential parts of the Taxpayer's argument and the Department's counter-argument, residency and domicile still will be considered for the sake of argument as part of this decision.

NMSA 1978, § 7-2-2 (S) (2003) of the Income Tax Act defines the term "resident" as:

> an individual who is domiciled in this state during any part of the taxable year or an individual who is physically present in this state for one hundred eighty-five days or more during the taxable year; but any individual, other than someone who was physically present in the state for one hundred eighty-five days or more during the taxable year, who, on or before the last day of the taxable year, changed the individual's place of abode to a place without this state with the bona fide intention of continuing actually to abide permanently without this state is not a resident for the purposes of the Income Tax Act [7-2-1 NMSA 1978] for periods after that change of abode;

Regulation §3.3.1.9(A) NMAC (4/29/2005) mirrors this statutory definition almost exactly by stating that a resident is either an individual who is domiciled in New Mexico or an individual who is physically present in New Mexico for a total of 185-days or more during the tax year. In other words, by statute and regulation there are two possible basis of residency in New Mexico: either the person was physically present in New Mexico for 185-days or the person was domiciled within the state during any part of the tax year.

The evidence in this case suggests that the Taxpayer was physically present in New Mexico during TY05 for at least 185-days. At the very least, the Taxpayer failed to carry her burden to overcome the assessment by showing that she was physically present in New Mexico for less than 185-days. Since the Taxpayer was likely physically present in New Mexico for at

least 185-days during TY05, the Taxpayer would qualify as a resident of New Mexico and not the Navajo Nation for income tax purposes under NMSA 1978, § 7-2-2 (S) (2003).

Even considering for the sake of argument the other possible basis of residency under statute and regulation, domicile, the Taxpayer fails to carry her burden. That is not to say that the Taxpayer lacks a genuine intention to return to her home site lease on the Navajo Nation at some point in the future. Only that under the numerous domicile factors articulated by the regulation, too many factors weight against the Taxpayer for the Taxpayer to carry her burden to overcome the assessment.

Regulation §3.3.1.9 NMAC (4/29/2005) defines "domicile" as the

> place where an individual has a true, fixed home, is a permanent establishment to which the individual intends to return after an absence, and is where the individual has voluntarily fixed habitation of self and family with the intention of making a permanent home. Every individual has a domicile somewhere, and each individual has only one domicile at a time.

To determine domicile, Regulation §3.3.1.9(C)(4) NMAC (4/29/2005) provides twelve domicile factors to consider:

> (a) homes or places of abode owned or rented (for the individual's use) by the individual, their location, size and value; and how they are used by the individual;
>
> (b) where the individual spends time during the tax year and how that time is spent; e.g., whether the individual is retired or is actively involved in a business, and whether the individual travels and the reasons for traveling, and where the individual spends time when not required to be at a location for employment or business reasons, and the overall pattern of residence of the individual;
>
> (c) employment, including how the individual earns a living, the location of the individual's place of employment, whether the individual owns a business, extent of involvement in business or profession and location of the business or professional office, and the proportion of in-state to out-of-state business activities;

(d) home or place of abode of the individual's spouse, children and dependent parents, and where minor children attend school;
(e) location of domicile in prior years;
(f) ownership of real property other than residences;
(g) location of transactions with financial institutions, including the individual's most active checking account and rental of safety deposit boxes;
(h) place of community affiliations, such as club and professional and social organization memberships;
(i) home address used for filing federal income tax returns;
(j) place where individual is registered to vote;
(k) state of driver's license or professional licenses;
(m) where items or possessions that the individual considers "near and dear" to his or her heart are located, e.g., items of significant sentimental or economic value (such as art), family heirlooms, collections or valuables, or pets.

Of the twelve listed domicile factors under Regulation §3.3.1.9(C)(4) NMAC (4/29/2005), four factors clearly support the Taxpayer's position, four factors clearly support the Department's position, one factor is arguably of equal weight to both parties, and two other factors are not applicable (one factor, the location of domicile in previous years, is a circular consideration under this fact pattern, as the same questions with respect to TY05 are also present in previous years).

The two factors not particularly applicable to this analysis are (f), the ownership of real property other than the residence, and (d) the home of spouse, children, or dependant parents. The Taxpayer acknowledged that other than her home site lease on the Navajo Nation and her rental property in Gallup, she owned or rented no other property. Additionally, there is no evidence that the Taxpayer has a spouse or any children, and the Taxpayer acknowledged that both of her parents have passed on.

The factor with evidence supporting both Taxpayer and the Department is factor (a), homes or place abode owned or rented by the individual, their location, size and value, and how used by the individual. On the one hand, it is clear that the Taxpayer's home lease site on the

Navajo Nation is the only property that the Taxpayer owns. It is also the property that she intends to return upon retirement. On the other hand, it is clear that in TY05, the Taxpayer was living primarily in her rental property in Gallup, NM. Given the state of the buildings on her home lease site on the Navajo Nation, the evidence established that in TY05 the Taxpayer's rental property in Gallup was larger and in a better livable condition at that time. In fact, based on the testimony of the Taxpayer, it does not sound like the Taxpayer was even in a position to live on her home lease site on the Navajo Nation in TY05 without first undertaking substantial and time-consuming rebuilding of the vandalized structures on that property.

The four factors supporting the Taxpayer are her employment status as a teacher on the Navajo Nation, her community affiliation with the Kinlichee Chapter of the Navajo Nation, her exclusive voter registration on the Navajo Nation, and the possession of materials of sentimental value at the Hogan on her home lease site on the Navajo Nation. It is clear from the evidence that the Taxpayer's maintains her connections with her home community on the Navajo Nation, where she returns frequently for ceremonial and familial purposes (though when she does return for these purposes, she apparently stays with family near Kinlichee rather than at her home lease site). The Taxpayer also is a dedicated teacher for the Navajo Nation, which further shows a commitment to her Navajo community. Although the Department attempted to minimize the importance of the Taxpayer' s cultural connections during closing arguments, the Taxpayer's cultural connections with her native traditions are one factor that do support the Taxpayer's position.

