STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF **D&O #18-43**
MARK A. & IKESHA M. OWENS
TO RETURN ADJUSTMENT NOTICE ISSUED UNDER
LETTER ID NO. L1784380208

v. Case Number 18.07-159R

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

On August 23, 2018, Hearing Officer Ignacio V. Gallegos conducted a merits hearing in the matter of the tax protest of Mark A. Owens and Ikesha M. Owens ("Taxpayers") pursuant to the Tax Administration Act and the Administrative Hearings Office Act. At the hearing, Mark A. Owens and Ikesha M. Owens appeared representing themselves. Staff attorney Marek Grabowski, Esq., appeared representing the opposing party in the protest, the Taxation and Revenue Department of the State of New Mexico ("Department").

Ikesha Owens was the sole witness for the Taxpayers. Protest auditor, Ms. Mary Griego, appeared as a witness for the Department. Taxpayer's Exhibits 1, 2, 3, 4 and 5 were admitted into the record without objection. The Department's Exhibits A and B were admitted without objection. The Hearing Officer took administrative notice of all documents contained in the administrative file. All exhibits are more fully described in the Administrative Exhibit Log.

The main issue presented before this tribunal in this protest is whether Mr. and Mrs. Owens are "taxpayers" as contemplated by the Tax Administration Act and Income Tax Act. After making findings of fact in this matter and discussing the arguments and the pertinent legal authority in more detail, this tribunal ultimately concludes/rules that the Department prevails in this matter, as the Taxpayer was unable to show either physical presence in New Mexico or substantial evidence of business activity within the State of New Mexico. The hearing officer determines that Taxpayers are not "taxpayers" subject to the

New Mexico Tax Administration Act and therefore are not entitled to receive the refundable credits for which they applied.

FINDINGS OF FACT

1. On February 27, 2018, the Department issued a Return Adjustment Notice giving the Taxpayers notice that there were changes made to their New Mexico Personal Income Tax return for tax year ending December 31, 2016. [Taxpayer Ex. 1A, 1B; Letter ID# L1784380208].

2. The adjustments made by the Department, and noticed in the Return Adjustment Notice letter made a change to line 39 "Overpayment" and specified as a reason for the adjustment that there was a "Calculation error. Amount modified based on information in return." [Taxpayer Ex. 1A, 1B; Letter ID# L1784380208].

3. On May 22, 2018, Taxpayer sent a Formal Protest letter to the Department. [Administrative File].

4. On May 29, 2018, the Department received the Taxpayer's protest letter dated May 22 2018. [Administrative File].

5. On June 11, 2018, the Department acknowledged Taxpayer's protest. [Letter ID # L0327757616; Administrative File].

6. On July 3, 2018, the Department sent Taxpayers a letter explaining the denial of refund. The letter explained the Department's position (later advocated at the hearing) that the Taxpayers are not "taxpayers" as defined by the Tax Administration Act, and that they had no New Mexico income, therefore apportionment was "statutorily prohibited." The letter referenced the statutes, regulations, and a prior non-precedential case before this tribunal. [Taxpayers' Exhibit 5A and 5B].

7. On July 18, 2018, the Department submitted a Hearing Request to the Administrative Hearings Office in which it requested a hearing on the merits of Taxpayer's protest. [Administrative File].

8. On July 18, 2018, the Administrative Hearings Office issued a Notice of Administrative Hearing that set a hearing on the merits of Taxpayer's protest for August 23, 2018. [Administrative File].

9. On August 7, 2018, the Department submitted a Motion for Summary Judgment, which included Exhibits A-001 through A-009 and B-001 through B-004. [Administrative File].

10. On August 23, 2018, a hearing was held at the Administrative Hearings Office, in the Wendell Chino Building, Suite 269, in Santa Fe, New Mexico, a total of 73 days from when the protest was acknowledged by the Department.

11. Taxpayers are a married couple who reside in Vancouver, Washington. [Department Exhibits A and B; Administrative File].

12. Taxpayers became foster parents of four children from New Mexico in 2016. Taxpayers formally adopted the four children from New Mexico in July of 2016. [Testimony of Mrs. Owens, Hearing Record 08/23/18 (H.R.) 28:20-28:50, 48:50-49:20; Department Ex. B -001, B-002, B-003, and B-004].

