STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
JACK & KAREN DILL **No. 17-42**
TO RETURN ADJUSTMENT NOTICE
ISSUED UNDER LETTER
ID NO. L1391478064

DECISION AND ORDER

A hearing occurred in the above-captioned protest on August 22, 2017 before Chris Romero, Esq., Hearing Officer, in Santa Fe, New Mexico. At the hearing, Jack Allan Dill ("Taxpayer") appeared in person and represented Taxpayers *pro se*. Since the facts and circumstances of the protest relate only to the employment of Mr. Dill, references to "Taxpayer" in its singular form shall be interpreted as referring to Mr. Dill, but may also be intended to reference both Taxpayers when required by the context. Reference to "Taxpayers" in its plural form is intended to refer to both of the above-captioned 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. Department Exhibits A – D were admitted into the evidentiary record without objection. Taxpayers did not proffer any exhibits for the record of the hearing. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On April 18, 2017, under Letter ID No. L1391478064, the Department issued a Return Adjustment Notice.

2. On April 28, 2017, the Department's Protest Office received Taxpayers' formal protest of the Department's Return Adjustment Notice.

3. On May 22, 2017, the Department acknowledged receipt of Taxpayers' protest of its Return Adjustment Notice.

4. On June 30, 2017, the Department submitted a Hearing Request that requested a hearing on the merits of Taxpayers' protest.

5. On June 30, 2017, the Administrative Hearings Office sent Notice of Administrative Hearing, setting this matter for a merits hearing on July 27, 2017.

6. On July 24, 2017, Taxpayers submitted a request that the hearing be continued.

7. Rather than continue the hearing set for July 27, 2017, the Chief Hearing Officer and the parties utilized the allotted time to conduct a telephonic scheduling conference.

8. The parties did not object that the telephonic scheduling hearing conducted on July 27, 2017 was within 90 days of Taxpayers' protest and satisfied the 90-day hearing requirement of NMSA 1978, Sec. 7-1B-8 (A).

9. On July 27, 2017, the Administrative Hearings Office filed and served the Second Notice of Administrative Hearing which set a hearing on the merits of Taxpayers' protest for August 22, 2017 at 9 a.m.

10. On August 14, 2017, Taxpayer submitted to the Administrative Hearings Office and the Department correspondence summarizing Taxpayers' positions together with copies of documents referenced therein.

11. In 2016, Mr. Dill resided in the states of Indiana and New Jersey. At no relevant time was Mr. Dill a resident of New Mexico. [Testimony of Mr. Dill; Testimony of Ms. Bernardo].

12. In 2016, Mr. Dill was the CEO, President, and CFO of Indian Jewelers Supply Co. Inc. (hereinafter "IJS"). [Testimony of Mr. Dill].

13. IJS is a wholesale supplier of materials and tools serving jewelry manufacturers.

[Testimony of Mr. Dill].

14. IJS is established in New Mexico and engages in business in Gallup and Albuquerque with its headquarters being in Gallup. [Testimony of Mr. Dill].

15. IJS does not engage in business in Indiana or New Jersey. [Testimony of Mr. Dill].

16. Mr. Dill is under contract with IJS until 2018. [Testimony of Mr. Dill].

17. Mr. Dill's contract with IJS requires that he be physically present in New Mexico for no less than the aggregate of 10 days per month. Otherwise, Mr. Dill may perform his contractual obligations from his resident states. [Testimony of Mr. Dill; Dept. Ex. B-2, Sec. 3].

18. Mr. Dill's contract with IJS provides that he be compensated $85,000.00 per year to be paid in bi-weekly installments. [Dept. Ex. B-2, Sec. 4; Testimony of Ms. Bernardo].

19. Mr. Dill's primary employment responsibilities for IJS concern its administrative and financial operations. [Testimony of Mr. Dill; Dept. Ex. B-1, Sec. 1].

20. Attending to his primary employment responsibilities does not require a physical presence in New Mexico. In 2016, Mr. Dill performed the overwhelming majority of his employment responsibilities from his home states by telephone and other electronic means. [Testimony of Mr. Dill].

21. Mr. Dill estimated that he was physically present in New Mexico for 24 percent of tax year 2016. [Testimony of Mr. Dill].

