

Legislative Finance Committee Presentation: Tax Protest Hearing Process

Joint Presentation

by TRD Secretary John Monforte and AHO Chief Hearing Officer Brian VanDenzen

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Objectives of Presentation

- ▶ To provide an overview of the Administrative Hearings Office (“AHO”) and the work it does.
- ▶ To provide an overview of the Tax Protest Hearing Process, including identifying TRD’s and AHO’s distinct roles in that process.
- ▶ To highlight general statistical information about AHO’s workload and the tax protest docket.
- ▶ To highlight a few areas where statutory changes could improve the efficiency of the hearing process.
- ▶ To answer your questions about the tax protest hearing process.



Limitations of Presentation

- ▶ By statute and regulation, the Administrative Hearings Office is prohibited from:
 - ▶ Engaging in the formulation of tax policy (Section 7-1B-7 NMSA 1978);
 - ▶ Discussing the merits of pending matters before AHO (Section 7-1B-7 NMSA 1978 and Reg. 22.6002.17 NMAC);
 - ▶ Revealing confidential, taxpayer information (Section 7-1-8.1 through 8.10 NMSA 1978);
 - ▶ Making any public statements, commitments, or pledges about a particular matter or issue that might reasonably be expected to affect the outcome of the matter or create a question about the fairness of a proceeding or the impartiality of the hearing officer. (Reg. 22.6002.17 NMAC)
- ▶ The Administrative Hearings Office and Taxation and Revenue Department are two separate agencies, each with their own unique statutory roles.



About the Administrative Hearings Office (AHO)

- ▶ Before 2015, tax protests hearings were heard by the Hearings Bureau of the New Mexico Taxation and Revenue Department (TRD).
- ▶ There was a movement to make the Hearings Bureau an independent hearing office separate from TRD, which finally came to fruition in 2015 with the passage and enactment of the bipartisan Administrative Hearings Office Act, Section 7-1B-1 through 9 NMSA 1978.
- ▶ TRD's Hearings Bureau staff became the new Administrative Hearings Office, an agency independent of TRD.
- ▶ AHO is administratively attached to DFA, however, DFA plays no supervisory role over AHO.



AHO Budget

- ▶ AHO’s first budget and staffing in FY16 came from the transfer of existing TRD-budgeted funds and staffing.
 - ▶ Included 15 program positions and money to hire one additional FTE person to handle financial duties, for a total of 16 FTEs.
 - ▶ AHO has not fundamentally expanded beyond that initial transfer of staffing from TRD.
- ▶ AHO general fund dollars have decreased since the initial transfer from TRD, experienced increase in overall budget because of the transfer of hearing fees collected by MVD out of the Motor Vehicle Suspense Fund.

Revenue Source	FY2016	FY2017	FY2018	FY2019
General Fund appropriation	1,554,800.00	1,593,500.00	1,503,700.00	1,503,700.00
Statutory reduction to appropriation	(9,300.00)	(87,600.00)		
Adjusted General Fund Appropriation	1,545,500.00	1,505,900.00	1,503,700.00	1,503,700.00
MVD Suspense Fund	0.00	100,000.00	155,000.00	165,000.00
Total Appropriation	1,545,500.00	1,605,900.00	1,658,700.00	1,668,700.00



More About AHO

- ▶ AHO conducts and adjudicates state administrative protest hearings under the Tax Administration Act, the Property Tax Code, the Motor Vehicle Code, and the Implied Consent Act. This results into two essential hearing types:
 1. **Implied Consent Act, DWI license revocation hearings.**
 - ▶ Conduct any hearing involving driver's license issues.
 - ▶ Main type of hearing is DWI license revocation hearings under the Implied Consent Act.
 - ▶ AHO conducts between 3,000-6,000 of these hearings across the state each year.
 - ▶ Historically, AHO has had 8 hearing officer positions that focus mostly on conducting Implied Consent Act hearings.
 2. **State Tax Protest Hearings pursuant to the Tax Administrative Act.** A taxpayer is challenging TRD's assessment, denials of refunds, credits, notices of property valuation, etc.
 - ▶ 2.5 full time hearing officers positions, one high level hearing officer who handles a full docket; one who has a $\frac{3}{4}$ docket of medium level tax protests, and I maintain a $\frac{3}{4}$ tax docket of complex cases.



