

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

**IN THE MATTER OF THE PROTEST OF
SHARON RAY
TO ASSESSMENTS ISSUED UNDER LETTER
ID NOS. L1882541008, L0137710544, L1211452368 and L0674581456**

No. 15-14

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on March 31, 2015, before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Frank Crociata, attorney for the Department. Danny Pogan, audit supervisor, appeared and testified as a witness for the Department. Sharon Ray (“Taxpayer”) appeared and testified. Her husband, Ritchie Ray, appeared as a witness. The Exhibits introduced into the record are Exhibits 1-4 and A. Based on the evidence and arguments presented, **IT IS DECIDED AND ORDERED AS FOLLOWS:**

FINDINGS OF FACT

1. On September 2, 2014, the Department issued four gross receipts tax assessments against Taxpayer: 1) in the amount of \$532.75 in principal, \$106.55 in penalty, and \$110.53 in interest for the tax year of January 1, 2008 through December 31, 2008 [**Letter Id. No. L1882541008**]; 2) in the amount of \$188.15 in principal, \$37.63 in penalty, and \$30.43 in interest for the tax year of January 1, 2009 through December 31, 2009 [**Letter Id. No. L0137710544**]; 3) in the amount of \$172.20 in principal, \$34.44 in penalty, and \$21.00 in interest for the tax year of January 1, 2010 through December 31, 2010 [**Letter Id. No. L1211452368**]; and 4) in the amount of \$71.96 in principal, \$14.40 in penalty, and \$6.19 in interest for the tax year of January 1, 2011

through December 31, 2011. [**Letter Id. No. L0674581456**].

2. Taxpayer was audited through the Department's Schedule C mismatch program whereby the Internal Revenue Service provides computer records of Schedule C returns which are compared to the Department's gross receipts tax program. [**Exhibit 4**].

3. Taxpayer filed a protest to the assessments on October 22, 2014.

4. The Department acknowledged the protest on October 27, 2014. [**Letter Id. No. L1882979280**].

5. On December 11, 2014, the Department requested a hearing in this matter.

6. On December 12, 2014, the Hearings Bureau mailed a Notice of Administrative Hearing setting the hearing for January 12, 2015. Taxpayer requested a continuance on January 2, 2015 and amended the request on January 6, 2015.

7. The Hearings Bureau issued a Continuance Order and Amended Notice of Administrative Hearing on January 12, 2015 setting the hearing for March 31, 2015.

8. Taxpayer was not registered to do business in New Mexico for the tax years at issue. [**Exhibit 4**].

9. Taxpayer failed to file gross receipts returns for the tax years at issue. [**Exhibit 4**].

10. During the tax years at issue, Taxpayer was an associate for Usana Health Sciences ("Usana"). [03-31-15 CD 09:10-09:15].

11. Usana is a "down the line" sales organization. Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 11 (January 2015).

12. Usana offers its products to customers through a process it calls "direct selling." Usana Health Sciences (April 2015) <https://www.usana.com/dotCom/opportunity/directselling>.

13. "Direct selling," according to Usana's website is the "distribution method

employed ... where products are sold person-to-person, away from a fixed retail location.” Usana Health Sciences (April 2015) <https://www.usana.com/dotCom/opportunity/directselling>.

14. Usana is located at 838 West Parkway Blvd., Salt Lake City, Utah 84120.

[Exhibits 1-3]; Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 1 (January 2015).

15. Usana manufactures and sells nutritional and personal care products. Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015).

16. Usana describes its associates as “Our customer base comprises two types of customers: "Associates" and "Preferred Customers." Associates share in our company vision by acting as independent distributors of our products in addition to purchasing our products for their personal use. Preferred Customers purchase our products strictly for personal use and are not permitted to resell or to distribute the products.” Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015).