13. In 2016, Taxpayers entered into two separate agreements with the State of New Mexico, one that was in effect before the adoption, and one that was in effect after the adoption. The second agreement, entitled "Adoption Assistance Agreement," outlines the terms of the continued receipt of monthly payments to Taxpayers for adoption assistance. [Testimony of Mrs. Owens, H.R. 25:50-27:20, 42:50-43:50, 1:01:50-1:01:30, 1:10:00-1:11:00, 1:16:00-1:17:00; Taxpayers Exhibits 4A, 4B, 4C, and 4D].

14. Taxpayers were required to undergo training by both the State of Washington and the State of New Mexico to become caregiving "providers" before the adoption. Before receiving payments from the State of New Mexico, Mrs. Owens was required to provide a Form W-9 to the State. The State did not provide the Taxpayers with a form 1099 for miscellaneous income at the end of the year. [Testimony of Mrs. Owens, H.R. 26:20-26:50, 42:50-43:50, 47:20-47:45, 58:50-59:30, 1:08:00-1:10:50, 1:23:00-1:25:10].

15. Pursuant to the two agreements, Taxpayers received income from New Mexico sources in 2016, including payments for adoption-related attorney expenses, for work-related child care expense (prior to adoption), and for their own services as care providers (#162868) licensed by the New Mexico Children, Youth, and Families Department (CYFD). In total, Taxpayers received $29,036.40 in 2016 from the State of New Mexico. [Testimony of Mrs. Owens, H.R. 25:50-27:00, 43:30-44:30, 59:10-59:30, 1:00:45-1:01:45, 1:16:00-1:19:40; Taxpayer Exhibit 2A; Taxpayer Ex. 3A, 3B].

16. The CYFD also certified that each of the four adoptive children met the State of New Mexico's definition of "special needs child" pursuant to NMSA 1978, Section 32A-5-44. Within the CYFD certification document, there is a note to the parent stating: "For your information, should you choose to apply for tax exemption under Section 7-2-5-4, NMSA 1978, a copy of this certification must accompany your New Mexico Income Tax Return." [Testimony of Mrs. Owens, H.R. 28:00-28:35; Testimony of Ms. Griego, H.R. 1:45:00-1:47:00; Department Ex. B -001, B-002, B-003, and B-004].

17. The Taxpayers filed a 2016 Personal Income Tax Return (PIT-1) with the State of New Mexico, including a Schedule of New Mexico Allocation and Apportionment of Income (PIT-B) and a Rebate and Credit Schedule (PIT-RC) claiming a refund of $1,000.00 as tax credit for each of the four adopted special needs children. [Taxpayer Ex. 2B, 2C; Department Ex. A-001 through A-009].

18. The Taxpayers relied upon Department's publicly available instructions when completing all New Mexico tax returns and schedules. The instructions for the Special Needs Adopted Child Tax Credit do not specify any special record-keeping requirements, or require that the claimant be a New Mexico Resident. The PIT-RC instructions provide no instruction or formula for calculating allocation or apportionment of income for out-of-state residents. [Testimony of Mrs. Owens, H.R. 21:45-22:45, 24:20-25:00, 50:30-52:25; *see also* Instructions for 2016 PIT-RC[1]].

[1] Available online: http://realfile.tax.newmexico.gov/2016pit-rc-ins.pdf

19. Taxpayers supplied the Department attorney previously working on the case (Kenneth Fladager) with an amended PIT-RC to reflect the correct information, based on the Department's July 3rd letter explaining the "taxpayer" definition. [Testimony of Mrs. Owens, H.R. 43:30-46:00, 1:20:00-1:23:00; Taxpayer Exhibit 2].

20. Taxpayers acknowledged that the PIT-RC as filed was inaccurate insofar as line 4 of Section I should have been changed. Line 4 requires, as part of modified gross income, that the Taxpayers report "all income of the taxpayer and household members, both taxable and nontaxable, and undiminished by losses." [Testimony of Mrs. Owens, H.R. 1:20:00-1:23:00; Department Exhibit A5].

