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

IN THE MATTER OF THE PROTEST OF
MARY ANN MENDONCA **No. 05-01**
ASSESSMENT OF INTEREST ISSUED
UNDER LETTER ID NO. L0932663296

DECISION AND ORDER

This matter came before Margaret B. Alcock, Hearing Officer, on a Statement of Stipulated Facts and Joint Memorandum filed by the parties, who asked that the above-referenced protest be decided based on the parties' written submission and without a hearing. The Taxation and Revenue Department ("Department") was represented by Peter Breen, Special Assistant Attorney General. Mary Ann Mendonca ("Taxpayer") represented herself. Based on the facts and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is a New Mexico resident who filed a timely 1999 New Mexico personal income tax return ("PIT-1") showing tax due in the amount of $61.00.

2. The Taxpayer included a check for $61.00 with her return.

3. Because the Taxpayer filed federal Form 1040EZ to report her 1999 income to the federal government, her federal standard deduction and exemption were combined as a single amount on Line 5 of her federal return.

4. The instructions to the 1999 New Mexico PIT-1 directed taxpayers who filed Form 1040EZ to report their combined federal deduction and exemption on Line 7 of the PIT-1 (federal standard or itemized deduction amount) and leave Line 8 of the PIT-1 (federal exemption amount) blank.

5. The Taxpayer followed the Department's instructions and correctly completed her 1999 New Mexico PIT-1.

6. In reviewing the Taxpayer's return, the Department incorrectly concluded that the Taxpayer had not taken the federal exemption to which she was entitled.

7. Even though the New Mexico PIT-1 requires taxpayers to include their address and telephone number on their return, the Department never contacted the Taxpayer in this case to ask why she had not claimed the federal exemption on Line 8 of the PIT-1 or notify her that she might have overreported her tax liability.

8. Instead of contacting the Taxpayer, the Department acted on its own initiative to erroneously credit her with an additional federal exemption in the amount of $2,750.00 and recalculate her New Mexico income tax liability.

9. On April 10, 2000, the Department notified the Taxpayer that she had overpaid her 1999 New Mexico income tax and sent her an unsolicited refund check in the amount of $167.50. The Department did not provide any explanation for the adjustment.

10. At the time the check was sent to the Taxpayer, the Department was not authorized to make unsolicited refunds. The Department's action was also directly contrary to Department Regulation 3 NMAC 1.9.8 (now codified as 3.1.9.8 NMAC) to NMSA 1978, § 7-1-26, which states that the Secretary of the Department "has not been given statutory authority to initiate" a refund and that "[t]he person affected must initiate the claim for refund."

11. In 2003, the Department received information from the Internal Revenue Service that led the Department to discover the duplicate exemption amount credited to the Taxpayer on her 1999 New Mexico income tax return.

12. On August 21, 2003, the Department issued an assessment under Letter ID No. L0932663296, assessing the Taxpayer for $165.00 of 1999 personal income tax, which was the deficiency created by the Department's unauthorized refund to the Taxpayer, plus $82.61 of interest and $16.50 of penalty.

13. On August 29, 2003, the Taxpayer paid the tax principal assessed.

14. On September 10, 2003, the Taxpayer filed a written protest to the assessment of interest and penalty.

15. The Department subsequently abated the penalty and recalculated the amount of interest assessed, reducing the interest to $80.44.

DISCUSSION

The issue to be decided is whether the Taxpayer is liable for the $80.44 of interest assessed on the $165.00 tax deficiency created by the Department's unauthorized return of a portion of the Taxpayer's 1999 personal income tax. The Taxpayer argues that she should not be liable for interest because the $165.00 check she received from the Department does not meet the definition of a refund under the Tax Administration Act, but was an unauthorized payment made on the Department's own initiative. It is the Department's position that interest is due on all underpayments of tax, without regard to the circumstances that led to the underpayment.

Applicable Law. NMSA 1978, § 7-1-67 governs the imposition of interest 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....

Although the language of the statute appears to limit the imposition of interest to situations where a tax is not paid by the statutory due date, the definition of "tax" in NMSA 1978, § 7-1-3 indicates that

interest is also due on tax deficiencies created by erroneous refunds. Section 7-1-3(V)[1] provides that the term "tax" includes:

> 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.