22. Mr. Dill's estimate represented approximately 88 days present in New Mexico considering that 2016 was a leap year containing 366 days.

23. Although the Mr. Dill's contract required that he be physically present in New Mexico for 10 days per month, which represented 120 days per year, the Department did not dispute testimony that his actual presence in 2016 was less than what was contractually required.

24. Mr. Dill filed a 2016 PIT-1 in which he allocated and apportioned 24 percent of his income to the State of New Mexico and claimed a refund. The percent apportioned and allocated to New Mexico represented the time he was working for IJS while physically present within New Mexico. [Testimony of Mr. Dill].

25. IJS issued a W-2 to Mr. Dill which indicated that it withheld New Mexico personal income tax in the amount of $1,970.07. [Dept. Ex. D; Testimony of Ms. Bernardo].

26. The W-2 also reported the sum of $56,884.93 as wages, tips, and other compensation. [Testimony of Ms. Bernardo; Dept. Ex. D (Box 1)].

27. Relying in relevant part on the Instructions for 2016 PIT-B Schedule of New Mexico Allocation and Apportionment of Income (hereinafter "2016 PIT-B Instructions"), Mr. Dill calculated a net New Mexico income tax obligation of $384.00. Because IJS withheld $1,970.00 (rounded to the nearest dollar), Mr. Dill sought a refund of the difference, representing $1,586.00. [Testimony of Mr. Dill].

28. The Department recalculated Taxpayers' New Mexico income tax obligation. In contrast with Mr. Dill's calculation, it allocated and apportioned 100 percent of his income from IJS to New Mexico resulting in a net New Mexico income tax obligation of $1,575.00. [Testimony of Ms. Bernardo; Dept. Ex. A; Dept. Ex. C].

29. The Department issued a refund in the amount of $395 based on its adjustment of Taxpayers' return. [Testimony of Ms. Bernardo].

30. The difference between the amounts Taxpayers' assert should be refunded ($1,586.00), and the sum actually refunded by the Department ($395.00), represents the amount of controversy in this protest ($1,191.00). [Testimony of Ms. Bernardo].

31. Mr. Dill also filed resident returns as required by his resident states of Indiana and New Jersey. Mr. Dill resided in Indiana prior to relocating to New Jersey where he presently

resides. [Testimony of Mr. Dill].

32. Taxpayer paid state income tax in the amounts of $4,411 to Indiana and $373 to New Jersey on the income he generated from IJS in 2016. [Testimony of Mr. Dill].

DISCUSSION

The issue presented in this protest is whether the non-resident Taxpayers were entitled to allocate and apportion income among New Mexico, and the states in which they resided during tax year 2016. The Department conceded that Taxpayers did not reside in New Mexico at any time relevant to this protest. However, the Department asserts that 100 percent of the wages reported by IJS were taxable in New Mexico because Mr. Dill was employed in New Mexico, although primarily working remotely from his resident states of Indiana and New Jersey.

Presumption of Correctness and Burden of Proof

Although no assessment was issued in this case, and thus the typical presumption of correctness found under NMSA 1978, Sec. 7-1-17 (C) (2007) does not apply, Taxpayer nevertheless carries the burden in the protest proceeding under Regulation 3.1.8.10 NMAC (8/30/2001) and must establish entitlement to the claimed refund.

Personal Income Tax

Payment of New Mexico personal income tax is governed by NMSA 1978, Sections 7-2-1 to 36. Unless otherwise exempted by law, "[a] tax is imposed at the rates specified in the Income Tax Act upon the net income of every resident individual and upon the net income of every nonresident individual employed or engaged in the transaction of business in, into or from this state, or deriving any income from any property or employment within this state." *See* NMSA 1978, Sec. 7-2-3 (1981). New Mexico law, NMSA 1978, Sec. 7-2-12 (2003), goes on to require that any resident or any person deriving income from New Mexico file a state income tax return. Like many states, the calculation of New Mexico's personal income tax liability begins

with a taxpayer's adjusted gross income as reported to the IRS. *See* NMSA 1978, Sec. 7-2-2 (A) (2010); *See also Holt v. N.M. Dep't of Taxation & Revenue*, 2002- NMSC-34, ¶23, 133 N.M. 11 ("calculation of the taxpayers' state income tax is based upon their adjusted gross income…on their federal return.").