Tax Administration Act and Tax Protests

- ▶ The Tax Administration Act (TAA), Section 7-1-1 through 82 NMSA 1978, establishes the general procedural rules for administration of most of the state's tax programs.
- ▶ Section 7-1-24 NMSA 1978 of the TAA gives taxpayers the ability to protest and dispute:
 - ▶ An assessment of tax;
 - ▶ The application of any provision of the TAA against a Taxpayer except the issuance of a subpoena or summons; or
 - ▶ The denial of or failure either to allow or deny:
 - ▶ Credit or rebate; or
 - ▶ claim for refund.
- ▶ Similarly, the Taxpayer Bill of Rights under Section 7-1-4.2 NMSA 1978 gives taxpayers the right to seek review of TRD's actions under the TAA.



Mechanics of Filing Tax Protest

- ▶ Section 7-1-24 NMSA 1978 requires taxpayers to file a written protest with TRD within 90-days of TRD's challenged action.
 - ▶ Note- the protest does not go to AHO initially, but to TRD.
 - ▶ For protests regarding a claim for refund, taxpayers have two options to contest TRD's decision on the refund claim
 - 1) File an administrative protest with TRD pursuant to Section 7-1-24; or
 - 2) Bypass the administrative protest process by filing a civil action (lawsuit) directly in the District Court in Santa Fe. (Section 7-1-26 NMSA 1978).
 - ▶ Filing of one (either a protest or civil suit) precludes the other option.
- ▶ Generally the grounds cited in the formal protest become the issues addressed during the hearing process.



TRD's Handling of the Protest

- ▶ Under the Administrative Hearings Office Act, Section 7-1B-8 (A) NMSA 1978, TRD receives the protest.
 - ▶ TRD's Protest Bureau reviews the protest to ensure it meets the statutory requirements and sends an acknowledgment of receipt of a valid protest to the taxpayers.
 - ▶ TRD assigns a protest auditor to review and work the protest.
- ▶ If TRD and a taxpayer are unable to resolve the protest, TRD is required within 45 days to request a hearing with the Administrative Hearings Office. *See Section 7-1B-8 (A) NMSA 1978.*
 - ▶ TRD's Protest Bureau files an electronic hearing request with AHO.
 - ▶ This is when AHO becomes aware of the protest.



AHO Schedules the Protest Hearing

- ▶ Upon receipt of a request for hearing on a protest, the Chief Hearing Officer reviews the protest letter and TRD's request for hearing form.
- ▶ Based on assessment of the complexity of the case, and the preference of TRD in the request for hearing, the Chief Hearing Officer sets the case for a hearing under a **two-track hearing process** implemented in 2013.
 - ▶ For simple cases the case is set for a **merits hearing** within 90-days of TRD's acknowledgement of receipt of a protest. (Section 7-1B-8 (A) NMSA 1978).
 - ▶ In FY2017, TRD requested a Merits Hearing in **109 cases, or 35% of new cases.**
 - ▶ For more complex, litigious cases, where the parties anticipate extensive discovery and motions practice before conduct of the merits hearing, required under Section 7-1B-6 (D) NMSA 1978, the matter is set for a **scheduling hearing**. At the scheduling hearing, discovery, motions deadlines, and a merits hearing date is selected.
 - ▶ In FY2017, TRD requested a Scheduling in **200 cases, or 65% of new cases.**



