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

IN THE MATTER OF THE PROTEST OF
TUILIAN BROWN & DEBORAH YELLOWHORSE **No. 14-13**
TO ASSESSMENTS ISSUED UNDER LETTER
ID NOs. L0211359184 and L2013390288

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on March 17, 2014 at 2:00 p.m. before Brian VanDenzen, Esq., Hearing Officer, in Santa Fe. Tuillian Brown appeared *pro se* for Tuillian Brown and Deborah Yellowhorse ("Taxpayers"). Staff Attorney Elena Morgan appeared representing the State of New Mexico, Taxation and Revenue Department ("Department"). Protest Auditor Milagros Bernardo appeared as a witness for the Department. Taxpayers' Exhibits 1-4 and Department Exhibits A, D, and E 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 January 3, 2014, the Department assessed Taxpayers $4,247.00 in personal income tax principal, $0.00 in penalty, and $330.68 in interest for a total assessment of $4,577.68 for the reporting period ending December 31, 2010. **[Letter id. no. L2013390288]**

2. On January 10, 2014, the Department assessed Taxpayers $3,662.00 in personal income tax principal, $732.40 in penalty, and $189.11 in interest for a total assessment of $4,583.51 for the reporting period ending December 31, 2011. **[Letter id. no. L0211359184]**.

3. On January 27, 2014, Taxpayers timely protested both assessments.

4. On February 27, 2014, the Department requested a hearing in this matter.

5. On February 28, 2014, the Hearings Bureau issued Notice of Administrative Hearing, scheduling this matter for March 17, 2014.

6. Taxpayers Tuillian Brown and Deborah Yellowhorse are married and filed their taxes jointly in 2010 and 2011.

7. During the relevant period, Deborah Yellowhorse was an active duty officer for the Public Health Service ("PHS"). [**Taxpayers Ex. #3**].

8. Taxpayers used Shirley's Tax Service, Shirley Hutchison, in Gallup to assist with preparing and filing their 2010 and 2011 tax returns. [**Taxpayers Ex. #2**].

9. In preparing and filing their 2010 and 2011 New Mexico Personal Income Tax returns with the assistance of Shirley Hutchison, Taxpayers claimed an exemption from income tax of Deborah Yellowhorse's wages from PHS.

10. Shirley Hutchison advised Taxpayers that Debra Yellowhorse's PHS income was deductable. [**Taxpayers Ex. #2**].

11. Shirley Hutchison is not registered with the State of New Mexico as a certified public accountant or registered public accountant. [**Department Ex. D**].

12. Ms. Yellowhorse incorrectly believed that Ms. Hutchison was a CPA.

13. Ms. Yellowhorse had used Shirley's Tax Service to prepare her taxes before her marriage to Mr. Brown.

14. Once married, based on Ms. Yellowhorse's previous practice, Taxpayers continued to use Shirley's Tax Service. Mr. Brown trusted Ms. Yellowhorse's previous use of Ms. Hutchison and made no independent inquiry about Ms. Hutchison's credentials.

15. The evidence is insufficient to find that Shirley Hutchison was a competent tax accountant.

16. In 2010, 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. A-1]**.

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. A-2]**.

18. Although the Department did not initially assess penalty for the personal income tax year ending on December 31, 2010 on its formal Notice of Assessment, letter id. no. L2013390288, the Department did list a penalty charge of $254.82 on its spreadsheet of liabilities as of the date of hearing, **Department Ex. E**. It is unclear how the Department calculated its penalty charge of $254.82 because that number does not equate to the 20% maximum penalty required under the relevant statute.

19. As of the date of hearing, for the personal income tax year ending on December 31, 2010, Taxpayers owed $4,247.00 in personal income tax, 20% civil penalty, and $358.61 in interest. **[Department Ex. E]**.

20. As of the date of hearing, for the personal income tax year ending on December 31, 2011, Taxpayers owed $3,662.00 in personal income tax, $732.40 in civil penalty, and $358.61 in interest. **[Department Ex. E]**.

DISCUSSION

There are two issues at protest. The first issue is whether Taxpayers were entitled to an exemption of Ms. Yellowhorse's PHS wage income in 2010 and 2011 under the NMSA 1978, Section 7-2-5.11 (2007) exemption for armed forces salaries. The second issue is whether Taxpayers are entitled to an abatement of assessed interest and penalty because they relied on the advice of Shirley Hutchison in claiming the Section 7-2-5.11 exemption from personal income taxation of Ms. Yellowhorse's PHS wages in 2010 and 2011.