17. Usana associates earn compensation in four ways:

- *Commissions*. “The primary way an Associate is compensated is through earning commissions. Associates earn commissions through generating sales volume points, which are a measure of the product sales of their down-line sales organization. Sales volume points are assigned to each of our products and comprise a certain percent of the product price in U.S. dollars. To be eligible to earn commissions, an Associate must sell a certain amount of product each month ("Qualifying Sales"). Qualifying Sales may include product that the Associates use personally or that they resell to consumers. Associates do not earn commissions on these Qualifying Sales. Associates may earn commissions on their sale of products above the Qualifying Sales as well as the sale of products by Associates in their down-line organization and to Preferred Customers. Additionally, Associates do not earn commissions for simply recruiting and enrolling others in their down-line organization. Commissions are paid only when products are sold. We pay Associate commissions on a weekly basis.”
- *Bonuses*. “We offer Associates several bonus opportunities, including our leadership bonus, elite bonus, and lifetime matching bonus. These bonus opportunities are based on a pay-for-performance philosophy and, therefore, are paid out when the Associate achieves the required performance measures.”
- *Retail Mark-Ups*. “As discussed previously, in markets where retail mark-ups are

permitted, our Associates purchase products from us at the Preferred Price and may resell them to consumers at higher retail prices. In this case, the Associate retains the retail mark-up as another form of compensation.”

- *Contests and Promotions.* “We periodically sponsor contests and promotions designed to incentivize Associates to generate sales, grow their down-line organization, and increase product users. These promotions are also based on a pay-for-performance philosophy and, therefore, are only paid upon the achievement of the promotion objectives.”

Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015).

18. Taxpayer claimed that she was not a distributor for Usana. [03-31-15 CD 13:49-13:54].

19. Taxpayer testified that she received compensation from Usana when she recruited and enrolled New Mexico customers and if the customers purchased products. Taxpayer testified that she would receive 10% of the product amount. [03-31-15 CD 10:50-11:45, 13:02-13:45].

20. After the customer was recruited, the New Mexico customer would place their order on-line and provide Taxpayer’s associate’s identification number on the order form. [03-31-15 CD 13:05-13:41].

21. The Usana products were shipped directly to the customer in New Mexico. [03-31-15 CD 13:54-14:12].

22. Taxpayer’s testimony is not entirely consistent with Usana’s public information describing the four ways that an associate may be compensated.

23. Taxpayer received commissions from Usana. Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015).

24. Taxpayer may not have entirely understood the basis for her compensation from Usana.

25. Taxpayer testified that she did not receive any products to sell for Usana. [03-31-

15 CD 13:12-13:15].

26. Usana issued Taxpayer a 1099 for tax years 2008, 2009, 2010 and 2011. **[Exhibits 1-3].¹**

27. The amount of miscellaneous income reported on the 1099 from Usana was:

2008	\$3,650.00
2009	\$2,950.00
2010	\$2,700.00
2011	\$1,100.00

[Exhibits 1-4].

28. For tax year 2008, Taxpayer had additional income of \$4,703.00 reported on her Federal Schedule C return other than the Usana 1099 income. **[Exhibit 4].**

29. Taxpayer did not protest the gross receipts tax on the \$4,703.00 income.

30. On May 16, 2014, the Department issued Taxpayer a Notice of Limited Scope Audit Commencement-Gross Receipts letter. **[Exhibit 4].**

31. Taxpayer employed Julia C. Adams, CPA to prepare her income tax returns. **[03-31-15 CD 09:22].**

32. Taxpayer testified that Ms. Adams did not advise her to register and file gross receipts returns. **[03-31-15 CD 14:15-15:00].**

DISCUSSION

The sole issue to be determined is whether the Department properly assessed Taxpayer for gross receipts tax, penalty and interest for the tax years January 1, 2008 through December 31,

¹ Taxpayer did not have a copy of her 1099 for tax year 2008 but she did not dispute the amount listed for 2008 on the Notice of Limited Scope Audit.

2011 for her commissions. Taxpayer argued that she did not receive commissions. In addition Taxpayer requested that the penalty be forgiven because she was unaware.

Burden of Proof and Standard of Review.

Section 7-1-17(C) provides that any assessment of taxes made by the Department is presumed to be correct. NMSA 1978, §7-1-17(C) (2007). Accordingly, it is Taxpayer's burden to present evidence and legal argument to show that she is entitled to an abatement, in full or in part, of the assessment issued against her. *See, Carlsberg Management Co. v. State, Taxation and Revenue Dep't.*, 1993-NMCA-121, 116 N.M. 247. In addition, all receipts of a person engaging in business are presumed to be subject to the gross receipts tax pursuant to NMSA 1978, Section 7-9-5(A) (2002).