Scheduling Hearings

- ▶ Conducting the scheduling hearing within 90-days harmonizes two statutory provisions:
 - ▶ The mandate to conduct a hearing within 90-days under Section 7-1B-8 NMSA 1978;
 - ▶ The mandate to allow for a fair and ample opportunity for both sides to present their case, including allowing for a discovery process and for submission of motions, as required under Section 7-1B-6(D) NMSA 1978.
 - ▶ Discovery for a moderate to complex case typically will exceed 90-days.
- ▶ Upon objection to conducting the scheduling hearing, a merits hearing will promptly be set. *See Reg. 22.600.3.8 NMAC.*
 - ▶ In the five years of using this approach, a party has objected to a scheduling hearing fewer than 10 times.
- ▶ During the scheduling hearing, the parties discuss the issues in the protest and the hearing officer-ALJ tries to use their own knowledge and experience of tax law to get the parties to focus productively on what needs to happen to move the protest forward in an efficient manner.
- ▶ At the Scheduling Hearing, discovery and motions deadlines are set, and a formal merits hearing date(s) is set.



Scheduling Hearings (Continued)

- ▶ By getting the parties engaged and communicating during the Scheduling Hearing, AHO often finds there are areas of potential agreement needing further exploration.
- ▶ Sometimes a Scheduling Hearing turns into a soft form of mediation.
- ▶ This is an area where a statutory change expressly authorizing a formal mediation process as part of the tax protest process, could result in improved interaction between TRD and taxpayers at an earlier stage of the process short of full litigation.



The Merits Protest Hearing

- ▶ With agreement of both parties, under Section 7-1B-8(B) NMSA 1978, the protest hearing can occur via videoconference, a process we are currently starting to implement under our new hearing regulations, 22.600.3.10 NMAC.
- ▶ The protest hearing is a confidential, closed proceeding unless a taxpayer requests it to be an open hearing. See Section 7-1B-8 (B) NMSA 1978.
- ▶ A taxpayer may be represented by a bona fide employee, an attorney, or a certified public accountant at the protest hearing. In personal income tax cases only, an enrolled agent may also represent a taxpayer. See Section 7-1B-8 (B) NMSA 1978.



Merits Protest Hearing (Continued)

- ▶ Generally, taxpayers have the burden of proof during the hearing to overcome the presumption of correctness that attached to TRD's assessment. *See* Section 7-1-17 (C) NMSA 1978. Under case law, taxpayers also generally have the burden to establish entitlement to claim for refund or claim for credit.
 - ▶ Under case law, if taxpayer's case overcomes the presumption of correctness in the case, the burden then shifts to TRD to reestablish the correctness of its action.
 - ▶ Taxpayers present their case first, including exhibits/documents and witness testimony.
 - ▶ TRD then presents its case, including its witnesses (usually just the assigned protest auditor) and its exhibits/documents.
 - ▶ All witness testimony is given under oath and is subject to cross-examination.
- ▶ AHO has the statutory authority to subpoena witnesses and compel production of documents for the hearing, under Section 7-1B-6 (D)(3) NMSA 1978.
 - ▶ TRD also has general subpoena power authority under Section 7-1-4 (D) NMSA 1978.
 - ▶ Unlike TRD's statutory subpoena power, AHO's subpoena power lacks a clear enforcement mechanism for failure to comply with a subpoena.
 - ▶ This is an area where some additional legislative clarity about the enforcement mechanism and when AHO or TRD's subpoena power applies could help streamline the process.