Under NMSA 1978, Section 7-1-17(C) (2007), the assessments of tax issued in this case are presumed correct. Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, §7-1-3 (X) (2013).Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department's assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight). 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 did not continue to argue at hearing that Ms. Yellowhorse's PHS wages were exempt, the requirements of Section 7-2-5.11 still must be addressed both because that issue was identified in the protest letter and because the substantive requirements of the exemption provide 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 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 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. Consequently, Ms. Yellowhorse's income earned from PHS was not entitled to the exemption under Section 7-2-5.11 and Taxpayers are liable for the assessed tax.

Taxpayers nevertheless argued that they should not be held liable for penalty and interest in this matter because they relied on the tax preparation services and advice of Shirley Hutchison, Shirley's Tax Service, to claim the exemption under Section 7-2-5.11.

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 the tax principal liability is satisfied regardless of Ms. Hutchison's erroneous advice.

Turning to penalty, while the Department did assess civil penalty for the income tax period ending on December 31, 2011, the Department did not initially assess penalty on

Taxpayers under its formal Notice of Assessment for the personal income tax period ending on December 31, 2010. However, at hearing the Department sought to impose penalty for that year in **Department Ex. E**, an update of Taxpayers' liabilities as of the date of hearing. NMSA 1978, Section 7-1-30 allows the Department to collect "any amount of civil penalty… in the same manner as, and concurrently with, the amount of tax which it relates, without assessment or separate proceedings of any kind." Although the undersigned hearing officer has some concerns about the effectiveness of the Department's notice of 2010 as an issue at hearing, Taxpayers were given an opportunity to review the Department's exhibit and Taxpayers did not make any arguments regarding the notice of penalty in 2010. Moreover, Taxpayers were on notice that civil penalty was an issue at hearing given that the Notice of Assessment for the 2011 personal income tax year contained an assessment of civil penalty. Limited to the facts of this case involving the imposition of standard civil negligence penalty in one year where it was not formally assessed but Taxpayers had notice that it was at issue in another assessed year, Section 7-1-30 allowed the Department to seek collection of penalty during the protest hearing.[1]

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).

[1] Since civil penalty was not formally assessed for the 2010 personal income tax year, the Department is not entitled to the presumption of correctness under Section 7-1-17 (C) for civil penalty in that year.

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.

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." In this case, Taxpayers were negligent under Regulation 3.1.11.10 (B) & (C) NMAC in both 2010 and 2011 because of their inaction in failing to pay the full personal income tax when due and because of their erroneous belief that Ms. Yellowhorse's PHS income was exempt from personal income tax under the exemption.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception: "[n]o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." Further, in relevant part to this protest, Regulation 3.1.11.11 (D) NMAC (emphasis added) allows for abatement of penalty when a "taxpayer *proves* that the failure to pay a tax… was caused by *reasonable reliance* on the advice of *competent* tax counsel or *accountant* as to the taxpayer's liability after full disclosure of all relevant facts." Black's Law Dictionary, 22 (9th ed. 2009), defines "accountant" as "a person authorized under applicable law to practice public accounting."

Here, there is little doubt that Taxpayers relied on the advice of Shirley Hutchison of Shirley's Tax Service to erroneously claim the exemption under Section 7-2-5.11. [**Taxpayers Ex. #'s 1 & 2**]. However, there is very little evidence that Ms. Hutchison was a competent

accountant. Although Deborah Yellowhorse apparently believed that Ms. Hutchison was a CPA based on her letter of March 12, 2014, Ms. Hutchison is not listed as a CPA (or other licensed accounting professional) by the State of New Mexico Regulation and Licensing Department. [**Department Ex. D**]. Nor does Ms. Hutchison identify herself as a CPA on her letterhead or the signature line of her letter to the Department. [**Taxpayers Ex. #2**]. Ms. Hutchison did not appear to testify, and her letter admitted into the record as **Taxpayers Ex. #2** is silent as to her credentials. Mr. Brown made no separate inquiry into Ms. Hutchison's credentials and simply assumed she was qualified based on Ms. Yellowshorse's previous use of Ms. Hutchison. The fact that Ms. Yellowhorse assumed Ms. Hutchison was a CPA when Ms. Hutchison was not in fact a CPA or other licensed accountant demonstrates that Ms. Yellowhorse did not exercise much diligence in determining Ms. Hutchison's credentials and competency. Because tax preparers are not a licensed or regulated industry in New Mexico, without more specific information about Ms. Hutchison's particular credentials, there is insufficient evidence on this record to make a competency determination.

Taxpayers cannot prove that it was "reasonable" for them to rely on the advice of Ms. Hutchison or that Ms. Hutchison was a competent tax accountant when they were unaware of her credentials. 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. Generally, a taxpayer cannot "abdicate this responsibility merely by appointing an accountant as its agent in tax matters." *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶14, 108 N.M. 795. This is particularly true when a taxpayer is without a reasonable basis to determine that the accountant selected is competent.