Gross Receipts.

Generally speaking, goods sold or services performed within the State of New Mexico are taxable. The term "gross receipts" is broadly defined in Section 7-9-3.5(A)(1):

- (1) "gross receipts" means the total amount of money or the value of other consideration received from selling property in New Mexico, from leasing or licensing property employed in New Mexico, from granting a right to use a franchise employed in New Mexico, from selling services performed outside New Mexico, the product of which is initially used in New Mexico, or from performing services in New Mexico. In an exchange in which the money or other consideration received does not represent the value of the property or services exchanged, "gross receipts" means the reasonable value of the property or services exchanged;"

NMSA 1978, §7-9-3.5(A)(1) (2007). The Gross Receipts and Compensating Tax Act, specifically Section 7-9-3(M), defines "service" as "all activities ... which activities involve predominately the performance of a service as distinguished from selling or leasing property." NMSA 1978, §7-9-3(M) (2007).

There are also two applicable regulations that provide that commissions are gross receipts.

They are Regulation 3.2.1.14(HH)(4) NMAC which provides that:

Commissions and other consideration received by an independent contractor from performing a sales service in New Mexico with respect to a service to be performed by other persons are gross receipts whether or not the other person reports and pays gross receipts tax with respect to the receipts from the performance of the underlying service. This situation involves two transactions. The first is the performance of the underlying service by the other person for the customer and the second is the performance of the sales service by the independent contractor for the performer of the underlying service. The receipts from the performance of the underlying service for the customer are gross receipts of the person performing that service. Receipts, whether in the form of commissions or other remuneration, of the person performing the sales service are gross receipts of the person performing the sales service.

In addition Regulation 3.2.105.10 NMAC provides that “receipts from commissions paid to such salesperson for selling property in New Mexico are subject to the gross receipts tax.” The Department stated that Regulation 3.2.1.14(HH) (3) applies to the case at hand which provides that independent contractors for a multi-level sales company with presence in New Mexico who receive commissions, that those commissions are gross receipts. However, there is no evidence of whether Usana has presence in New Mexico.

During the tax years at issue, Taxpayer was an associate for Usana, a “down the line” sales organization. Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 11 (January 2015).² Usana manufactures and sells nutritional and personal care products. Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015). Taxpayer offered Usana products to New Mexico customers through a process Usana calls “direct selling.” Usana Health Sciences (April 2015)

² The Hearing Officer takes administrative notice of Usana’s Annual Report, which is a public document, pursuant to Regulation 3.1.8.10(C).

<https://www.usana.com/dotCom/opportunity/directselling>.³ “Direct selling,” according to Usana’s website is the “distribution method employed ... where products are sold person-to-person, away from a fixed retail location.” Usana Health Sciences (April 2015)

<https://www.usana.com/dotCom/opportunity/directselling>. According to Usana’s website, an associate is a “distributor.” Usana Health Sciences (April 2015)

<https://www.usana.com/dotCom/opportunity/directselling>. Taxpayer testified that she was paid when she recruited New Mexico customers and if the customers purchased products. After the customer was recruited, the New Mexico customer would place their order on-line and provide Taxpayer’s associate’s identification number on the order form. **[03-31-15 CD 13:05-13:41]**.

Taxpayer testified that she would receive 10% of the product amount. **[03-31-15 CD 10:50-11:45, 13:02-13:45]**. The Usana products were shipped directly to the customer in New Mexico. **[03-31-15 CD 13:54-14:12]**.