Resolving/Disposing of a Tax Protest

- ▶ After conclusion of the hearing, the parties may request and the assigned Administrative Law Judge may require submission of additional legal briefing, proposed findings of fact, and proposed conclusions of law. See Section 7-1B-6(D)(2) NMSA 1978 and Regulation 22.600.3.25 NMAC.
- ▶ Upon receipt of all the evidence at the conclusion of the hearing, and any required post-hearing legal briefing or other submissions, the assigned Administrative Law Judge reviews the record, researches the legal issue, and prepares the final decision and order.
 - ▶ A final decision and order is made in writing, and contains the following:
 - ▶ Detailed Findings of Fact, often with specific citations to the supporting evidence or the specific testimony supporting the finding.
 - ▶ A detailed discussion section addressing the arguments of the parties and analyzing the factual and legal issues presented in the matter.
 - ▶ Conclusions of Law in the matter.
 - ▶ The final decision and order is extremely important because it has multiple audiences:
 - ▶ The two parties in dispute in the hearing;
 - ▶ The Court of Appeals, as the reviewing body;
 - ▶ Although AHO's final decision and order has no formal legal precedence (stare decisis or controlling authority), both TRD and tax professionals rely on them in addressing (and avoiding) similar issues.
 - ▶ The Legislature and LFC staff can also review the decision and orders for general guidance about what statutory areas that could be addressed by the Legislature.
 - ▶ All decisions and orders are public documents, available for review at <http://www.tax.newmexico.gov/tax-decisions-orders.aspx> . AHO also has an email distribution list for decisions.



Time to Dispose of a Tax Protest Hearing

- ▶ Many factors impact the time it takes to resolve a case. Here are some examples:
 - ▶ The complexity of the case: bigger, more complex cases simply take longer to fairly adjudicate.
 - ▶ Whether the parties need extensive exchange of information and discovery before conducting the hearing, as allowed under Section 7-1B-6 NMSA 1978.
 - ▶ The knowledge of the parties before AHO about substantive and procedural tax law.
 - ▶ Whether there is a similar case on appeal: appeals can take between six months to two years to resolve.
 - ▶ Whether a taxpayer is waiting for IRS adjustments.
 - ▶ The availability of hearing officer to conduct the hearing and write the decision.



Growth in the Tax Docket (by Calendar Year)

Calendar Year	New Hearing Requests (cases) Filed	Decisions and Orders Issued
2008	34	11
2009	58	14
2010	67	35
2011	102	48
2012	54	46
2013	235	82
2014	382	89
2015	275	69
2016	402	113
2017	493	88



Dispositions: Fiscal Year 2016 Protest Hearings

- ▶ In Fiscal Year 2016, the Administrative Hearings Office received **406** new tax protest hearing requests.
- ▶ **375** of those cases are resolved and closed (though some decisions are still under appeal).
- ▶ There are still **9** active protest cases from FY16 on the docket.
- ▶ There are **22** cases that are “**stayed**”—meaning placed on hold—pending resolution of an appeal or waiting approval of a closing agreement (settlement) between the parties.
 - ▶ These 31 cases, either active or stayed, relate primarily to the construction cost segregation appeal (Weil Construction Case) and the chemical reagent deduction under 7-9-65 NMSA 1978 issue under appeal.
- ▶ Total Outstanding FY16 Amounts drawn from hearing request forms (rough approximate, TRD will have a more complete picture):
 - ▶ \$14 million in assessments
 - ▶ \$59 million in outstanding refund/credit claims.
- ▶ The current average disposition time for FY16 cases is **222** days.



Dispositions: Fiscal Year 2017 Protest Hearings

- ▶ In Fiscal Year 2017, the Administrative Hearings Office received **345** new tax protest hearing requests.
- ▶ **261 (75%)** of those cases are resolved and closed (though some decisions are still under appeal).
- ▶ The current average disposition time for FY17 cases is **193** days.
- ▶ There are still **52 (15%)** active protest cases in FY17 still on the docket.
- ▶ There are **32 (10%)** cases that are **stayed** pending resolution of an appeal or waiting approval of a closing agreement (settlement) between the parties.
- ▶ The main disputed issues on the outstanding cases involve:
 - ▶ High Wages Jobs Tax Credit under Section 7-9G-1 NMSA 1978
 - ▶ Medical Deductions under 7-9-93 NMSA 1978 (related to the Healthsouth Decision and Order)
 - ▶ Chemical reagent deduction under 7-9-65 NMSA 1978 (cases addressing this deduction are currently under appeal before the Court of Appeals)
- ▶ Total Outstanding FY17 Amounts (rough approximate, TRD will have a more complete picture):
 - ▶ \$79 million in assessments.
 - ▶ \$77 million in outstanding refund/credit claims.