In this case, the Department determined that because the non-resident Taxpayer was employed in New Mexico, all of his income from IJS was taxable under Sec. 7-2-3, and that he was not entitled to allocate and apportion income from IJS among New Mexico and his resident states of Indiana and New Jersey. The Department relied heavily on that portion of Sec. 7-2-3 which states "[a] tax is imposed at the rates specified in the Income Tax Act . . . upon the net income of every nonresident individual employed or engaged in the transaction of business in, into or from this state, or deriving any income from . . . employment within this state." The Department's contention was that although Taxpayer was a non-resident, his net income derived from employment within New Mexico, which would also include transacting business in, into, or from New Mexico.

Taxpayer did not dispute that his income was taxable under Sec. 7-2-3. However, Taxpayer asserted that the central issue was the application of NMSA 1978, Sec. 7-2-11 (A). The relevant portions of NMSA 1978, Sec. 7-2-11 (A) provide as follows:

> **7-2-11. Tax credit; income allocation and apportionment.**
>
> A. Net income of any individual having income that is taxable both within and without this state shall be apportioned and allocated as follows:
>
> …
>
> (4) compensation of a nonresident taxpayer shall be allocated to this state to the extent that such compensation is for activities, labor or personal services *within this state*[.];
>
> (Emphasis Added)

The Department argues that this provision also supports its determination that, consistent with NMSA 1978, Sec. 7-2-3, all income deriving from employment within New Mexico is taxable to New Mexico regardless of where the employment duties were performed. In contrast, Taxpayer asserts entitlement to apportion and allocate his net income based on the percentage of time he was compensated for activities, labor or personal services actually performed while *within this state*. Therefore, the central issue may be addressed by interpreting and applying the statute's use of the phrase "within this state."

The first step in statutory interpretation is to look at the plain language of the statute and to refrain from further interpretation if the plain language is not ambiguous. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n.,* 2009-NMSC-013, 146 N.M. 24. Statutes are to be applied as written unless a literal use of the words would lead to an absurd result. *See New Mexico Real Estate Comm'n. v. Barger*, 2012-NMCA-081, ¶ 7. If a statute is ambiguous or would lead to an absurd result, then it should be construed in accordance with the legislative intent or spirit and reason for the statute, even though it may require a substitution or addition of words. *See id*. *See also State ex rel. Helman v. Gallegos*, 1994-NMSC-023, 117 N.M. 346. *See also Kewanee Indus., Inc. v. Reese*, 1993-NMSC-006, 114 N.M. 784.

In other contexts, New Mexico courts have acknowledged that "[t]he plain meaning of 'within this state' is quite broad and does not specify a distinction between public and private property in the interior of the State of New Mexico." *See State v. Johnson*, 130 N.M. 6, 9 (2000). Even given the broad definition acknowledged in *Johnson*, the court generally acknowledged that the phrase referred to the "interior of New Mexico." *Id*. This construal is consistent with the common meaning of "within" which is defined simply as "in or into the interior: inside[.]" *See Merriam Webster's Collegiate Dictionary* (10th ed. 1994). Accordingly, the Hearing Officer is

persuaded that the statute's use of the phrase "within this state" is intended to define, and consequently limit the application of the statute to an area within the geographic boundaries of New Mexico.

This construction of the phrase, "within this state," is also consistent with the Department's 2016 PIT-B Instructions, a form published by the Department to assist taxpayers with apportioning and allocating income deriving from within and without New Mexico. *See Instructions for 2016 PIT-B – Schedule of New Mexico Allocation and Apportionment of Income*. Line 1 of the 2016 PIT-B Instructions explains, "[o]nly if wages were earned *in* New Mexico, do non-residents allocate income from line 1 to New Mexico." (Emphasis Added). The instructions go on to provide for Column 2 of Line 1 that:

> **Non-resident.** Enter the part of column 1 that came from *services performed in New Mexico*.
> (Emphasis Added)

In the case at hand, Taxpayer was employed by IJS which is based in New Mexico. However, due to the nature of the work, Taxpayer was permitted to work remotely from his residence in Indiana, and then from his residence in New Jersey after he relocated. Taxpayer, required by IJS to be present in New Mexico for at least 10 days per month, attempted to apportion and allocate a percentage of income to New Mexico that corresponded with the period of time that he was physically present within this state while performing employment obligations for which he was compensated by IJS.