According to Usana’s Annual Report, associates earned compensation in four ways (commissions, bonuses, retail mark-ups, and contests and promotions) from Usana. Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015). According to Usana’s Annual Report, associates received “commissions.” Usana Health Sciences, Inc., *Annual Report-Form 10-K*, at 3 (January 2015). The Annual Report states that, “The primary way an Associate is compensated is through earning commissions. Associates earn commissions through generating sales volume points, which are a measure of the product sales of their down-line sales organization. Sales volume points are assigned to each of our products and comprise a certain percent of the product price in U.S. dollars. To be eligible to earn commissions, an Associate must sell a certain amount of product each month ("Qualifying Sales"). Qualifying Sales may

³The Hearing Officer takes administrative notice of Usana’s website, pursuant to Regulation 3.1.8.10(C).

include product that the Associates use personally or that they resell to consumers. Associates do not earn commissions on these Qualifying Sales. Associates may earn commissions on their sale of products above the Qualifying Sales as well as the sale of products by Associates in their down-line organization and to Preferred Customers. Additionally, Associates do not earn commissions for simply recruiting and enrolling others in their down-line organization. Commissions are paid only when products are sold. We pay Associate commissions on a weekly basis.”

Taxpayer performed a service for Usana in New Mexico; namely recruiting and enrolling customers and selling the customers Usana products. Taxpayer argued that the products were delivered from outside New Mexico. It is not relevant that the products were delivered from outside of New Mexico. Taxpayer earned a commission on the sales volume points which were created when Taxpayer recruited and enrolled New Mexico customers and the customers purchased Usana products. Therefore, the commissions received by Taxpayer from Usana are gross receipts and taxable. Again, since Taxpayer did not protest the gross receipts tax on the \$4,703.00 income, this amount is also taxable.

Civil Penalty.

Civil penalty is imposed when a taxpayer is “negligent” or disregards the Department’s rules and regulations in not filing a return or paying tax when it is due. Section 7-1-69(A)(1) states that:

(e)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;

(Emphasis added). NMSA 1978, Section 7-1-69(A)(1) (2007). The Department's regulation provides that, "negligence" includes "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances; inaction by taxpayers where action is required; inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention" for either failing to file a return on time or failing to make a payment on time. Regulation 3.1.11.10 NMAC. Inadvertent error is defined as "negligence." *See El Centro Villa Nursing Center v. Taxation & Revenue Department*, 1989-NMCA-070, ¶14, 108 N.M. 795.

Taxpayer testified that at the time she was performing services for Usana, she was unaware that she was required to register and file gross receipts returns. **[03-31-15 CD 14:15-15:00]**. Taxpayer employed Julia C. Adams as her certified public accountant. **[03-31-15 CD 09:22]**. Taxpayer testified that Ms. Adams did not advise her to register and file gross receipts returns. **[03-31-15 CD 14:15-15:00]**.

The regulations provide exceptions to the negligence definition. After reviewing the exceptions or indications of nonnegligence found in regulation 3.1.11.11 NMAC (1/15/01), the only possible applicable regulation that might apply to Taxpayer is found in that paragraph D of the regulation applied. Regulation 3.1.11.11(D) provides that:

(t)he taxpayer proves that the failure to pay tax or to file a return 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; failure to make a timely filing of a tax return, however, is not excused by taxpayer's reliance on an agent;

To meet this regulation, it requires Taxpayer to prove that she reasonably relied on the advice of a competent accountant and that the competent accountant provided incorrect tax advice. The term “reasonable reliance” is a factual determination made by the Hearing Officer. It requires evidence that the taxpayer acted reasonably or acted in a “(f)air, proper or moderate under the circumstances” and the person exercised reliance or a “(d)ependence or trust” on the advice of a competent accountant. *Black’s Law Dictionary*, 1379, 1404 (9th ed. 2009). This indication, as with the other indications of nonnegligence, are in keeping with the holding in *El Centro Villa Nursing Center v. Taxation & Revenue Dep’t.*, where the court stated that “(u)nder the statutory definition of negligence, it is inappropriate to impose a penalty where the taxpayer acted reasonably in failing to report income or to pay taxes.” *Id.* at ¶6. The court also held that a taxpayer is not relieved of his or her duty to ascertain the possible tax consequences of his action or inaction by abdicating this responsibility by merely appointing an accountant to act as an agent in tax matters. *Id.* at ¶14. Thus, in reading the regulation and *El Centro Villa*, the hiring of an accountant by itself is insufficient to prove that a taxpayer is nonnegligent. The taxpayer must act reasonably and he or she must have relied on the accountant’s incorrect tax advice.