Dispositions: Fiscal Year 2018 Protest Hearings

- ▶ In Fiscal Year 2018, preliminary numbers through the end of the 3rd quarter, the Administrative Hearings Office received **411** new tax protest hearing requests.
- ▶ **180 (44%)** of those cases are resolved and closed (though some decisions are still under appeal).
- ▶ There are still **231** active and stayed protest cases from FY18 still on the docket.
- ▶ The three main disputed issues on the outstanding cases involve:
 - ▶ High Wages Jobs Tax Credit under Section 7-9G-1 NMSA 1978
 - ▶ Medical Deductions under 7-9-93 NMSA 1978 (related to the Healthsouth Decision and Order)
 - ▶ Chemical reagent deduction under 7-9-65 NMSA 1978 (cases addressing this deduction are currently under appeal before the Court of Appeals)
- ▶ Total Outstanding FY18 Amounts (rough approximate, TRD will have a more complete picture):
 - ▶ \$60 million in assessments.
 - ▶ \$98 million in outstanding refund/credit claims.



Appeals

- ▶ By statute, both parties have a right to appeal a tax protest decision and order directly to the New Mexico Court of Appeals. See Section 7-1B-8 (C) NMSA 1978.
- ▶ Currently, there are at least 21 AHO decisions and orders under appeal before the Court of Appeals. At least three of the pending appeal issues could potentially significantly narrow the scope or resolve many of the outstanding issues in stayed cases before AHO:
 - ▶ Construction Cost Segregation Issue (*Weil Construction*, Appeal No. A-1-CA-35845, Taxpayer appeal filed 9/14/2016)
 - ▶ Medical Deduction under 7-9-93 NMSA 1978 (*Golden Services*, Appeal No. A-1-CA-36987, TRD appeal filed 1/18/2018)
 - ▶ Chemical reagent deduction under 7-9-65 NMSA 1978 (*Tucson Electric*, No. A-1-CA-35781, Taxpayer appeal filed 7/21/2016, & *Peabody Coalsales Company*, No. A-1-CA-36632, Taxpayer appeal filed 8/29/2017)
- ▶ Based on our log of appealed cases, an appeal typically takes between six months to two years, with an approximate average of 18-months. If the decision is appealed further to the New Mexico Supreme Court, or federally, the appeals period will be longer.
- ▶ Historically, the Administrative Hearings Office has been affirmed/mostly affirmed on main issue by the Court of Appeals in approximately 76% of cases.



Ways to Improve Hearing Disposition Efficiency from AHO's Perspective

- ▶ Make statutory changes that expressly allow for a mediation process.
- ▶ Sometimes, the tax protest docket gets clogged with very minor merits hearings when much more significant cases should be the priority and the focus.
 - ▶ TRD's authority to resolve cases is limited by constitutional and statutory provisions, and the way the language is currently written under Section 7-1-17 (A) NMSA 1978's \$25.00 assessment limitation, TRD interprets that amount only to create a duty to assess any liability exceeding \$25 rather than as a prohibition to assessments under that amount.
 - ▶ Statutory changes could make clear that assessments of less than \$25.00 should not be pursued through hearing.
- ▶ As AHO discussed in previous years, **increasing the number of dedicated tax hearing officer/ALJs.**
 - ▶ Increase their classification in a manner that will allow AHO to retain and recruit tax subject matter experts.
 - ▶ Provide funding to increase training opportunities for ALJs in tax law.
 - ▶ These protest cases are important for both the state, in efficiently collecting revenue with certainty, and Taxpayers/business in determining their risk/opportunity in New Mexico. Providing additional resources into improving the efficiency of the process benefits both the state and the business/taxpaying community.
- ▶ A comprehensive and modern case and docket management software would allow AHO to improve hearing efficiency and make tracking of efficiency and other statistical information more possible.