21. Taxpayers indicated that the income received from New Mexico had been deemed untaxable from the Federal perspective, pursuant to Internal Revenue Service Notice 2014-07[2], a Medicare waiver of payments to care providers. For this reason, the Taxpayers listed payments from New Mexico as "Other income" on the IRS form 1040. [Testimony of Mrs. Owens, H.R. 47:30-49:15, 1:11:00-1:12:30].

22. Ms. Mary Griego as a protest auditor with the Department reviewed the documents associated with this case, and sought verification from the Internal Revenue Service (IRS) to confirm Taxpayers' income sources. [Testimony of Ms. Griego, H.R. 1:40:00 through 1:45:00].

23. The IRS documents Ms. Griego obtained consisted of W-2s and a Schedule C, which she observed had no New Mexico-sourced income to go into Line 9 of the 2016 PIT-1. [Testimony of Ms. Griego, H.R. 1:43:00-1:45:00].

24. Ms. Griego regarded the Taxpayers, by virtue her review of the documents, as not having taxable income from New Mexico, or a tax liability in the State of New Mexico. [Testimony of Ms. Griego, H.R. 1:42:40-1:45:00; Department Exhibit A-001 through A-009].

25. Ms. Griego indicated that there is no place in the PIT-B to report the type of non-taxable earnings the Taxpayers have shown at the hearing. [Testimony of Ms. Griego, H.R. 1:57:00-01:58:00].

[2] Available online at https://www.irs.gov/pub/irs-drop/n-14-07.pdf

26. Ms. Griego, until this case, was unaware of the fact that the PIT-B instructions promulgated by the Department have no instruction on where to place non-taxable income if earned from New Mexico, on the PIT-B form. [Testimony of Ms. Griego, H.R. 1:55:00-1:56:00, 2:00:00-2:03:00].

27. For guidance, Ms. Griego reviewed a hearing officer's decision on a similar issue, Decision number 13-38. The decision indicates when determining the applicability of the credit, allocation and apportionment of the Special Needs Adopted Child Credit for out of state residents with New Mexico income is appropriate. [Testimony of Ms. Griego, H.R.1:47:30-1:50:20, 2:04:15-30].

28. Ms. Griego indicated that when looking at New Mexico tax liability, her reference point is the PIT-B, which is the allocation and apportionment of income schedule. [Testimony of Ms. Griego, H.R. 1:59:20-2:00:00].

29. Ms. Griego indicated that the PIT-RC is typically used by low-income filers. The entry of "public assistance" as contemplated in line 7 of the PIT-RC, does not include child care payments made by the State. [Testimony of Ms. Griego, H.R. 2:00:00-2:09:05].

DISCUSSION

Taxpayers are residents of the State of Washington who filed a New Mexico personal income tax return in 2016. The Taxpayers filed Personal Income Tax returns in New Mexico, including the PIT-1, PIT-B and PIT-RC, claiming a Special Needs Adopted Child Tax Credit for each of the four children they adopted from New Mexico in 2016. The Department sent a return adjustment notice, effectively denying the requested refund. Taxpayers protested this denial of claim for credit. At the hearing, two protested issues remain: whether the Taxpayers are "taxpayers" under the statute, and whether the credit, if any, should be apportioned based on the New Mexico-sourced income percentage revealed by Taxpayers.

Burden of Proof

The presumption of correctness under NMSA 1978, Section 7-1-17 (C) (2007) does not attach in this matter because the Department did not issue an assessment under Section 7-1-17. Taxpayers nevertheless have the burden to establish that they were entitled to their claim for credit pursuant to Regulation 3.1.8.10 NMAC (08/30/2001) and must establish entitlement to the claimed refund. The denial of Taxpayers' claim for refund is viewed under the lens of a presumption of correctness. *See Corr. Corp. of Am. of Tenn. v. State*, 2007-NMCA-148, ¶17 & ¶29, 142 N.M. 779.