Although Decisions and Orders of the Hearings Bureau are not precedential, one previous Decision and Order of the Hearings Bureau is highly persuasive in this matter given its similar facts. *In the Matter of the Protest of Red Mesa Construction*, No. 03-03, the taxpayer had no knowledge about the qualifications of the accounting service it used but assumed that the accounting service was competent simply because the accounting service held itself out as a tax preparer. In rejecting that taxpayer's claim for abatement of civil negligence penalty in that matter, Hearing Officer Margaret Alcock stated that "[a] taxpayer's reliance on a tax professional must be active and informed—not passive and unaware—in order to support a finding that the taxpayer's failure to pay tax was not negligent…" In other words, without actively learning of the person's base of competency, a taxpayer cannot determine whether the person is "competent" or whether it is "reasonable" to rely on the advice of that person for the purposes of Regulation 3.1.11.11 (D) NMAC.

That logic extends to the facts of this protest: without some active consideration of Ms. Hutchison's qualifications and competency, it was not "reasonable" for Taxpayers to rely exclusively on her advice in claiming the exemption at issue, particularly because of the plain contrary language of the statutory exemption and the Department's instructions. Therefore, Regulation 3.1.11.11 (D) NMAC does not provide a basis to abate penalty in this matter. Moreover, without evidence of a detailed consultation with Ms. Hutchison about her credentials and her knowledge basis of the applicability of the exemption given the clear contradictory nature of the Department's instructions, Taxpayers did not demonstrate that they made a mistake of law in good faith and on reasonable grounds under Section 7-1-69 (B). *See C & D Trailer Sales v. Taxation and Revenue Dep't*, 1979-NMCA-151, ¶8-9, 93 N.M. 697 (penalty upheld where there was no evidence that the taxpayer "relied on any informed consultation" in deciding not to pay

tax). Given the plain language of the statutory exemption and the Department's instructions limiting the exemption to the Army, Navy, Air Force, Marine Corps, and Coast Guard, there is no good faith basis on reasonable grounds pursuant to Section 7-1-69 (B) to conclude that PHS' wages are exempted under Section 7-2-5.11.

The Department's spreadsheet of liabilities as of the date of hearing, **Department Ex. E**, under calculated the amount of civil penalty below the maximum 20% limit required by Section 7-1-69 for tax year 2010. The Department should recalculate the amount of penalty in accord with the provisions of Section 7-1-69. Taxpayers are liable for the assessed tax principal, recalculated 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 were not entitled to claim an exemption of Ms. Yellowhorse's PHS income because the Section 7-2-5.11 exemption only applies to members of active duty armed services. Under federal law, 10 U.S.C. § 101(a)(4) (2013), active duty armed services means only the Army, Navy, Air Force, Marine Corps, and Coast Guard.

C. Under Section 7-1-67, Taxpayers are liable for accrued interest under the assessments.

D. Although the Department did not formally assess Taxpayers for civil penalty for the personal income tax reporting period ending on December 31, 2010 before hearing, under Section 7-1-30 the Department can collect civil penalty concurrently with the collection of an amount of tax to which it relates without an assessment or separate proceeding. Taxpayers were on notice that civil penalty was an issue at hearing given the assessment for 2011 personal income tax penalty.

E. Under Regulation 3.1.11.10 NMAC, Taxpayers' inaction in not paying income tax on Ms. Yellowhorse's PHS income and Taxpayers' erroneous belief that Ms. Yellowhorse's PHS's income was exempt from personal income tax was negligent for the purposes of Section 7-1-69.

F. Taxpayers did not prove that they reasonably relied on the advice of a competent tax accountant. Consequently, Regulation 3.1.11.11 (D) NMAC does not provide a basis to abate penalty in this matter under the assessment of 2011 personal income tax.

G. Without more specific evidence about their consultation with Ms. Hutchison, her credentials, and the basis for her conclusion why the exemption applied despite the clear language of the statute and the Department's instructions, Taxpayers did not show that they failed to pay the tax as a result of a mistake of law made in good faith and on reasonable grounds under Section 7-1-69 (B).

For the foregoing reasons, Taxpayers' protest **IS DENIED.** The Department's spreadsheet of liabilities as of the date of hearing, **Department Ex. E**, under calculated the amount of civil penalty below the maximum 20% limit required by Section 7-1-69 for tax year 2010. The Department must recalculate the amount of penalty in 2010 in accord with the provisions of Section 7-1-69 and provide Taxpayers with an updated total outstanding liability for both 2010 and 2011 personal income tax years. Interest continues to accrue under Section 7-1-67 until tax principal is satisfied.

DATED: April 17, 2014.

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