The Hearings Bureau has ruled in numerous cases that reasonable reliance on a CPA may be a reason for abatement of penalty especially when it seems clear from the evidence that the accountant provided “incorrect tax advice.” *See, Carlos Chavez Formerly dba Mayan Construction*, Decision and Order No. 12-09 (the accountant failed to review the work of Taxpayer’s employee and failed to properly advise Taxpayer of time deadlines); *Jesus Hernandez*, Decision and Order No. 11-16 (the accountant stated in a letter that he had provided taxpayer with incorrect advice); *Wal-Mart*, Decision and Order No. 06-07 (taxpayer relied on in-house tax accountants to form a subsidiary company to reduce state tax liability); *Children’s Orchard*, Decision and Order

No. 01-05 (taxpayer hired an accountant to give them advice to assist them in making sure their taxes were properly paid); and *Eileen P. Cahoon*, Decision and Order No. 98-38 (taxpayer relied on her accountant's advice in not providing a timely NTTC). *But see, Marilyn Stock*, Decision and Order 05-04 (taxpayer was not granted a refund of the penalty amount she paid even though she had relied on her CPA who used the wrong tax table in determining her tax liability). In this case, it is not clear what advice was given to Taxpayer by Ms. Adams. Taxpayer's actions were based on her erroneous belief or inattention which is by definition negligent and subject to civil penalty. Therefore, Taxpayer owes the penalty amount.

Interest.

New Mexico law is very clear on the imposition of interest when the principal amount of tax is unpaid when due, even if the payment is received one day late. Section 7-1-67(A) (2007) states that interest "shall be paid" on taxes that are not paid on or before the date on which the tax is due. NMSA 1978, §7-1-67(A) (2007). The word "shall" is interpreted to mean that the Department does not have discretion and must assess interest if principal tax is due and owing. *Marbob Energy Corporation v. NM Oil Conservation Commission*, 2009-NMSC-013, ¶22, 146 N.M. 24. The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Because the principal amount of tax was not paid when it was due, interest was properly assessed on the principal amount until the date it was paid. Therefore, Taxpayer owes the interest amount calculated through date of payment of the principal.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely written protest to the Notice of Assessments Letter Id. Nos. L1882541008, L0137710544, L1211452368 and L0674581456 for gross receipts tax principal,

penalty and interest for the tax years ending 2008, 2009, 2010 and 2011.

B. Jurisdiction lies over the parties and the subject matter of this protest.

C. The hearing was timely set as required by NMSA 1978, Section 7-1-24.1(A) (2013).

D. Pursuant to NMSA 1978, Section 7-1-17(C) (2007), the Department's assessment is presumed to be correct, and it is Taxpayer's burden to come forward with evidence and legal argument to establish that it was entitled to an abatement.

E. Taxpayer provided services in New Mexico to Usana; specifically, Taxpayer generated sales volume points, which are a measure of the product sales of the down-line sales.

F. The sales volume points were created when Taxpayer recruited and enrolled New Mexico customers and the customers purchased Usana products.

G. Taxpayer received commissions from Usana based on the sales volume points.

H. Taxpayer was negligent in not filing her gross receipts returns when due for the tax years 2008, 2009, 2010 and 2011; accordingly, she owes penalty.

I. The total amount due for tax year 2008 is \$532.75 in principal, \$106.55 in penalty, and \$110.53 in interest; for the tax year 2009, the amount due is \$188.15 in principal, \$37.63 in penalty, and \$30.43 in interest; for the tax year 2010, the amount due is \$172.20 in tax, \$34.44 in penalty, and \$21.00 in interest; and for the tax year of January 2011, the amount due is \$71.96 in principal, \$14.40 in penalty, and \$6.19 in interest.

J. Interest continues to accrue until the principal is paid in full and should be applied to the principal amount of tax due in accordance with NMSA 1978, Section 7-1-67 (2007).

For the foregoing reasons, the Taxpayer's protest **IS DENIED**.

DATED: April 30, 2015

Monica Ontiveros

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