Tax credits are legislative grants of grace to a taxpayer that must be narrowly interpreted and construed against a taxpayer. *See Team Specialty Prods. v. N.M. Taxation & Revenue Dep't*, 2005-NMCA-020, ¶9, 137 N.M. 50, 107 P.3d 4. Under the rationale of *Team Specialty Prods*, Taxpayers carry the burden of proving that they are entitled to the claimed credit. Although a credit must be narrowly interpreted and construed against a taxpayer, it still should be construed in a reasonable manner consistent with legislative language. *See Sec. Escrow Corp. v. State Taxation & Revenue Dep't*, 1988-NMCA-068, ¶9, 107 N.M. 540. Consequently, Taxpayers must show that they are entitled to the refundable credit that is the basis of their claim for refund, and that the Department acted in error in issuing the return adjustment denying the refund.

Special Needs Adopted Child Tax Credit.

The Special Needs Adopted Child Tax Credit is found under NMSA 1978, Section 7-2-18.16 (2007). Section 7-2-18.16 allows for a $1,000.00 refundable credit in each tax year for each eligible child. The statute reads:

> A. A taxpayer who files an individual New Mexico income tax return, who is not a dependent of another individual and who adopts a special needs child on or after January 1, 2007 or has adopted a special needs child prior to January 1, 2007, may claim a credit against the taxpayer's tax liability imposed pursuant to the Income Tax Act. The credit authorized pursuant to this section may be referred to as the "special needs adopted child tax credit".
> B. A taxpayer may claim and the department may allow a special needs adopted child tax credit in the amount of one thousand dollars ($1,000) to be claimed against the taxpayer's tax liability for the taxable year imposed pursuant to the Income Tax Act.
> C. A taxpayer may claim a special needs adopted child tax credit for each year that the child may be claimed as a dependent for federal taxation purposes by the taxpayer.

D. If the amount of the special needs adopted child tax credit due to the taxpayer exceeds the taxpayer's individual income tax liability, the excess shall be refunded.
E. A husband and wife who file separate returns for a taxable year in which they could have filed a joint return may each claim only one-half of the special needs adopted child tax credit provided in this section that would have been allowed on a joint return.
F. As used in this section, "special needs adopted child" means an individual who may be over eighteen years of age and who is certified by the children, youth and families department or a licensed child placement agency as meeting the definition of a "difficult to place child" pursuant to the Adoption Act; provided, however, if the classification as a "difficult to place child" is based on a physical or mental impairment or an emotional disturbance the physical or mental impairment or emotional disturbance shall be at least moderately disabling.

Historically, the legislation that preceded the current statute was NMSA 1978, Section 7-1-5.4 (repealed 2007)[3]. While the former statute was in effect, it was an exemption of $2,500.00, rather than a refundable credit of $1,000.00 as it is currently. The CYFD certification issued to the Taxpayers upon adoption of the children reflected the old statute that has been superceded by the current statute. The regulation interpreting the former statute, Regulation 3.3.4.10 NMAC (12/14/00), has not been changed to reflect that the exemption is now a refundable credit.

The evidence presented at the hearing is clear that Mark and Ikesha Owens adopted four children from New Mexico who each qualified as "special needs" under the statute. The remaining questions are first, whether Mark and Ikesha Owens are to be considered "taxpayers" and second, whether a refund, if any, is to be apportioned according to New Mexico-based income.

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[3] Section 7-2-5.4. Exemption; adopted special needs child. [Repealed 2007.]
A. Any individual who has adopted a special needs child on or after January 1, 1988 may claim an exemption for each such child in an amount specified in Subsection B of this section not to exceed two thousand five hundred dollars ($2,500) of income includable, except for this exemption, in net income until the taxable year in which the special needs child may no longer be claimed as a dependent for federal income tax purposes. Individuals having income both within and without this state shall apportion this exemption in accordance with regulations of the secretary.
B. For single individuals, heads of household and married individuals filing joint returns, for any taxable year beginning on or after January 1, 1988, the amount of the exemption under this section shall be two thousand five hundred dollars ($2,500). For married individuals filing separate returns, for any taxable year beginning on or after January 1, 1988, the amount of the exemption under this section shall be one thousand two hundred fifty dollars ($1,250).
C. As used in this section, "special needs child" means an individual under eighteen years of age who is certified by the human services department or a licensed child placement agency as meeting the definition of a "difficult to place child" in Subsection B of Section 32A-5-44 NMSA 1978; provided, however, that no such classification shall be based upon physical or mental handicap or emotional disturbance that is less than moderately disabling.

