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

IN THE MATTER OF THE PROTEST OF
AILEEN & DAVID WONG **No. 13-21**
TO ASSESSMENTS ISSUED UNDER LETTER
ID NO. L0539001664, L1075872576, L0002130752,
L1523809600, L0986938688 and L2060680512

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on August 6, 2013 before Brian VanDenzen, Esq., Tax Hearing Officer, in Santa Fe. Dr. David Wong appeared *pro se*, representing Aileen and David Wong ("Taxpayers"). Staff Attorney Aaron A. Rodriguez appeared representing the State of New Mexico, Taxation and Revenue Department ("Department"). Protest Auditor Milagros Bernardo appeared as a witness for the Department. Department Exhibits E, H, J, and L were admitted into the record, as described in the Administrative Exhibit Log. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On May 9, 2013, the Department assessed Taxpayers $6,096.00 in personal income tax principal, $0.00 in penalty, and $138.58 in interest for a total assessment of $6,234.58 for the reporting period ending December 31, 2011. **[Letter id. no. L0539001664]**

2. On May 9, 2013, the Department assessed Taxpayers $6,016.00 in personal income tax principal, $0.00 in penalty, and $358.65 in interest for a total assessment of $6,374.65 for the reporting period ending December 31, 2010. **[Letter id. no. L1075872576]**.

3. On May 9, 2013, the Department assessed Taxpayers $5,300.00 in personal income tax principal, $0.00 in penalty, and $730.96 in interest for a total assessment of $6,030.96 for the reporting period ending December 31, 2008. **[Letter id. no. L0002130752]**.

4. On May 16, 2013, the Department assessed Taxpayers $5,726.00 in personal income tax principal, $1,145.200.00 in penalty, and $596.60 in interest for a total assessment of $7,467.80 for the reporting period ending December 31, 2009. **[Letter id. no. L1523809600]**.

5. On May 16, 2013, the Department assessed Taxpayers $60.00 in personal income tax principal, $12.00 in penalty, and $3.98 in interest for a total assessment of $75.98 for the reporting period ending December 31, 2010. **[Letter id. no. L0986938688]**.

6. On May 16, 2013, the Department assessed Taxpayers $65.00 in personal income tax principal, $13.00 in penalty, and $2.07 in interest for a total assessment of $80.07 for the reporting period ending December 31, 2011. **[Letter id. no. L2060680512].**

7. On May 31, 2013, Taxpayers filed a written protest of the assessments.

8. On June 14, 2013, the Department acknowledged receipt of Taxpayers' protest.

9. On June 22, 2013, Taxpayers timely filed an amended protest email with Department Protest Auditor Milagros Bernardo. In that amended protest, Taxpayers withdrew their protest with respect to assessed personal income tax principal under each assessment, but continued to protest the imposition of penalty and interest. **[Department Ex. J]**.

10. On July 16, 2013, the Department requested a hearing in this matter.

11. On July 17, 2013, the Hearing Bureau issued Notice of Administrative Hearing, scheduling this matter for August 6, 2013.

12. During the relevant period, Dr. Wong worked in New Mexico as an active officer for the Public Health Service ("PHS"). **[Department Ex. J]**.

13. PHS is part of the United States military's Uniformed Services. **[Department Ex. J]**.

14. Based on informal statements and advice of Dr. Wong's colleagues, when filing their personal income tax returns, Taxpayers claimed an exemption from income tax for Dr. Wong's wages earned while employed as an active officer with PHS in personal income tax years 2008, 2009, 2010, and 2011. **[08-06-13 CD 14:44-15:03].**

15. Taxpayers did not consult with an accountant or an attorney before submitting their 2008 through 2011 personal income tax returns. [**08-06-13 CD 14:31-44**].

16. In 2008 through 2011, the Department's "Instructions for PIT-ADJ Schedule of Additions and Deductions/Exemptions" stated that pay from members of "active duty military service in the armed forces of the United States" may be listed on line 15 of the PIT-ADJ and may be exempted from state income tax. The Department's instructions further indicated that "armed forces" includes the Army, Navy, Air Force, Marine Corps, and Coast Guard. **[Department Ex. E-8]**.

17. In addition to the instruction identified in **FOF #16**, in its "Instructions for 2011 PIT-ADJ Schedule of Additions and Deductions/Exemptions" the Department added an express instruction that the "[p]ay, wages or salaries paid by the U.S. Public Health Services does not qualify for the exemption." **[Department Ex. H-8]**.

18. On June 20, 2013, Taxpayers paid the assessed personal income tax under the assessments, stopping further interest accrual. **[Department Ex. J**; **08-06-13 CD 21:34-22:26]**.