In reliance on this definition, the Department has adopted Regulation 3.1.10.18 NMAC, which addresses the issue of "excess" refunds as follows:

> C. **When interest applies to repayments of excess refunds**.
>
> (1) "Tax" as defined by the Tax Administration Act, includes any amount of any credit, rebate or refund paid by the department contrary to any law subject to administration under the Tax Administration Act. An excess credit, rebate or refund paid is a tax owed to the state. When no due date is specified by statute, the due date of such a tax is 30 days after the excess credit, rebate or refund is received by the taxpayer. Interest shall be applied for each month or fraction thereof from the due date until the excess credit, rebate or refund is paid.
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> (2) Unless the preponderance of evidence indicates another date, the person to whom the department mails an excess credit, rebate or refund shall be presumed to have received the excess credit, rebate or refund seven days after the department mailing.
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> (3) Subsection C of Section 3.1.10.18 NMAC applies to any excess credit, rebate or refund paid by the department after January 1, 1994.

The Department's Unsolicited Refund Comes Within the Definition of "Tax." The first issue to be addressed is whether the Department's unsolicited payment to the Taxpayer can be characterized as a refund that comes within the definition of "tax" set out in NMSA 1978, § 7-1-3(V). The Taxpayer argues that the payment could not have been a refund because the Department did not have jurisdiction to make refunds. In support of her argument, the Taxpayer references two

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[1] At the time the Department made its erroneous payment to the Taxpayer in April 2000, this subsection was designated as § 7-1-3(U). Because no changes have been made to the text of the subsection, it will be referred to in this decision by its current designation of § 7-1-3(V).

federal tax cases discussing the procedures applicable to different types of refunds made by the Internal Revenue Service. *See, Singleton v. United States*, 128 F.3d 833 (4th Cir. 1997); *O'Bryant v. United States*, 49 F.3d 340 (7th Cir. 1995). In contrast to federal law, however, New Mexico law does not recognize the distinction between "rebate" and "non-rebate" refunds discussed in the federal cases. For this reason, these cases are not applicable to the issues raised here. *See*, *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 797, 779 P.2d 982, 984 (Ct. App. 1989) (federal negligence standard held inapplicable because it is inconsistent with state law); *State v. Long*, 121 NM 333, 911 P.2d 227 (Ct. App.), *cert. denied*, 121 N.M. 119, 908 P.2d 1387 (1995) (in tax cases, New Mexico courts follow federal law only to the extent they find that law persuasive).

In order to determine whether the Department's erroneous payment comes within the definition of "tax", it is necessary to examine the language of § 7-1-3(V) itself. The chief aim of statutory construction is to give effect to the intent of the legislature. *Roth v. Thompson*, 113 N.M. 331, 332, 825 P.2d 1241, 1242 (1992). The plain language of the statute is the primary indicator of legislative intent. *Whitely v. New Mexico State Personnel Board*, 115 N.M. 308, 311, 850 P.2d 1011, 1014 (1993). The words of a statute, including terms not statutorily defined, should be given their ordinary meaning absent clear and express legislative intention to the contrary. *State ex rel. Reynolds v. Aamodt*, 111 N.M. 4, 5, 800 P.2d 1061, 1062 (1990).

The language of § 7-1-3(V) is quite broad, and defines the term "tax" to include any "rebate or refund paid or credited by the department…to any person contrary to law…." Giving the phrase "contrary to law" its ordinary meaning, it certainly appears to cover the Department's unauthorized payment to the Taxpayer in this case. As the Department points out, to hold otherwise would foreclose the state from recovering such payments since the Department's authority to assess

taxpayers is limited to assessments of "tax." *See*, NMSA 1978, § 7-1-17. The interpretation of a statute must be consistent with legislative intent and must not render a statute's application absurd, unreasonable, or unjust. *Dona Ana Savings & Loan Association, F.A. v. Dofflemeyer*, 115 N.M. 590, 592, 855 P.2d 1054, 1056 (1993). The purpose of defining the term "tax" to include abatements, credits, rebates and refunds that are made "contrary to law" is to insure that the Department will be able to recover the erroneous payments once they are discovered. With that in mind, it is apparent that the unauthorized refund at issue in this case created a tax liability subject to assessment by the Department.

Interest Does Not Apply in the Context of this Case. Having determined that the deficiency created by the Department's erroneous refund was a "tax" subject to assessment, the next issue to be addressed is whether the Taxpayer is liable for interest on the deficiency. The only legal argument provided by the parties is the Department's assertion that "it is undisputed that the assessment of interest on 'tax' is not discretionary." Joint Memorandum at 4. This statement does not adequately address the unusual circumstances of this case. Nor does the Department's argument address the "context" clause contained in § 7-1-3(V) which states that the term "tax" means:

> any amount of any…refund paid or credited by the department…contrary to law *and includes, **unless the context requires otherwise**, the amount of any interest or civil penalty relating thereto*. (emphasis added)