Are the protesting Taxpayers "taxpayers" under the Tax Administration Act?

In a written motion for summary judgment, and in closing arguments, the Department argued that the Taxpayers in this case do not fit within the definition of "taxpayer" provided by NMSA 1978, Section 7-1-3 (AA). For purposes of clarity, Mark and Ikesha Owens throughout this decision and order are referred to as "Taxpayers" or "Taxpayer", with a capital "T". Taxpayers, generally, as defined in the Tax Administration Act, are referred to in this decision as "taxpayers" or "taxpayer" with a lower-case "t". The threshold question then is whether Taxpayers are "taxpayers."

The New Mexico Tax Administration Act, NMSA 1978, Section 7-1-1 *et seq.*, defines a "taxpayer." Because this protest pertains to the year 2016, we apply the statute that was in effect in 2016, although it was amended slightly in 2017, yet the amendment would have no effect on this protest. NMSA 1978, Section 7-1-3 (AA) (2015) defines "taxpayer" as "a person liable for payment of any tax; a person responsible for withholding and payment or for collection and payment of any tax; a person to whom an assessment has been made, if the assessment remains unabated or the amount thereof has not been paid; or a person who entered into a special agreement to assume the liability of gross receipts tax or governmental gross receipts tax of another person and the special agreement was approved by the secretary pursuant to the Tax Administration Act."

The Taxpayers in this case raised the issue that "any tax" could refer back to federal tax, or other tax imposed by a governmental authority. The Department argued that "any tax" only refers to "tax" as defined by the Tax Administration Act. The Tax Administration Act definition of "tax" in effect at the time was "the total amount of each tax imposed and required to be paid, withheld and paid or collected and paid under provision of any law made subject to administration and enforcement according to the provisions of the Tax Administration Act and, unless the context otherwise requires, includes the amount of any interest or civil penalty relating thereto; "tax" also means any amount of any abatement of tax made or any credit, rebate or refund paid or credited by the department under any law subject to administration and enforcement

under the provisions of the Tax Administration Act to any person contrary to law and includes, unless the context requires otherwise, the amount of any interest or civil penalty relating thereto." NMSA 1978, Section 7-1-3 (Y) (2015).[4]

"Any tax" as the Department rightly argued, has a built-in limitation to any tax "made subject to administration and enforcement according to the provisions of the Tax Administration Act." Despite the common and broad meaning of "any" advocated by the Taxpayers, to interpret the statute in the extremely broad manner Taxpayers have proposed would lead to overreaching beyond the state's borders and therefore would lead to an unintended result. "Tax statutes, like any other statutes, are to be interpreted in accordance with the legislative intent and in a manner that will not render the statutes' application absurd, unreasonable, or unjust." *City of Eunice v. State Taxation & Revenue Dep't*, 2014-NMCA-085, ¶8 (internal citations and quotations emitted).

The next consideration, then, is the tax act at issue here, the New Mexico Income Tax Act, NMSA 1978, Section 7-2-1 *et seq.* The Income Tax Act also defines a "taxpayer", but differently than the Tax Administration Act. "'Taxpayer' means any individual subject to the tax imposed by the Income Tax Act." NMSA 1978, Section 7-2-2 (Z) (2014).

The Income Tax Act notably does not define "tax," but does delineate who is subject to the Income Tax Act. "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, deriving any income from any property or employment within this state." NMSA 1978, Section 7-2-3 (1981).

It is undisputed that the Taxpayers are not New Mexico residents, so it is necessary to consider the concept of "engaging in the transaction of business in, into, or from this state." If Taxpayers were to fall

[4] This statute was also slightly amended in 2017. Neither of the amendments made substantive changes to the language analyzed in the case at hand.

into the purview of the Income Tax Act statute it would be necessary to fit their activity into the concept of "business in, into, or from this state." The question then would become, whether the State of New Mexico, by requiring the Taxpayer to receive trainings, become certified in the care of disabled and special needs children, and requiring the completion of a W-9 form, was treating the act of fostering and adoption akin to a business enterprise. It should be noted that Taxpayers did not hint, suggest, or argue that the adoptions constituted some sort of business, but their question of whether the state treated it as such is a necessary question to answer because the Taxpayers were unsure how to account for their payments "from the state."