The Hearing Officer was persuaded that Taxpayers' position was consistent with the plain letter of the law. In contrast, the Department's position contradicts its own interpretation and application of Sec. 7-2-11 as observed in the 2016 PIT-B Instructions. The instructions reflect the Department's interpretation of the law and are presumed to be a proper implementation of the provisions of law to which the Department should be bound. *See* NMSA

1978, Sec. 9-11-6.1 (G).

The Department's position in this protest appears to promote an unwritten policy that compensation paid to a non-resident for employment performed outside New Mexico for an employer within New Mexico is taxable to New Mexico. It is probable that as technology advances, opportunities to telecommute, such as those afforded to Taxpayer, will be more common. Some jurisdictions, such as New York, have been addressing issues arising from remote employment for decades. In *Huckaby v. New York State Division of Tax Appeals*, 829 N.E.2d 276 (N.Y. 2005), the New York court of appeals addressed a scenario similar to the facts in the present case. In that case, the taxpayer was a computer programmer who was employed by an organization based in New York. However, the taxpayer resided in Tennessee. Similar to Taxpayer in the present matter, the taxpayer performed most of this work from his home in Tennessee and traveled to New York as circumstances occasionally required. During the years at issue, the taxpayer spent approximately 75 percent of his time working from his home in Tennessee with the remainder working in New York. He allocated and apportioned income between New York and Tennessee based on the number of days he worked in each state.

After completing an audit, the state of New York determined that 100 percent of the taxpayer's New York-sourced income should be allocated to New York. In affirming the taxing authority, the New York court of appeals cited the long-standing policy of the state known as the "convenience of the employer test." The court explained that although the origins of the test were obscure, it was first embodied in the regulations of its taxing authority as early as 1960. The test was promulgated under the authority of an income tax statute which the court in *Huckaby* quoted as follows:

> "[i]f a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the tax commission, the items of income, gain, loss

> and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations." (Tax Law § 631[c].) *Huckaby*, 829 N.E.2d at 280.

The statute in *Huckaby* shares some characteristics with NMSA 1978, Sec. 7-2-3 and 7-2-11. In common with Sec. 7-2-3, both statutes embody the intention of imposing tax on individuals deriving income from transacting business in, into or from their states, and income from employment within the state. Similar with Sec. 7-2-11, it also embodies the intention to allow for income to be apportioned and allocated as the relevant taxing authority determines to be appropriate. It should be noted that although Sec. 7-2-3 and Sec. 7-2-11 do not include an express grant of authority to promulgate regulations, unlike the statute in *Huckaby*, the authority for the Department to promulgate regulations is provided elsewhere. NMSA 1978, Sec. 9-11-6.2 states:

> **9-11-6.2. Administrative regulations, rulings, instructions and orders; presumption of correctness.**
>
> A. The secretary is empowered and directed to issue and file as required by law all regulations, rulings, instructions or orders necessary to implement and enforce any provision of any law the administration and enforcement of which the department, the secretary, any division of the department or any director of any division of the department is charged, including all rules and regulations necessary by reason of any alteration of any such law. In order to accomplish its purpose, this provision is to be liberally construed.

Under the authority of the relevant statute in *Huckaby*, the New York taxing authority then promulgated the following regulation:

> "[i]f a nonresident employee . . . performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State. . . . *However, any allowance claimed for days worked outside New York State must be based upon the*

> *performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employer*" (20 NYCRR 132.18[a]). *Huckaby,* 829 N.E.2d at 280. (Emphasis added).

In other words, if the work is performed in another state due to convenience rather than necessity, then the compensation for that out-of-state work is taxable to New York. In *Huckaby*, the court found that the taxpayer's ability to work from Tennessee was more for the convenience of the taxpayer than for the necessity of the employer, in which case the state of New York was entitled to tax 100 percent of his income sourced from New York employment despite the fact that the taxpayer performed the majority of his employment functions in Tennessee.