The existence of a context clause cannot be ignored. This is illustrated by the New Mexico Court of Appeals' decision in *State v. Sheets*, 94 N.M. 356, 610 P.2d 760 (Ct. App.), *cert. denied*, 94 N.M. 675, 615 P.2d 992 (1980), which upheld the defendant's conviction for selling unregistered notes. One of the issues in the case concerned the meaning of the term "security." Although the definitions of "security" in federal and state law were virtually identical, the court rejected the defendant's

reliance on a law review article interpreting federal securities statutes, noting that the federal statutes contained a context clause while the state statute did not:

> Both federal statutes define "security" similarly to the New Mexico definition "unless the context otherwise requires". *See* 15 U.S.C. §§ 77b and 78c, *supra*. The New Mexico statute, § 58-13-2(H), *supra*, does not contain the "context" clause. Because of this statutory difference, the Nebraska Law Review article does not support defendant's contention that "security" in our statute excludes commercial notes.

94 N.M. 356, 361, 610 P.2d 760, 765. Six years after the *Sheets* decision, the New Mexico Legislature enacted the New Mexico Securities Act of 1986. In the new act, the definition of a "security" is now prefaced with a context clause. *See* NMSA 1978, § 58-13B-2.

In this case, the use of a context clause in § 7-1-3(V) indicates that there may be circumstances in which the assessment of a tax deficiency created by an erroneous refund should not include interest. Under the Tax Administration Act, the imposition of interest is not based solely on which party had the use of the funds at issue, but also on which party was responsible for the tax liability or overpayment. Pursuant to NMSA 1978, § 7-1-67, taxpayers are generally liable for interest on underpayments of tax because New Mexico has a self-reporting tax system, and the obligation is on taxpayers to report and pay their taxes by the statutory due date. NMSA 1978, § 7-1-13; *Tiffany Construction Co. v. Bureau of Revenue*, 90 N.M. 16, 17, 558 P.2d 1155, 1156 (Ct. App. 1976), *cert. denied*, 90 N.M. 255, 561 P.2d 1348 (1977). For the same reason, NMSA 1978, § 7-1-68 generally does not require the Department to pay interest on overpayments of tax which result from taxpayers' reporting errors. *Teco Investments v. Taxation and Revenue Department*, 125 N.M. 103, 109, 957 P.2d 532, 538 (Ct. App. 1998) (under NMSA 1978, Section 7-1-68(C), (D) (1994), interest is not paid on an overpayment caused by taxpayer error).

The legislature has enacted a number of exceptions to the general rules governing interest, however, when the Department fails to fulfill its statutory responsibilities to the taxpayer. For example,

Subsections (A)(6) and (A)(7) of § 7-1-67 provide for the suspension of interest on underpayments of tax when the Department fails to issue a timely assessment or fails to provide taxpayers with required notices. Subsections (C) and (D) of § 7-1-68 require the Department to pay interest on overpayments of tax when the Department fails to grant a taxpayer's refund claim within the time periods specified in the statute. In those cases, interest on overpayments resulting from the taxpayer's self-assessment is calculated from the date the claim for refund was filed; interest on overpayments resulting from an assessment issued by the Department is calculated from the date the taxpayer paid the assessment.

When a taxpayer files a claim for refund that later turns out to be erroneous, the general rule of § 7-1-67 applies because the taxpayer was the party who initiated the claim and represented that he was entitled to the refund. There is no inequity in holding the taxpayer responsible for interest on the deficiency created by his erroneous claim. That rationale does not apply here, however, where the Taxpayer never filed a claim for refund. To the contrary, the Taxpayer filed a return showing tax due and included a check to cover her liability. It was the Department that incorrectly determined the Taxpayer was entitled to a refund and then initiated the refund without statutory authority. Based on the legislature's overall approach to the imposition of interest, the Taxpayer should not be required to pay interest on the tax deficiency created by the Department's *ultra vires* act. The fact that § 7-1-67 does not contain a specific exception covering this scenario is not significant since the legislature would not expect the Department to act outside its jurisdiction. Given the unusual circumstances of this case, the context clause in § 7-1-3(V) provides the necessary authority for relieving the Taxpayer of liability for payment of interest.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to the assessment of interest made under Letter ID No. L0932663296, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Department's unauthorized refund to the Taxpayer created a tax liability that was properly assessed against the Taxpayer when the Department discovered its error.

3. The Taxpayer is not liable for interest on the tax deficiency created by the Department's unauthorized refund.

For the foregoing reasons, the Taxpayer's protest IS GRANTED, and the Department is ordered to abate the $80.44 of interest assessed against the Taxpayer.

DATED January 6, 2005.