By providing recompense to the foster parents and adoptive parents, and ensuring the children reside in a home where the parents are capable of providing them with necessary care, the State of New Mexico has benefitted from the activities of the adoptive parents. The state has given the Taxpayers income as a result, and this income, even if not taxable, suggests that the State of New Mexico recognized the activity to be valuable. However immeasurably valuable the activity is, raising children and adoption is simply not a business enterprise. The children and the parents are the ultimate beneficiaries of the specialized training, and profits are not measured in dollars but in more subtle and sometimes intangible ways. The adoption assistance payments, although they are "from the state," should not be considered business activity.

Likewise, the second part of Section 7-2-3 requires "deriving any income from… employment within this state." The Taxpayers certainly derived income as a result of their activity, but the activity was not "within this state." In other contexts, New Mexico courts have acknowledged that "[t]he plain meaning of 'within this state' is quite broad." *See State v. Johnson*, 2001-NMSC-001, ¶7, 130 N.M. 6. Even given the broad definition acknowledged in *Johnson*, the court generally acknowledged that the phrase referred to the "interior of New Mexico." *Id*. *See also The protest of Jack & Karen Dill*, Decision and Order #17-42 (N.M. Admin. Hearings Office, October 5, 2017; non-precedential).

Because the Taxpayers were not residents of New Mexico, were not physically present in New Mexico, and did not engage in business or income-generating activity within the state, under the Tax Administration Act, and the Income Tax Act, Taxpayers are not "taxpayers" as defined in the Acts.

The effect of Department's filing instructions.

At the hearing, the Taxpayers argued that the instructions for the PIT-1 and the PIT-RC led them to believe they could apply for the credit. The Department conceded that some of the instructions are not clear, but do not change the law. The Department indicated that the PIT-B is required for out-of-state filers and the PIT-RC is generally intended for low-income filers within the state.

The instructions issued by the Secretary of the Taxation and Revenue Department are presumed to be an accurate implementation of the law. NMSA 1978, Section 9-11-6.2 (G) indicates: "[a]ny regulation, ruling, instruction or order issued by the secretary or delegate of the secretary is presumed to be a proper implementation of the provisions of the laws that are charged to the department, the secretary, any division of the department or any director of any division of the department." The Department may interpret a tax statute without adopting a rule or regulation related to that statute. *See id.* When an agency is charged with the application of a statute, its construction is given some deference, but its construction will be disregarded if its interpretation of the statute is found to be unreasonable or unlawful. *See N.M. AG v. N.M. Pub. Regulation Comm'n*, 2013-NMSC-042, ¶ 12. Even if an agency's interpretation of a statute should have been codified under the State Rules Act, its interpretation is not void if it is a correct interpretation of the law. *See Dir., Labor & Indus. Div., N.M. DOL v. Echostar Communs. Corp.*, 2006-NMCA-047, ¶ 13-14, 139 N.M. 493. "[I]instructions … should be in ordinary, everyday language understood by the man or woman on the street." *Davis v. N.M. State Bureau of Revenue*, 1980-NMCA-153, ¶16, 620 P.2d 376, 95 N.M. 218.

Under the Personal Income Tax filing instructions, there are both required filers and permissive filers. Instructions for the 2016 PIT-1[5] indicate that the people who must file a PIT-1 are "[e]very person who is a New Mexico resident or has income from New Mexico sources" and "[e]very person who is required to file a federal income tax return." For non-residents, the instructions require "you must file in New Mexico when both the following are true: You are required to file a federal return. You have income from any New Mexico source whatsoever." Under this standard, Mark and Ikesha Owens "must" file in New Mexico, since the evidence shows that they are both required to file a federal return, and they have income from a New Mexico source. The instruction does not require tax payment liability.

The same instructions make some taxpayers believe that filing is permissive, even without tax liability: "Taxpayers not required to file a federal tax return with the IRS also are not required to file a New Mexico Personal Income Tax return, BUT they may want to do so to claim certain rebates and credits for low-income filers. You may also want to review Schedule PIT-RC and instructions to determine whether you qualify for *any* of the low-income rebates and credits that may be claimed on that schedule" (emphasis in original). The instructions give potential non-filers the encouragement to file to make a rebate or credit claim.

The instructions to apply for the Special Needs Adopted Child Tax Credit appear in the 2016 PIT-RC instructions[6]. The instructions indicate that in order to claim the refundable tax credits, an applicant does not need to meet the basic qualifications for Sections I through V of the PIT-RC. The basic qualifications include four bullet points:

> You must have been a resident of New Mexico during the tax year. You must have been physically present in New Mexico for at least six months during the tax year (except to claim the child day care credit). You were not eligible to be claimed as a dependent of another taxpayer for the tax year. You were not an inmate of a public institution for more than six months of the tax year.

[5] Available online at http://realfile.tax.newmexico.gov/2016pit-1-ins.pdf

[6] Available online at http://realfile.tax.newmexico.gov/2016pit-rc-ins.pdf

The plain language of the Departmental instructions then, by informing claimants that they need not meet the basic qualifications, therefore *allows* people who were (1) not a resident, (2) not present in the state, (3) were dependents, and (4) were incarcerated to make an application for the refundable credit. Yet, the specific instruction for Section VI and Line 24, in particular, informs claimants that the requirements are: "you file a New Mexico PIT-1 return, you are not a dependent of another taxpayer, you adopted a special needs child, and you claimed the special needs adopted child as a dependent on your federal tax return." As the Taxpayers pointed out, and the Department agreed, the instructions do not make clear who cannot file, aside from these qualifications, and also do not include any instruction for non-resident individuals as to how or whether to allocate and apportion income to receive a reduced credit.

The PIT-1 instructions inform taxpayers that "[d]epending on your residency status and your personal situation, other forms and schedules may also be necessary to attach to and file with your PIT-1." Among those additional forms and schedules is the PIT-B "[t]o allocate and apportion income received from employment, business, or property sources located inside and outside New Mexico, file PIT-B, Schedule of New Mexico Allocation and Apportionment of Income." The Taxpayers also filled out the 2016 PIT-B when completing their return.

Department's 2016 PIT-B instructions[7], in Line 1 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-residents "[e]nter the part of column 1 that came from services performed *in* New Mexico" (emphasis added). Since the Taxpayers here did not have wages or perform services "in" New Mexico, their income as non-residents was not to be allocated or apportioned to New Mexico, although some income came from a New Mexico source. The Taxpayer's contention that New Mexico allows allocation of income earned elsewhere to New Mexico is simply not borne out by the Department's instructions.

[7] Available online at http://realfile.tax.newmexico.gov/2016pit-b-ins.pdf

Mark and Ikesha Owens filed their PIT-1 and PIT-RC forms according to instructions published and promulgated by the Department. Nevertheless, simply following the Department's filing instructions does not guarantee that the credit will be granted. When an agency is charged with the application of a statute, its construction is given some deference, but its construction will be disregarded if its interpretation of the statute is found to be unreasonable or unlawful. *See N.M. AG v. N.M. Pub. Regulation Comm'n*, 2013-NMSC-042, ¶ 12. The Department's instructions simply do not account for the special instance seen here of individuals from outside New Mexico, with no New Mexico presence, and with no employment within New Mexico, who receive non-taxable income from the state and who have graciously fostered and adopted New Mexico children, and who wish to be subject to New Mexico tax laws. It is quite the reverse of most out-of-state tax protestants, who wish *not* to be subject to New Mexico tax laws. *See generally The protest of Jack & Karen Dill*, Decision and Order #17-42 (N.M. Admin. Hearings Office, October 5, 2017; non-precedential); *A&W Restaurants, Inc. v. Taxation and Revenue Dep't.*, 2018-NMCA-069; *see also Kmart Props, Inc., v. Taxation and Revenue Dep't.*, 2006- NMCA-026, 139 N.M. 177. Despite the fact that the Taxpayers filled out their tax returns according to the instructions promulgated by the Department, the Department's instructions alone, even giving due deference, simply do not create access to the credits the Taxpayers seek, without the will of the legislature to provide the credits to persons other than New Mexico "taxpayers." As stated above, the broad interpretation proposed by the Taxpayers in order to fit their tangential New Mexico connection into the definition of "taxpayer" simply does not bear the weight of sound reasoning.