Historical and Current Placement Or Why are We Talking About This

- ▶ Continued discussion about non-economic factors in the revenue forecast.
- ▶ Lack of Language Consistency.
- ▶ Lack of Application Consistency.
- ▶ Seeking Balance between the Protection of the General Fund and Economic Development.
- ▶ Causal relationship between economic downturn and an increase in protests.



Snapshot Example

- ▶ In 2016, the Protest Office acknowledged 1,900 formal protests.
- ▶ Approximately 1,800 protests were closed.
- ▶ Of those that were closed, approximately 1,200 were resolved by the protest office, usually penalty and interest cases and corrections or lack of documents.
- ▶ The percentage is about 67%-70% resolved at the protest level and 30%-33% legal handles through litigation (Protest or District Court).



Tax Protests at TRD

	FY13	FY14	FY15	FY16	FY17	FY18 YTD
Number of Protests Filed	326	501	471	797	609	194
Number of Protests Resolved	269	410	370	760	539	254
Cumulative Number of Protests Outstanding at End of FY	57	145	133	120	185	175

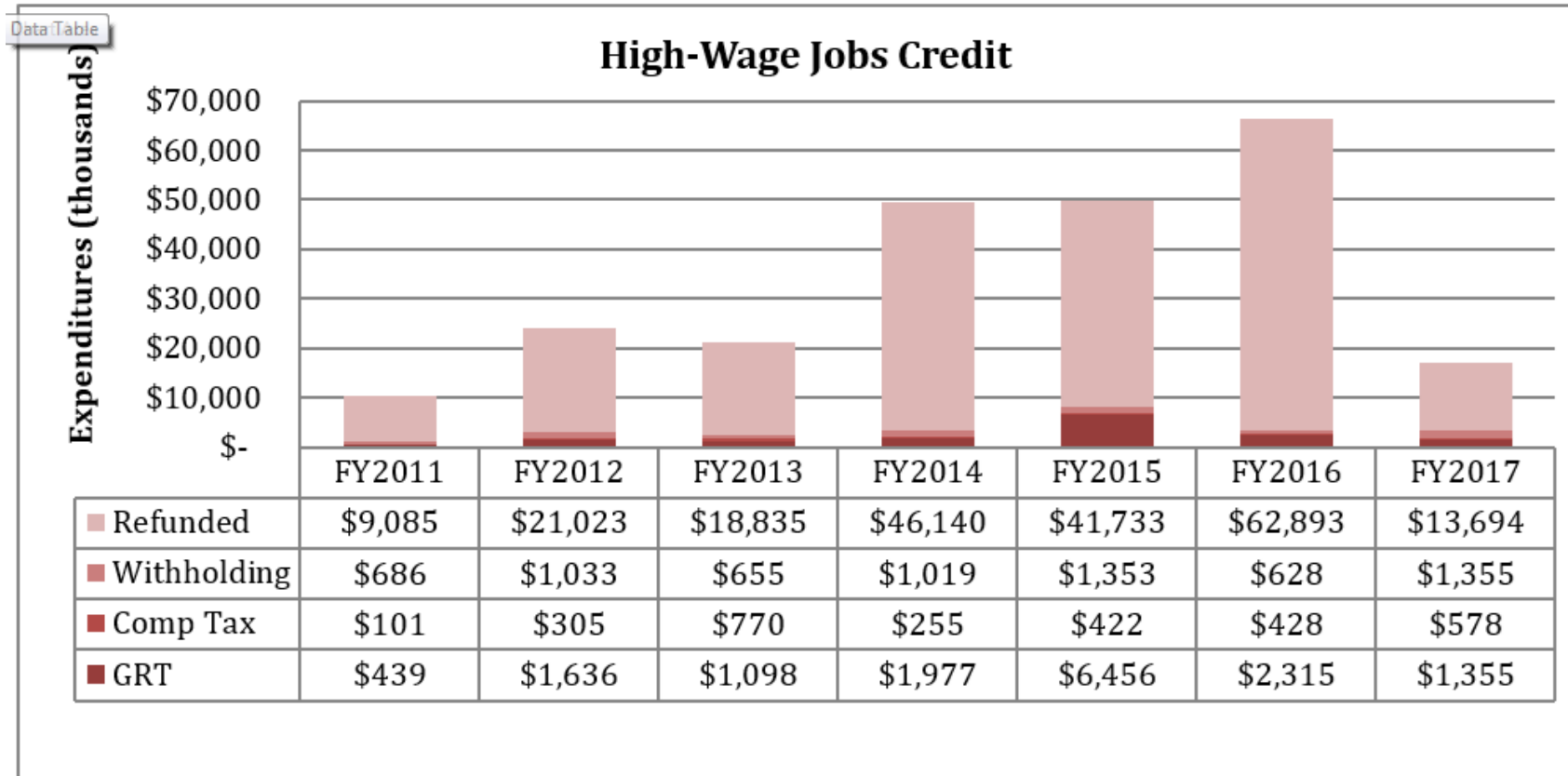


Top Five List of Reasons for Protest

Top Five Protest Issues by FY (identify issues and magnitude of protest value for each issue)	FY13	FY14	FY15	FY16	FY17	FY18 YTD
Issue 1	High-wage Tax Credit	High-wage Tax Credit	High-wage Tax Credit	High-wage Tax Credit	High-wage Tax Credit	Missing Documents
Issue 2	Missing documents	Missing documents	Missing documents	Missing documents	Missing documents	Disallowed net operating loss
Issue 3	Disallowed net operating loss	Disallowed net operating loss	Disallowed net operating loss	Chemical Reagent	Chemical Reagent	Erroneous reporting gross receipts tax
Issue 4	Missing payment	Missing payment	Hospital Credit 7-9-63 & 77.1	Hospital Credit 7-9-63 & 77.1	Hospital Credit 7-9-63 & 77.1	Hospital Credit 7-9-63 & 77.1
Issue 5	Statute of Limitation	Statute of Limitation	Cost Segregation	Cost Segregation	Statute of Limitation	High-wage Tax Credit