The "convenience of the employer test," although long-standing in New York, is not without its asserted defects. In fact, Hellerstein and Hellerstein, in the leading treatise on state taxation, state, "we believe that the 'convenience of the employer' rule is vulnerable to constitutional attack under the Due Process Clause and the Commerce Clause." *See J. Hellerstein & W. Hellerstein*, State Taxation, ¶20.05[4][e][i] (3rd ed. 2001-2015). Because New Mexico has not adopted the "convenience of the employer test," further discussion regarding those issues is not necessary.

However, the Department promotes a similar result as seen in *Huckaby* with one glaring difference. Unlike the taxing authority in New York, the Department has not promulgated any regulations adopting a "convenience of the employer test" or any other rule governing the allocation of income in situations where a non-resident derives income from remote employment in New Mexico. In contrast, and particularly in reference to the 2016 PIT-B Instructions, the Department's implementation of the law is that non-residents are only taxed on that portion of their net income which derived "from *services performed in New Mexico*." Taxpayer in this case, although performing some services in New Mexico, performed the majority of services in his

resident states in which he also paid income taxes on his IJS income.

The court in *Huckaby* made the following observation which the Hearing Officer found particularly noteworthy.

> In short, the statute facially evidences the Legislature's intent to tax nonresidents on all New York source income, and to task the Commissioner to develop a workable rule for apportioning and allocating the taxable income of nonresidents who work both within and without the state. The Commissioner has carried out his statutory responsibility by adopting the convenience of the employer test. *Huckaby*, 829 N.E.2d at 281.

In contrast, the Department did not direct the Hearing Officer's attention to any regulations addressing issues arising from remote employment of non-residents by New Mexico employers, nor was the Hearing Officer able to locate any other regulatory authority on this issue. Instead, the Department's only public position on this scenario, as of 2016, appeared in its 2016 PIT-B Instructions, which with respect for non-residents, applied only to compensation for "services performed in New Mexico."

Taxpayers' protest should be granted. Taxpayer should be allowed to apportion and allocate compensation among New Mexico and his resident states, based on the location of Taxpayer where the services were actually performed. In this protest, Taxpayer credibly testified that he was physically present in New Mexico for 24 percent of tax year 2016.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Department's Return Adjustment Notice issued under Letter ID No. L1391478064, and jurisdiction lies over the parties and the subject matter of this protest.

B. A hearing was timely set and held within 90-days of the Department's acknowledgment of receipt of a valid protest under NMSA 1978, Section 7-1B-8 (2015).

C. Taxpayer overcame overcome the presumption of correctness under Taxpayer under

Regulation 3.1.8.10 NMAC (8/30/2001) and established entitlement to the claimed refund.

D. Taxpayer was entitled to apportion and allocate income pursuant to NMSA 1978, because a percentage of his income was not derived from activities, labor, or performing services within this state pursuant to NMSA 1978, Sec. 7-2-11 (A) (4).

For the foregoing reasons, Taxpayers' protest **IS GRANTED**. Taxpayers' apportionment and allocation of income was proper and Taxpayers are entitled to a refund representing $1,586.00 less $395, an amount which was refunded at the time of the Department's Return Adjustment Notice. Therefore, Taxpayers' actual refund shall be $1,191.00.

DATED: October 5, 2017

Chris Romero
Hearing Officer
Administrative Hearings Office
Post Office Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), the parties have the right to appeal this decision by *filing a notice of appeal with the New Mexico Court of Appeals* within 30 days of the date shown above. If an appeal is not timely filed with the Court of Appeals within 30 days, this Decision and Order will become final. Rule of Appellate Procedure 12-601 NMRA articulates the requirements of perfecting an appeal of an administrative decision with the Court of Appeals. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may begin preparing the record proper. The parties will each be provided with a copy of the record proper at the time of the filing of the record proper with the Court of Appeals, which occurs within 14-days of the Administrative Hearings Office receipt of the docketing statement from the appealing party. *See* Rule 12-209 NMRA.

CERTIFICATE OF SERVICE

On October 5, 2017, a copy of the foregoing Decision and Order was mailed to the parties listed below in the following manner: