STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
FAMILY WORKSHOP LLC
JEFFREY BURROWS, **No. 15-37**
TO ASSESSMENTS ISSUED UNDER
LETTER ID NOS. L0029171664, L0283733968
AND TO STATEMENT OF ACCOUNT
LETTER ID NO. L0425586640

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on November 12 and 13, 2015 before Hearing Officer Dee Dee Hoxie. The Taxation and Revenue Department (Department) was represented by Ms. Cordelia Friedman, Staff Attorney. Ms. Simone Mehta-Campbell, Auditor, Ms. Alicia Muniz, Auditor, and Mr. Tom Dillon, Auditor, also appeared on behalf of the Department. Mr. Jeffrey Burrows, owner and director of Family Workshop LLC, (collectively Taxpayer) appeared for the hearing with his attorney, Mr. Wayne Chew. His CPA, Mr. Robert DePasquale, was also present on the first day of the hearing.

Halfway through the hearing, upon recommencement on November 13, 2015, the Taxpayer advised that he was dismissing his attorney and wished to proceed by representing himself. The Taxpayer then requested a continuance of the hearing, which was denied. The Taxpayer asked his attorney to remain for the limited purpose of cross-examining the Department's witness. The Taxpayer later advised that he was reinstating his attorney and that the written decision should be sent to his attorney. The Hearing Officer took notice of all documents in the administrative file. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On March 17, 2015, the Department assessed the Taxpayer for workman's compensation tax, penalty, and interest for the tax periods from September 30, 2010 through December 31, 2013. The assessment was for tax of $275.20 tax, penalty of $55.74, and interest of $25.49. [L0283733968]
2. On March 18, 2015, the Department assessed the Taxpayer for gross receipts tax, withholding tax, penalty, and interest for the tax periods from July 31, 2010 through January 31, 2014. The assessment was for gross receipts tax of $167,934.43, penalty of $33,560.31, and interest of $13,122.79, and for withholding tax of $(25.34), penalty of $21.53, and interest of $3.48. [L0029171664]
3. On March 18, 2015, the Department sent the Taxpayer a Statement of Account, reflecting the outstanding taxes owed by the Taxpayer for tax periods from July 31, 2010 through January 31, 2014. Each tax period was listed separately and listed each period's respective tax, penalty, and interest. [L0425586640]
4. On May 12, 2015, the Taxpayer filed a formal protest letter.
5. On June 8, 2015, the Department filed a Request for Hearing asking that the Taxpayer's protest be scheduled for a formal administrative hearing.
6. On June 9, 2015, the Hearings Office issued a notice of telephonic scheduling hearing. The hearing date was set within ninety days of the protest.
7. On July 6, 2015, a telephonic scheduling hearing was conducted. The scheduling order and notice of hearing on the merits was filed July 14, 2015.
8. The Taxpayer filed his witness list and request for subpoenas on August 28, 2015.

9. On September 2, 2015, a second notice of telephonic scheduling hearing was sent to the parties to discuss the increase in the number of witnesses and to determine if the hearing could be held in the amount of time previously allotted for it.

10. On September 4, 2015, a second telephonic scheduling hearing was held. The Taxpayer requested that the hearing on the merits be rescheduled to a date when additional time could be given to it. The Department opposed the request. The request was granted.

11. On September 8, 2015, a second scheduling order and amended notice of hearing on the merits was issued, and the previous setting of September 18, 2015 was vacated.

12. The Taxpayer does business in New Mexico as a provider of behavioral and mental health counseling services. The Taxpayer primarily deals with family issues, and has several licensed therapists working as employees or as independent contractors.

13. The Taxpayer has two locations, one in Albuquerque and one in Rio Rancho.

14. The Taxpayer has contracts with several insurance companies and their subsidiaries for providing counseling services to their customers. The Taxpayer is paid primarily by these insurance companies.

15. The Taxpayer typically receives a lump sum payment from the parent insurance companies, and typically did not keep track of what payments were for what services to which patients.

16. One of the insurance companies had a subsidiary that was responsible for making payments for the provision of health services under the state's Medicaid Program (Medicaid payments).