19. As of June 20, 2013, Taxpayers still owed $1,919.26 in interest and $1,170.20 in penalty under the assessments. **[Department Ex. L]**.

DISCUSSION

The case originates from Taxpayers' claim for exemption of personal income taxes on Dr. Wong's wages from PHS under NMSA 1978, Section 7-2-5.11 (2007) in tax years 2008, 2009, 2010, and 2011. Upon audit, the Department denied Taxpayers' claimed exemption and accordingly assessed Taxpayers for personal income taxes, penalty and interest. Taxpayers protested those assessments. Taxpayers eventually amended their protest, agreeing they were liable for personal income tax principal in each assessed year, but continuing to challenge the assessed penalty and interest.

Under NMSA 1978, Section 7-1-17(C) (2007), the assessments issued in this case are presumed correct. Consequently, Taxpayers have the burden to overcome the assessments. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428, 431. Moreover, "[w]here 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 and Revenue Department*, 1991-NMCA-024, ¶16, 111 N.M. 735, 740 (internal citation omitted); *See also TPL, Inc. v. N.M. Taxation & Revenue Dep't*, 2003-NMSC-7, ¶9, 133 N.M. 447, 451.

While Taxpayers conceded they were liable for the assessed personal income tax principal in each assessment, the substance of the exemption under Section 7-2-5.11 is still relevant because it provides context to the analysis of the civil negligence penalty issue. Under Section 7-2-5.11, "[a] salary paid by the United States to a taxpayer for active duty service in the *armed forces of the United States* is exempt from state income taxation." (emphasis added).

Federal law provides a definition for "armed forces of the United States." Under 10 U.S.C. § 101(a)(4) (2013) "armed forces" means "the Army, Navy, Air Force, Marine Corps, and Coast Guard." PHS members are not included in the federal definition of armed forces. In fact, Congress distinctly lists members of the armed forces, commissioned corps members of NOAA, and commissioned corps members of PHS in its definition of the broader "uniformed services." By not including PHS in the list of "armed forces" and separately listing armed forces from PHS in the definition of "uniformed services," it is clear that Congress did not intend PHS to be considered armed forces.

Consistent with this federal definition of "armed forces," in all of its "Instructions for PIT-ADJ Schedule of Additions and Deductions/Exemptions" for the relevant period, the Department informed taxpayers that armed forces included the Army, Navy, Air Force, Marine Corps, and Coast Guard. In 2011, the Department expressly added that members of PHS do not qualify for the exemption to its PIT-ADJ Schedule instructions. However, even before 2011, the language of the statute, the federal definition of armed forces, and the Department's accompanying instructions to the PIT-ADJ Schedule made it clear that only members of the armed forces—the Army, Navy, Air Force, Marine Corps, and Coast Guard—were eligible for the exemption. While there is no doubt that Dr. Wong and other members of PHS provide a valuable public service, the New Mexico Legislature choose to limit the exemption from income tax under Section 7-2-5.11 to members of the armed forces rather than include all members of the uniformed services. Thus, the wages any taxpayer earned from PHS were not entitled to a exemption under Section 7-2-5.11. Hence, Taxpayers rightfully conceded that they were not entitled to an exemption under Section 7-2-5.11 for Dr. Wong's PHS wages and thus liable for the assessed personal income tax principal on those wages during the relevant period.

Taxpayers nevertheless argued that they should not be held liable for penalty and interest in this matter because they claimed it was unreasonable for the Department to not communicate with members of the PHS that they did not qualify for the exemption under Section 7-2-5.11 when it became clear that PHS members were claiming that exemption. By failing to communicate that PHS members were not entitled to the exemption, Taxpayers argued that the Department did not meet the same "ordinary business care and prudence" standard that the public is held to under Regulation 3.1.11.10 NMAC, and therefore penalty and interest should be abated.

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, § 7-1-67 (2007) (italics for emphasis). Under the statute, regardless of the reason for non-payment of the tax, the Department has no discretion in the imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24, 32 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary). 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 Department has no discretion under Section 7-1-67 and must assess interest against Taxpayers from the time the personal income tax was due but not paid until when Taxpayers paid the tax on June 20, 2013.

When a taxpayer fails to pay taxes due to the State because of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, NMSA 1978 Section 7-1-69 (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 twenty percent of the tax due but not paid.

(*italics* added for emphasis).