Four factors support the Department's position. First, under factor (b), the Taxpayer spent most of her time in TY05 in Gallup, NM rather than at her home site on the Navajo Nation. The evidence supported that the Taxpayer paid for utilities including water, telephone, and cable

in Gallup during TY05 while not paying for any utilities on her home lease site on the Navajo Nation. The Taxpayer repeatedly emphasized that she only rented a place in Gallup because of the convenience of available housing in Gallup as opposed to the Mariano Lakes area and because of the convenience of commuting from Gallup to her work rather than the substantially greater distance from her home lease site to her work. If the Taxpayer benefits from the conveniences provided in Gallup to the point that she choose to reside there over someplace on the Navajo Nation during TY05, then there is nothing improper about the State requesting that she pay the requisite personal income taxes that support the infrastructure necessary to provide the conveniences that the Taxpayer values.

The next two factors supporting the Department's position, factors (g) and (i), stem from the Taxpayer's own federal income tax filings in TY05. Under factor (g), the location of Taxpayer's financial institutions during TY05, the Taxpayer's tax filings show that she banked with Bank of America, listing her Gallup rental address. Under factor (i), the home address of federal income tax filings, the Taxpayer filed her federal taxes for TY05 listing her address as her rental address in Gallup. Rather than listing either her Navajo Nation home lease site or her Navajo Nation P.O. Box address, Taxpayer voluntarily chose to use her Gallup rental address when filing her Federal income tax returns in TY05. The location in Gallup where the Taxpayer self-reported her address under penalty of perjury with the Federal government goes a long way in determining where the Taxpayer believed she resided during TY05.

Finally, supporting the Department's position is factor (k) given the Taxpayer's driver's license in New Mexico and her registration of numerous vehicles in New Mexico. In fact, the evidence is clear that the Taxpayer actually had her father's former truck towed to New Mexico from her home lease site in the Navajo Nation to Gallup, where she registered it here in New

Mexico. Again, while it is understandable that the Taxpayer wanted to avoid the possibility of vandalism at her home lease site by moving the truck (and all her vehicles) closer to her in Gallup, there is a cost to the State of New Mexico for that convenience of more frequent police patrols/presence that the Taxpayer benefits from in Gallup. New Mexico personal income tax is designed to recoup the costs of providing those conveniences and services to those who primarily benefit—residents of New Mexico.

In conclusion, even considering the domicile factors, the Taxpayer fails to overcome her burden in light of the equal balancing of the factors between the Taxpayer and the Department. Because the Taxpayer did not" live within" the geographic boundaries of the Navajo Nation in TY05, because the Taxpayer was physically present in New Mexico for at least 185-days in TY05, and because the Taxpayer otherwise failed to overcome the presumption of correctness of the assessment using the domicile factors, the Taxpayer was not eligible for exemption of New Mexico income tax in TY05 under NMSA 1978, §7-2-5.5 (1995). Consequently, the Taxpayer is obligated to pay State income tax, penalty, and interest for TY05.

Assessment of Penalty.

In her closing argument, the Taxpayer asked that the penalty be waived because the Taxpayer had no intent to defraud given that a reasonable person could conclude that she was domiciled on the Navajo Nation during TY05. While the Taxpayer's argument references fraud, this case does not involve the imposition of civil penalty for fraud under NMSA Section 7-1-69(D) (2003) nor does it involve any allegations of fraud under NMSA Section 7-1-72 or NMSA Section 7-1-73 (2006).

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 actions or inactions 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, due to her erroneous belief that she qualified for the exemption under NMSA 1978, §7-2-5.5 (1995), Taxpayer did not file and pay the appropriate New Mexico personal income tax for TY05 when due. While certainly not an intentional error or omission, erroneous belief, inadvertent error or inattention meets the legal definition of "civil 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 legally required by statute to impose penalty.

Computation of Penalty.

The Department imposed a civil penalty of 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 to increase a previously reached "not to exceed" limit of 10% by an additional 10% under 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 personal income taxes for TY05 when due on April 15, 2006. Under the old penalty statute in effect at the time of the Taxpayer's failure to file and pay tax when due, the disability for this transaction terminated at a 10% penalty in September 2006, five months after the personal income tax for TY05 were due but not paid. After that date, under the old penalty statute, no further civil penalty could be imposed even though the tax still remained due and unpaid after that date because the penalty had reached its "not to exceed" limit. 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 "not to exceed" 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, in a case closely on point, 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).

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 was 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 required to impose civil penalty in this instance, that civil penalty should not exceed 10% pursuant to NMSA 1978, Section 7-1-69 (2003). The assessment of penalty shall be reduced by 10%.

CONCLUSIONS OF LAW

1. Taxpayer filed a timely, written protest of the Notice of Assessment for 2005 personal income taxes, penalty, and interest issued under Letter No. # L0089824640, and jurisdiction lies over the parties and the subject matter of this protest.

2. Taxpayer failed to demonstrate that she lived within the boundaries of the Navajo Nation in Tax Year 2005, as required in order to claim the applicable exemption under NMSA 1978, §7-2-5.5 (1995).

3. Since the exemption under NMSA 1978, §7-2-5.5 (1995) does not apply, the Taxpayer is liable for personal income tax principal, interest, and penalty in tax year 2005.

4. 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 assessed in excess of the ten percent (10%) should 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 for tax year 2005 in the amount of $306.10.

DATED: August 17, 2011.