17. The contract with the subsidiary for making the Medicaid payments required separate approval and signatures. The contract also detailed several quality control provisions.

18. The Taxpayer knew that several changes to deductions regarding payments for health care services occurred from 2005 through 2007. The Taxpayer consulted with an accountant about the changes. The accountant advised the Taxpayer that payments made by a health management organization (HMO) or by a managed care organization (MCO) could be deducted from gross receipts.

19. In 2011, some of the Taxpayer's independently contracted therapists were selected for audit. They brought the issue to the Taxpayer, and the Taxpayer spoke with several Department employees about his therapists' gross receipts and about his gross receipts.

20. The Taxpayer indicated that some of the employees did not give him an answer about his gross receipts, but one employee definitely told him that payments from a HMO were probably deductible.

21. The Taxpayer understood the subsidiary making Medicaid payments to be a HMO or a MCO. Therefore, the Taxpayer was deducting the Medicaid payments from his gross receipts.

22. The Taxpayer reported all of his gross receipts at one tax rate, for the Albuquerque location, even though some of the gross receipts were for services rendered at the Rio Rancho location, which had a higher tax rate than Albuquerque.

23. Ms. Mehta-Campbell conducted an audit of the Taxpayer, which was completed in early 2015. Ms. Mehta-Campbell discovered that the Taxpayer had two locations and was reporting gross receipts only at the lower tax rate of one location.

24. Ms. Mehta-Campbell worked with the Taxpayer to determine what gross receipts were attributable to which location and what gross receipts were derived from Medicaid payments.

25. Ms. Mehta-Campbell determined that all of the receipts from the subsidiary were for Medicaid payments.

26. The Department assessed the Taxpayer for the gross receipts tax attributable to the gross receipts of the Medicaid payments and adjusted the tax rate according the location where the services were rendered.

27. The Taxpayer did not present any evidence or argument regarding the assessments of workman's compensation tax and withholding tax or their respective penalties and interest.

DISCUSSION

The issue to be decided is whether the Taxpayer is liable for gross receipts tax, workman's compensation tax, withholding tax, penalty, and interest as assessed. The Taxpayer argued that the payments from the subsidiary were deductible under the statute as the subsidiary functions as a managed health care service company, or as a HMO or a MCO. The Taxpayer argued that even if the subsidiary was not a HMO or MCO that the Department should be estopped from collecting the tax from him based on his conversations with the Department employees. The Taxpayer argued that he should not be expected to understand the provisions of the Tax Act when a professional accountant and the Department's own employees did not. The Taxpayer also argued that the Department improperly assessed him for taxes by going back more than three years.

The Department argued that the Medicaid payments should be treated as a sale of service to the government that is not deductible under statute. The Department argued that the Medicaid payments were also not deductible under the regulation. The Department argued that the

Taxpayer had underreported his gross receipts by more than 25% and that the assessment of taxes could go back as far as six years.

Burden of Proof.

Assessments by the Department are presumed to be correct. *See* NMSA 1978, § 7-1-17. Tax includes, by definition, the amount of tax principal imposed and, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." NMSA 1978, § 7-1-3. *See also El Centro Villa Nursing Ctr. v. Taxation and Revenue Department*, 1989-NMCA-070, 108 N.M. 795. Therefore, the assessment issued to the Taxpayer is presumed to be correct, and it is the Taxpayer's burden to present evidence and legal argument to show that he is entitled to an abatement. The burden is on the Taxpayer to prove that he is entitled to an exemption or deduction. *See Public Services Co. v. N.M. Taxation and Revenue Dep't.*, 2007-NMCA-050, ¶ 32, 141 N.M. 520. *See also Till v. Jones*, 1972-NMCA-046, 83 N.M. 743. "Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer." *Sec. Escrow Corp. v. State Taxation and Revenue Dep't.*, 1988-NMCA-068, ¶ 8, 107 N.M. 540. *See also Wing Pawn Shop v. Taxation and Revenue Dep't.*, 1991-NMCA-024, ¶ 16, 111 N.M. 735. *See also Chavez v. Commissioner of Revenue*, 1970-NMCA-116, ¶ 7, 82 N.M. 97.

Gross Receipts Tax.

Services performed within the State of New Mexico are subject to the gross receipts tax. *See* 3.2.1.18 (A) NMAC (2003). The Taxpayer admitted that he was engaged in a service business providing behavioral and mental health counseling. There was no dispute that the Taxpayer's services are subject to gross receipts tax. The Taxpayer argued that he was entitled

to deduct the amounts assessed from his gross receipts under Section 7-9-93 as they were payments made by a MCO. The Department argued that the subsidiary was not a MCO for various reasons and that the payments from Medicaid funds were excluded from the deduction by Regulation 3.2.241.12.

Health care service payments.

A health care service provider may deduct payments made for providing "commercial contract services or medicare part C services" when those payments are made by a "managed health care provider or health care insurer". NMSA 1978, § 7-9-93 (A) (2007). The Taxpayer's health care services would be commercial contract services. *See* Exhibit E. Medicaid payments are not deductible. *See* 3.2.241.12 NMAC (2006). The Department argued that the Taxpayer was selling a service to the government, which is not deductible under Section 7-9-54. The Taxpayer was not selling a service to the government; he was selling a service to his patients. The payments for those services were coming from the government by way of a third-party administrator of funds. The Taxpayer conceded that the subsidiary was making Medicaid payments.

The Taxpayer argued that the statute did not prohibit the deduction of Medicaid payments and argued that the deduction was allowed if the entity distributing payments was a MCO or a managed health care provider. The Taxpayer argued that the regulations were also not clear as one says that payments from a third party administrator are deductible under the statute and another says that Medicaid payments are not deductible. *See* 3.2.241.9 NMAC and 3.2.241.12, respectively. The Department argued that the subsidiary was really a third-party administrator and did not meet the criteria to be considered a MCO. The Department also argued that the regulation made it clear that Medicaid payments are not deductible. *See* 3.2.241.12 NMAC.

The parties focused their arguments on whether the subsidiary was a MCO, or a "managed health care provider" as it is called in the statute. NMSA 1978, § 7-9-93. However, a closer reading of the statute reveals that the status of the subsidiary is not the critical issue. *See id.* The statute itself excludes from deduction payments that are made for providing health care services to Medicaid patients. *See* NMSA 1978, § 7-9-93. The statute allows for deductions for "payments by a managed health care provider…for commercial contract services". NMSA 1978, § 7-9-93 (A). However, the statute goes on to define "commercial contract services" as

> health care services performed by a health care practitioner pursuant to a contract with a managed health care provider or health care insurer *other than* those health services provided for medicare patients pursuant to Title 18 of the federal Social Security Act *or for medicaid patients* pursuant to Title 19 or Title 21 of the federal Social Security Act[.] NMSA 1978, § 7-9-93 (B) (emphasis added).

The statute itself excludes payments for services to Medicaid patients from the deduction. *See id.* The gross receipts at issue in this case are payments for services to Medicaid patients. Therefore, those payments are not deductible and are subject to gross receipts tax.

Again, the right to a deduction must be clear and unambiguously granted by the statute, and the right to take the deduction must be clearly established by the Taxpayer. *See Sec. Escrow Corp.*, 1988-NMCA-068, ¶ 8. The statutory definition of "commercial contract services" expressly excludes Medicaid payments from the deduction. *See* NMSA 1978, § 7-9-93 (B). Regulation 3.2.241.12, which says that Medicaid payments are not deductible, is consistent with the statute. *See* NMSA 1978, § 7-9-93 and 3.2.241.12 NMAC. *See also Chevron U.S.A. Inc. v. State ex rel. Taxation and Revenue Dep't*, 2006-NMCA-050, ¶ 16, 139 N.M. 498 (holding that agency regulations that interpret a statute are presumed to be proper). Consequently, the Taxpayer failed to establish that he was entitled to deduct the Medicaid payments from his gross receipts.

Timeliness of the Gross Receipts Tax Assessment.

The Taxpayer argued that the assessment was not timely since it occurred more than three years after the 2010 and 2011 tax years. Generally, assessments must be made within three years of the end of the calendar year in which the tax was due. *See* NMSA 1978, § 7-1-18. The Taxpayer's gross receipts taxes were due monthly. Under the general rule, the Department would have had until the end of 2013 and 2014 to assess for 2010 and 2011, respectively. *See id.* Subsequent tax years in the assessment fall within the general three-year period and were clearly timely.

When a taxpayer underreports the tax liability by more than 25%, the Department has six years to assess. *See* NMSA 1978, § 7-1-18. Both parties made several arguments on whether the Taxpayer had underreported his gross receipts by more than 25%. However, these arguments mischaracterize the provision of the statute; the inquiry is whether the Taxpayer "in a return understate[d] by more than twenty-five percent the amount of *liability for any tax* for the period". *Id.* (emphasis added). For example, a taxpayer could make a typographical error on a return and report only $10 of gross receipt, when the true amount was $100. Assuming a 10% tax rate, that taxpayer could then also incorrectly report his gross receipts tax liability to be $9, rather than $10, which would be underreporting the tax liability by 10%. In that hypothetical situation, the Department would only have three years to assess since the taxpayer did not underreport the tax liability by more than 25%, even though the taxpayer underreported the gross receipts by more than 25%. Therefore, the timeliness of the assessment hinges on whether the Taxpayer underreported his gross receipts tax liability by more than 25%.

Mr. Dillon testified that his understanding was that the Taxpayer was filing returns and reporting zero gross receipts tax liability. The audit report, Exhibit A, contains a history of the

Taxpayer's filing and lists returns that were filed by the month and year and what gross receipts tax liability was reported on each return. The list in Exhibit A coincides by month and year to the list contained in the Statement of Account, L0425586640. The list in Exhibit A shows that the Taxpayer was not filing every month in 2010 and 2011. However, in every month that was filed for those two years, zero tax liability was reported. Therefore, the Taxpayer underreported his tax liability by 100%. The list in Exhibit A also shows that the Taxpayer was still filing sporadically in 2012 and filed regularly in 2013, and that the Taxpayer was reporting some gross receipts tax liability during those months. However, the percentage does not matter for years after 2011 since those years fall within the general three-year limit. As the Taxpayer was underreporting his tax liability by 100% in 2010 and 2011, the Department had six years to assess. The assessment occurred in 2015 and was, therefore, timely.

Estoppel.

The Taxpayer argued that the Department should be estopped from assessing him based on his conversations with the Department's employees and their representations that payments from a HMO were probably deductible. The Department can be estopped from taking action against a taxpayer when the party's action or inaction was due to a regulation in effect at the time or a ruling addressed to the party personally in writing by the secretary that was in effect at the time that the liability arose. *See* NMSA 1978, § 7-1-60 (1993). Rulings must meet certain criteria. *See id.* *See also* NMSA 1978, § 9-11-6.2 (1995). To be effective, a ruling must be reviewed by the attorney general or other legal counsel of the Department and the ruling must reflect that such review was done. *See* NMSA 1978, § 9-11-6.2 (C). A ruling must be signed by the secretary and by counsel to show that such a review took place. *See* 3.1.2.8 NMAC (2000). Rulings are also required to be written statements that interpret specific statutes. *See* NMSA

1978, § 9-11-6.2 (B) (2). A verbal conversation is not sufficient to estop the Department from taking action. *See* NMSA 1978, § 7-1-60.

Equitable estoppel may be found against the state where there is "a shocking degree of aggravated and overreaching conduct or where right and justice demand it." *Wisznia v. State, Human Servs. Dep't,* 1998-NMSC-011, ¶ 17, 125 N.M. 140. Generally, statements of opinion on matters of law do not give rise to estoppel when the facts are known to both parties. *See Rainaldi v. Pub. Employees Ret. Bd.*, 1993-NMSC-028, ¶ 16, 115 N.M. 650. Equitable estoppel against the state is disfavored, especially in cases involving taxes. *See Taxation and Revenue Dep't v. Bien Mur Indian Market,* 1989-NMSC-015, ¶9-10, 108 N.M. 228. Equitable estoppel will not apply against the state when it would be contrary to the requirements of statute. *See Rainaldi*, 1993-NMSC-028, ¶ 18-19. *See also In re Kilmer*, 2004-NMCA-122, ¶ 26, 136 N.M. 440. Moreover, the statements by the Department's employees to the Taxpayer were not definitive as they said that payments from a HMO were probably deductible. However, even if estoppel were to apply, the Hearing Officer could not grant it. *See AA Oilfield Serv. v. New Mexico SCC*, 1994-NMSC-085,118 N.M. 273 (holding that an administrative agency cannot grant the equitable remedy of estoppel because that power is held exclusively by the judiciary).

Workman's Compensation and Withholding.

The Taxpayer did not present any evidence to refute the assessments of workman's compensation tax, withholding tax, and their respective penalties and interest. Therefore, the assessments of those taxes are presumed to be correct. *See* NMSA 1978, § 7-1-17.

Assessment of Penalty on Gross Receipts Tax.

The Taxpayer argued that the Department initially told him that it would not assess penalty. The Taxpayer was then asked to provide a letter from his accountant detailing what

advice he was given on this issue. The Taxpayer was not able to obtain such a letter, and the Department assessed penalty. The Taxpayer felt that he took appropriate action and tried to discern what payments were subject to gross receipts by consulting with an accountant and by speaking to the Department's employees.

Penalty is due whenever a person fails to pay a tax when it is due, if that failure was due to negligence. *See* NMSA 1978, § 7-1-69. A taxpayer may be entitled to abatement of penalty when the taxpayer relied on advice of counsel or an accountant, or in various other circumstances that establish that the taxpayer was not negligent. *See* 3.1.11.11 NMAC (2001). Moreover, negligence is defined as "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances". 3.1.11.10 NMAC. The Taxpayer consulted an accountant and spoke to Department employees about the issue. Based upon the totality of the evidence, the Taxpayer was not negligent. Therefore, penalty assessed on the gross receipts tax is hereby abated.

Assessment of Interest.

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). The word "shall" indicates that the assessment of interest is mandatory, not discretionary. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n.*, 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 tax was not paid when it was due, interest was properly assessed.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely written protest to the Notices of Assessment of workman's compensation taxes, withholding taxes, and gross receipts taxes issued under Letter ID

numbers L0029171664 and L0283733968 and to the Statement of Account issued under Letter ID number L0425586640, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Taxpayer was not entitled to deduct payments for services to Medicaid patients from its gross receipts, so the gross receipts tax was properly assessed. *See* NMSA 1978, § 7-9-93 (B). *See also* 3.2.241.12 NMAC.

C. The Taxpayer was not negligent on his gross receipts taxes because he exercised ordinary business care. *See* NMSA 1978, § 7-1-69. *See also* 3.1.11.10 and 3.1.11.11 NMAC. Penalty on the gross receipts taxes, the amount of $33,560.31, is HEREBY ABATED.

D. The Taxpayer was properly assessed for interest. *See* NMSA 1978, § 7-1-67 (A).

E. The assessments for 2010 and 2011 were timely as they occurred within six years and the Taxpayer was underreporting his tax liability by more than 25%. The assessments for 2012, 2013, and 2014 were timely as they occurred within three years. *See* NMSA 1978, § 7-1-18.

F. Statutory estoppel does not apply. *See* NMSA 1978, § 7-1-60.

G. The Taxpayer effectively abandoned his protest as to the workman's compensation tax and the withholding tax, and their respective penalties and interest, and their assessments are presumed correct. *See* NMSA 1978, § 7-1-17.

For the foregoing reasons, the Taxpayer's protest **is GRANTED IN PART and DENIED IN PART**.

DATED: December 8, 2015.

Dee Dee Hoxie

DEE DEE HOXIE
Hearing Officer
Administrative Hearings Office

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