As discussed above, 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 like here, Taxpayers actions or inactions were unintentional.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, NMSA 1978 Section 7-1-69 (B) (2003) provides a limited exception: "No penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." Further, under Regulation 3.1.11.11 NMAC, there are several situations where a taxpayer can show nonnegligence, none of which were demonstrated in this protest.

Regulation 3.1.11.10 NMAC 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."

Although Taxpayers argue that the Department should be held to this same ordinary business case care and prudence standard articulated under Regulation 3.1.11.10 (A) NMAC, there is no statute, regulation, or case law that applies this same standard to the Department. Perhaps this is because under New Mexico's self-reporting tax system, "every person is charged with the reasonable duty to ascertain the possible tax consequences" of his or her actions. *Tiffany Construction Co. v. Bureau of Revenue*, 1976-NMCA-127, ¶5, 90 N.M. 16, 17. While the

Department should provide guidance (which it in fact did in this case in the form of the PIT-ADJ Schedule instructions), ultimately under the rationale expressed in *Tiffany Construction Co.*, Taxpayers have a reasonable duty to report accurately their tax liabilities. This reasonable duty might require the person to consult with a qualified tax professional. *See id*. Under *Tiffany Construction Co*., failure to do reasonable research into what the tax law requires or to meet with a qualified tax professional "may constitute negligence." *Id.*

While Taxpayers argued that the Department should have provided more information to PHS that PHS commissioned corps were not eligible for the exemption, the Department's instructions throughout the relevant period clearly spelled out that only members of the Army, Air Force, Marine Corps, Navy, and Coast Guard qualified for the exemption. By omission from the list, it is reasonably clear that PHS members are not eligible for the exemption. The fact that in 2011 the Department added a specific provision that PHS members are not entitled to an exemption under Section 7-2-5.11 does not alter the analysis in this case because the previous instructions in no way suggested, either expressly or implicitly, that PHS members might qualify for the exemption. Ultimately, Taxpayers themselves had an obligation under *Tiffany Construction Co.* to conduct their own research about the requirements of the law or consult with a tax professional.

Considering that *Wing Pawn Shop*, ¶16, 740, places the onus on taxpayers to clearly establish they were entitled to exemption from taxation, the absence of PHS from that list on the instructions would cause a reasonable taxpayer acting with ordinary business care and prudence to contact a qualified tax professional before claiming the exemption. Given the unambiguous language of the statute, the federal definitions of armed forces, and the Department's instructions, a tax professional would have been able to determine quickly that PHS members were not entitled to

the exemption. Taxpayers did not consult with a tax professional before claiming an exemption from personal income tax on Dr. Wong's wages. Instead, Dr. Wong acknowledged that he relied on the representations of his colleagues at PHS that his wages were exempt under Section 7-2-5.11 rather than conducting his own independent research or consulting with a qualified tax professional.

Without doing any independent research into the requirements of the exemption, it cannot be said under Section 7-1-69 (B) that Taxpayers' error resulted from a mistake of law made in good faith. Moreover, by failing to independently research the requirements of the exemption, Taxpayers relied on an erroneous belief that they were entitled to the exemption. An erroneous belief constitutes civil negligence under Regulation 3.1.11.10 (C) NMAC. Finally, by not consulting with a qualified tax professional about the exemption, Taxpayers were negligent under Regulation 3.1.11.10 (A) NMAC and under the rationale discussed in *Tiffany Construction Co*., ¶5, 17. Consequently, Taxpayers are liable for the assessed penalty and interest. Taxpayers' protest is denied.

CONCLUSIONS OF LAW

A. Taxpayers filed a timely, written protest to the assessments. Jurisdiction lies over the parties and the subject matter of this protest.

B. Taxpayers, in filing an amended protest, conceded that they were not entitled to an exemption of personal income tax under Section 7-2-5.11 for Dr. Wong's wages earned while on active duty with PHS.

C. Under NMSA 1978, Section 7-1-67 (2007), Taxpayers are liable for accrued interest under the assessments.

D. Under Regulation 3.1.11.10 (C) NMAC, Taxpayers' erroneous belief was negligent. Given the unambiguous language of the statute, the federal definition of armed forces, and the Department's instructions, Taxpayers' failure to consult with a qualified tax professional in this matter constituted negligence under Regulation 3.1.11.10 (A) NMAC and under *Tiffany Construction Co*., ¶5, 17. Thus, Taxpayers are liable for civil penalty pursuant to Section 7-1-69 (2007).

For the foregoing reasons, Taxpayers' protest **IS DENIED.** Taxpayers owe $1,919.26 in interest and $1,170.20 in penalty for a total outstanding liability of $3,089.46.

DATED: August 13, 2013.

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