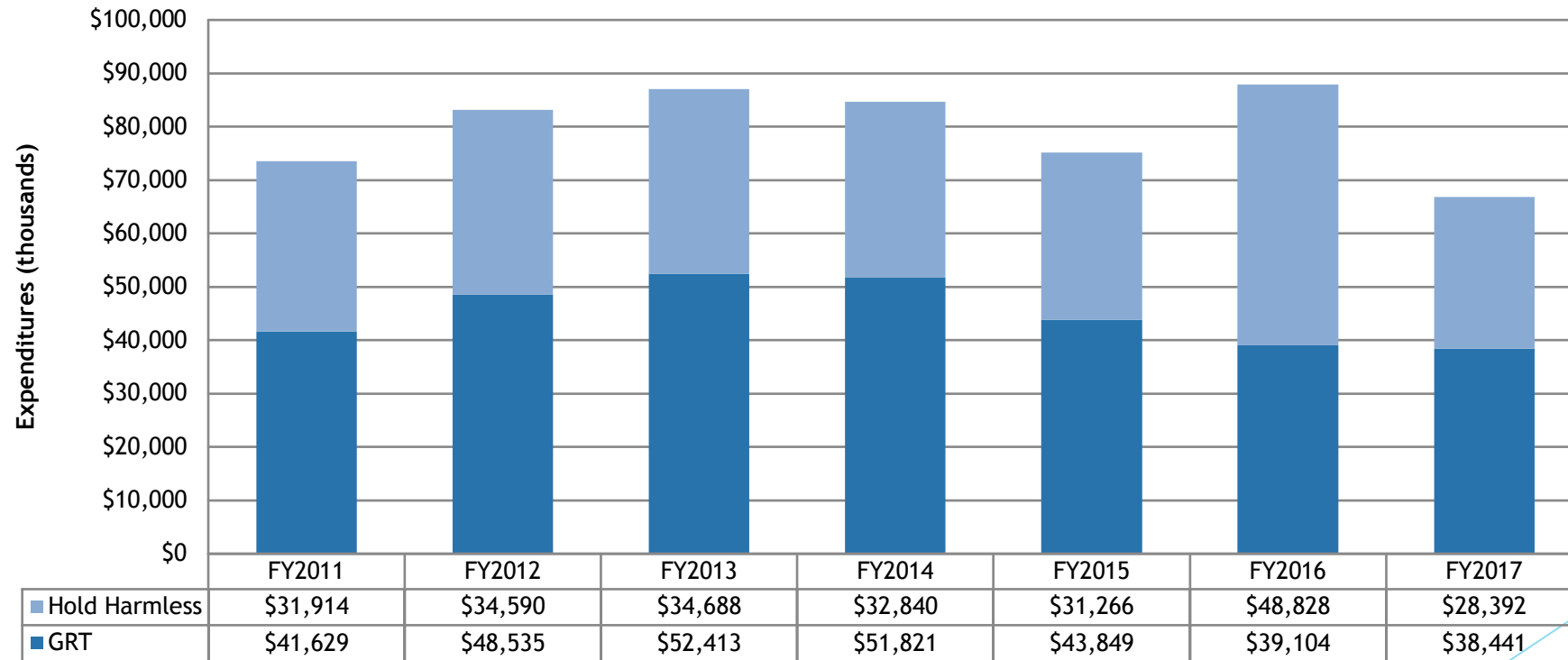


High-Wage Jobs Credit



Hospital Credit

Health Care Practitioner Services Deduction



Chemical Reagent

- ▶ Chemical reagent deduction under 7-9-65 NMSA 1978 (*Tucson Electric*, No. A-1-CA-35781, Taxpayer appeal filed 7/21/2016, & *Peabody Coalsales Company*, No. A-1-CA-36632, Taxpayer appeal filed 8/29/2017)
- ▶ Single largest risk category from a financial perspective
- ▶ Second series type of reagent cases currently scheduled on the hearing calendar in June, 2018
- ▶ Various bills in the 2018 legislative session considered Section 7-9-65 NMSA 1978.



Ways to Improve from a TRD Perspective

- ▶ Development of the Business Credit Unit.
 - ▶ Five FTE within the Office of the Secretary that include an attorney and economist to assist day-to-day determinations and develop long term policy
 - ▶ Best Practice
- ▶ Strengthening the Legal Bureau.
 - ▶ Adding additional staff
 - ▶ Re-class of at least four positions to Attorney 4 for purposes of retention and recruitment
 - ▶ Inclusion of cases into GenTax.
- ▶ Tax Incentive Statute Construction.
- ▶ Additional Regulations.
 - ▶ High-Wage Jobs Tax Credit
 - ▶ Cost Segregation



Questions

- ▶ Before we address your questions, it is important to reiterate some of AHO's limitations on addressing:
 - ▶ Questions dealing with the formulation of substantive tax policy (Section 7-1B-7 NMSA 1978);
 - ▶ Questions addressing the merits of any pending matters before AHO (Section 7-1B-7 NMSA 1978 and Reg. 22.6002.17 NMAC);
 - ▶ Questions that might require addressing such a small pool of taxpayers that it could be considered revealing confidential, taxpayer information (Section 7-1-8.1 through 8.10 NMSA 1978);
 - ▶ Questions that might require making any public statements, commitments, or pledges about a particular matter likely to be before AHO. (Reg. 22.6002.17 NMAC)
- ▶ In light of these limitations, AHO may have to defer to TRD to answer some of your questions.
- ▶ With that, we stand for questions.