Due Process

Taxpayers raised the argument that the Department did not afford them adequate notice of the reason for the denial of the refundable credit in a timely fashion. *See Garcia ex rel. Garcia v. LaFarge*, 1995-NMSC-019, 119 N.M. 532, 893 P.2d 428 ("Although [the] plaintiffs' due process arguments were not a model of clarity, and certainly could have been made with more specificity, they were sufficient to

alert the trial court and opposing counsel to the substance of the argument being made") (Partially overruled on other grounds by *Cahn v. Berryman*, 2018-NMSC-002); *accord State v. Figueroa*, 2010-NMCA-048, 242 P.3d 378, 148 N.M. 811 (cert. granted 148 N.M. 584). Under New Mexico law, "[p]roperty interests are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits." *N.M. Dep't. of Workforce Solutions v. Garduño*, 2016-NMSC-002, ¶13. Here, a properly enacted statute gave rise to a refundable credit, and the CYFD certificates (Exhibit B1-4) gave rise to a reasonable belief that the statute applied to these adoptive parents.

The property interest in obtaining a refundable credit is a protectable right. Taxpayers' contention challenges the keystones of the administrative process: notice and an opportunity to be heard. The challenge stems from the perceived tardiness of the Department in giving a rationale for the refund denial. The rationale for the Department's action came in the form of a letter sent by the protest auditor, dated July 3, 2018, which was more than a month after the Taxpayers sent their formal protest letter questioning the perfunctory and not at all enlightening Return Adjustment Notice. The July 3, 2018 letter explained the Department auditor's reasoning in denying the credit, and was sent to Taxpayers before the Administrative Hearings Office sent notice of the administrative hearing, and well before the hearing took place on August 23, 2018. The Taxpayers had an opportunity to prepare their case, address the Department's contentions, attend the hearing, cross-examine the Department's witnesses, and seek rulings from the impartial Hearing Officer, and they did so. The Taxpayers were not denied due process of law. *Garduño*, 2016-NMSC-002, ¶ 32-33 (Applicant not prejudiced by late notice as long as notice was not affirmatively misleading, and applicant was able to prepare and participate in the hearing).

CONCLUSIONS OF LAW

A. Taxpayer filed a timely written protest to the return adjustment notice showing a denial of refund issued by the Department, dated February 27, 2018, and jurisdiction lies over the parties and the subject matter of this protest.

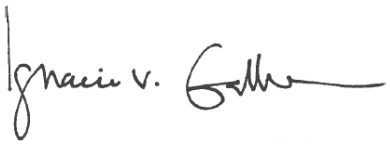
B. The Administrative Hearings Office held a hearing August 23, 2018, within the 90-day hearing requirement provided in NMSA 1978, Section, 7-1B-8 (A) and Regulation 22.600.3.8 (E).

C. Pursuant to *Team Specialty Prods. v. N.M. Taxation & Revenue Dep't*, 2005-NMCA-020, ¶9, 137 N.M. 50, 107 P.3d 4, it is Taxpayer's burden to come forward with evidence and legal argument to establish entitlement to the credit.

D. Taxpayers were unable to establish that the activity of fostering and adopting children from New Mexico was income-generating activity within the state to validate the claim that they are "taxpayers" as defined under the Tax Administration Act and the Income Tax Act. *See* NMSA 1978, Section 7-1-3 (AA) (2015) and Section 7-2-2 (Z) (2014).

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

Dated: December 21, 2018.



Ignacio V. Gallegos
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

I hereby certify that I mailed the foregoing Decision and Order to the parties listed below this 21st day of December, 2018 in the following manner:

First Class Mail *Interdepartmental State Mail*

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John D. Griego
Legal Assistant
Administrative Hearings Office
Post Office Box 6400
Santa Fe, NM 87502
PH: (505)827-0466
FX: (505)827-9732
john.griego1@state.nm.us