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

IN THE MATTER OF THE PROTEST OF
KIMBERLY AND WILLIAM FLORES **10-5**
TO ASSESSMENTS ISSUED UNDER
LETTER ID NOS. L0160023936 &l0166672768.

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on February 16, 2010, before Sally Galanter, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Ida Lujan, Special Assistant Attorney General. Ms. Kimberly Flores and Mr. William Flores ("Taxpayers") appeared representing themselves. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Taxpayer, Kimberly Flores, engaged in baby sitting for pay from the State of New Mexico, CYFD, in the years 2005 and 2006.

2. Taxpayers filed their 2005 personal income tax returns indicating gross receipts of $5,787.00 on Schedule C of their federal income tax return and no gross receipts on their state return for the same year. (Department Exhibit A).

3. Taxpayers filed their 2006 personal income tax returns indicating gross receipts of $4,572.00 on Schedule C of their federal income tax return and no gross receipts on their state return for the same year. (Department Exhibit B).

4. The tape match system, based on tax information supplied from the Internal Revenue Service (IRS), revealed the discrepancy between the federal and state tax returns.

5. On July 2, 2008, as a result of the information obtained from the IRS, the Department mailed to Taxpayers a notice of limited scope audit concerning the discrepancy for both 2005 and 2006 tax years. (Department Exhibits A & B).

6. Taxpayer, Kimberly Flores, upon receiving the information, went to the Department office in Albuquerque and spoke with an unknown Department employee who notified her to wait until she received all documentation from the Department and then file a protest.

7. The Department sent a Reminder Notice of the Audit to Taxpayers on August 11, 2008 for tax years 2005 and 2006 noting a response requested date of August 31, 2008. (Department Exhibits A & B).

8. The Department sent a Notice of Potential Assessment to Taxpayers on September 2, 2008 for tax years 2005 and 2006 noting a response requested date of September 17, 2008. (Department Exhibits A & B).

9. On September 23, 2008, the Department assessed Taxpayers gross receipts tax in the amount of $365.98 in principal, $73.20 in penalty and $135.17 in interest for a total of $574.35 for tax period ending December 31, 2005. (Department Exhibit C).

10. On September 23, 2008, the Department assessed Taxpayers gross receipts tax in the amount of $291.60 in principal, $58.32 in penalty and $63.99 in interest for a total of $413.91 for tax period ending December 31, 2006. (Department Exhibit D).

11. On February 27, 2008, posted to the Department records that day, Taxpayers were refunded $411.00 as a result of their being no known outstanding tax liability on that date. (Department Exhibit E).

12. On August 25, 2008, posted to the Department records on October 20, 2008, Taxpayers received an income tax rebate of $200.00, and were notified that the rebate was offset against Taxpayers outstanding tax liability for 2005 reducing the amount of principal tax owed from $365.98 to $165.98 balance remaining due and owing. (Department Exhibit E).

13. While requesting and being granted an extension of time to file a written protest, Taxpayers timely filed a written protest to the assessments on December 22, 2008. (Department Exhibits F, G &H).

14. In the protest letter, Taxpayers protested the assessments and requested that the offset be refunded to them. (Department Exhibit H).

15. Taxpayer, Ms. Flores, expected her tax preparer to properly take out what taxes were owed and although knowing Taxpayers owed federal taxes she did not know they owed taxes to the state on the gross receipts income.

16. Taxpayer, Ms. Flores, attended a class based on her being paid through the state, CYFD, for the babysitting and was notified by the state that she would be responsible for payment of taxes as taxes were not being taken out of the funds prior to being paid.

17. The state of New Mexico sent Taxpayers a 1099 form for the income received for the babysitting services.

DISCUSSION

The primarily issue to be decided is whether Taxpayers are liable for the gross receipts taxes, civil penalty and continuing interest due to the non-reporting of gross receipts for babysitting services in the tax periods ending December 2005 and December 2006. An additional issue is whether Taxpayers are entitled to have the income tax rebate returned to them.

Taxpayers acknowledge that they probably owe the taxes but seek abatement of penalty and interest and the return of the income tax rebate. Taxpayers ask to be excused from payment of penalty and interest as Mr. Flores has been ill and has been out of work for some time and due to Taxpayers not having the funds to pay what is claimed to be due.

Burden of Proof. NMSA 1978, §7-1-17(C) (2007) provides that any assessment of tax by the Department is presumed to be correct. Regulation 3.1.6.12 (A) NMAC explains that once an assessment is mailed to a taxpayer that the presumption of correctness attaches and that therefore the taxpayer has the burden with evidence to dispute the correctness. Also NMSA 1978, §7-1-3 NMSA (2009) defines tax to include not only the amount of tax principal imposed but also, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." See *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989). See also, Regulation 3.1.6.13 NMAC. Accordingly, the presumption of correctness applies to the assessment of principal tax, to the penalty and interest, and it is Taxpayer's burden to present evidence and legal argument to establish that they are not liable for the gross receipts tax and are entitled to an abatement of interest and penalty.

Gross Receipts Tax Due. NMSA 1978, § 7-9-4 (1990) imposes an excise tax on the gross receipts of any person engaging in business in New Mexico. The definition of "engaging in business" is very broad including "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." NMSA, 1978, § 7-9-3.3 (2002). The statute makes no distinction between activities engaged in by large corporations and activities engaged in by small "mom and pop" operations.

Pursuant to NMSA 1978, §7-9-3.5 (A) (1) (2007), gross receipts "means the total amount of money…received…from performing services in New Mexico." Specifically Regulation 3.2.1.18 (P) (3) NMAC states,

> Receipts from providing day care for children in a situation where a person provides day care for children in a residence and the care for all these children is paid for by the state of New Mexico are subject to gross receipts tax.

In this case, Taxpayer, Ms. Flores entered into an agreement with CYFD, the State of New Mexico, to provide babysitting services for her grandchildren in return for the state paying her compensation for such services. Because this activity is included in "engaging in an activity" with the result of receiving a monetary benefit and because Taxpayer was performing this service in New Mexico, providing day care in her residence and being paid by the state, Taxpayers are liable for gross receipts tax on their income from those services.

Entitlement to Offset. The issue is whether Taxpayers are entitled to return of their income tax rebate awarded to them and subsequently offset against their tax liability. Taxpayers are liable for the unpaid taxes on the gross receipts received as a result of babysitting. NMSA 1978, §7-1-29(C) states, "In the discretion of the secretary, any amount of tax to be refunded may be offset against any amount of tax for which the person due to receive the refund is liable. The secretary or the secretary's delegate shall give notice to the taxpayer that the refund will be made in this manner…" The Department sent Notice of Refund Offset to Taxpayers on November 21, 2008 notifying them that they were entitled to an income tax rebate of $200.00 and that the rebate had been applied to their outstanding tax liability. The Department applied the rebate to the principal owed for 2005 gross receipts. (Department Exhibit E). The action by the Department

was in compliance with the law. Therefore Taxpayers are not entitled to return of their rebate amount.

Civil Penalty. NMSA 1978, §7-1-69 (2003, prior to amendments through 2007) governs the imposition of penalty. NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007), in effect prior to January 1, 2008 states,

> A. 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 t ax 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 ten percent of the tax due but not paid.

NMSA 1978 Sec. 7-1-69 (2003, prior to the amendments through 2007) provides that when a taxpayer fails to pay taxes due to the state as a result of negligence or disregard of rules and regulations, a penalty "shall be added" to the amount of the underpayment. The term "negligence" as used in Sec. 7-1-69 is defined in Regulation 3.1.11.10 NMAC (2001) as:

> (A) failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
> (B) inaction by taxpayers where action is required;
> (C) inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

Whether Taxpayers have acted negligently for purposes of the civil penalty imposed by §7-1-69 (2003, prior to amendments through 2007), is determined as of the date the taxes were due. Taxpayers had notice of an assessment by the department that taxes were claimed as due. Taxpayers failed to pursue their objections to the assessment with the ordinary care and prudence that a reasonable taxpayer would exercise under like circumstances after being notified that taxes were due. Taxpayers did not act to pursue resolution of the assessment when action was required. Taxpayers completed the

formal protest (Department Exhibit H) knowing there was a claim for taxes based on non-payment of gross receipts based on baby sitting funds received from the state. Taxpayers erroneously believed that they were not liable for any taxes owed to the state based on the gross receipts. This error meets the definition of negligence set out in Department regulations and in New Mexico case law. See *C & D Trailer Sales v. Taxation and Revenue Dept*., 93 N.M. 697, 699, 604 P.2d 835, 837 (Ct. App. 1979) (a taxpayer's mere belief that he is not liable to pay taxes is tantamount to negligence within the meaning of the statute); *El Centro Villa Nursing Center v. Taxation & Revenue Department*, 108 N.M. 795, P.797, 779 P.2d 982, 984 (Ct. App. 1989) (§ 7-1-69 is designed specifically to penalize unintentional failure to pay tax.).

While Taxpayer, Ms. Flores, testified that Taxpayers had a tax service complete their tax returns the evidence was insufficient to establish non-negligence pursuant to Regulation 3.3.11.11 (D) NMAC as there was no evidence that Taxpayers had any specific discussions with the tax preparer concerning gross receipts taxes owed to the state. Taxpayers did not establish that the failure to pay the tax was caused by the reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts as the evidence established that Taxpayers did not believe that they were liable to any taxes to the state based on the gross receipts from babysitting.

In the Notice of Limited Scope Audit commencement, the reminder of Notice of Limited Scope audit, the assessments for the tax years 2005 and 2006, and the acknowledgment letter of January 23, 2009 from the Department to Taxpayers, the Department notified Taxpayers that penalty will be assessed at a rate of 2% per month (to a maximum of 20%) on the principal amount of tax due until such tax is paid. (Department Exhibits A, B, C, D, I and J). Taxpayers certainly, had sufficient notice that a penalty would be assessed due to non-payment of the principal tax due.

Imposing a civil penalty on Taxpayer's liability was correct. The Department's calculation of the penalty is not correct. The Department imposed a twenty percent (20%) civil penalty on the principal of the gross receipts tax. (Department Exhibits C and D). The amount of negligence penalty added to the underlying principal tax liability by the Department is not in accordance with the meaning of §7-1-69 (2003, prior to amendments through 2007). §7-1-69 (A)(1) provides that if the tax required to be paid when due is not paid, the Department may add civil penalty in an amount "…**not to exceed** ten percent of the tax due but not paid." As the effective date of the legislative change as to the maximum penalty amount capped at 20%, under NMSA 1978, Sec. 7-1-69 (2007), was January 1, 2008, and the taxes at issue are 2005 and 2006, the total amount of penalty assessed to taxpayer is determined to be 10% of the principal amount. There was no retroactivity provision within this statute allowing for an additional civil penalty of ten percent (10%) to be applied to past due principal tax balances due as of January 1, 2008 that had already exceeded the maximum rate applied. This determination is based on *Phelps Dodge Corp. v. Revenue Division of the Taxation and Revenue Dept of the State of New Mexico,* 103 NM 20, 702 P.2d 10 (Ct. App. 1985), which following *Worman v. Echo Ridge Homes Cooperative, Inc.* 98 NM 237, 647 P.2d 870 (982) states, "new legislation must not alter the clear language of a prior statute if it is to be applied retroactively." Additionally, in *State v. Padilla,* 78 NM 702, 437 P.2d 163 (Ct. App. 1968), affirmed in *Psomas v. Psomas,* 99 NM 606, 661 P.2d 884 (1982), the court stated, "it is presumed that statutes will operate prospectively only, unless an intention on the part of the legislature is clearly apparent to give them retroactive affect." See also *Karpa v. Commission of Internal Revenue,* 909 F.2d 784 (1990) and *Bradbury Stamm Construction v. Bureau of Revenue,* 70 NM 226, 373 P.2d (1962).

Interest. NMSA 1978, § 7-1-67 (2007) governs the imposition of interest on the late payments of tax and provides, in pertinent part:

> A. If any tax imposed is not paid on or before the day on which it becomes due, ***interest shall be paid*** to the state on such amount from the first day following the day on which the tax becomes due, without regard to any extension of time or installment agreement, until it is paid... (emphasis added).

The use of the word "shall" indicates that the provisions of the statute are mandatory rather than discretionary. *State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). With limited exceptions that do not apply here, the New Mexico Legislature has directed the Department to assess interest whenever taxes are not timely paid until such time as the principal tax is paid in full. The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Here, the Taxpayer failed to pay gross receipts tax due to the state. In effect, the Taxpayer had a loan of state funds during the time taxes were owed but not paid. Therefore continuing interest is due until such time as the principal tax due is paid. The statutory rate is mandatorily set by the legislature, and neither the Department nor its hearing officer has the authority to adjust interest based on the financial or personal situations of individual taxpayers. See, *State ex rel. Taylor v. Johnson*, 1998-NMSC-015 ¶ 022, 961 P.2d 768, 774-775 (the legislature, not the administrative agency, declares the policy and establishes primary standards to which the agency must conform).

CONCLUSIONS OF LAW

A. The Taxpayers filed a timely, written protest to the assessments of gross receipts tax issued under Letter ID Nos. L0160023936 and L0166672768, and jurisdiction lies over the parties and the subject matter of this protest.

B. Taxpayers failed to meet their burden of proving that their income reported on their 2005 and 2006 federal income tax returns for babysitting is not subject to New Mexico gross

receipts tax. Therefore, the amounts of $5,787.00 and $4,572.00 are subject to New Mexico gross receipts tax.

C. The Department properly offset Taxpayer's income tax rebate against their outstanding 2005 gross receipts tax liability.

D. The amount of civil penalty added to the principal tax shall not exceed ten percent (10%) as provided in §7-1-69(A)(1)(2003, prior to amendments through 2007) and any amounts added or assessed in excess of the ten percent (10%) shall be abated.

E. Interest was correctly added and assessed, pursuant to NMSA 1978, §7-1-67, to the principal amount of tax, and continues to be applied until the principal tax is paid in full.

The Taxpayer was not negligent in failing to report gross receipts tax during the period at issue, and the negligence penalty imposed pursuant to NMSA 1978, § 7-1-69 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 penalty (10%) of the penalty amount for tax years 2005 and 2006 unless it has already done so.

DATED March 24, 2010.