

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

**IN THE MATTER OF THE PROTEST OF
MARGARET PALUMBO TO ASSESSMENT OF
PENALTY AND INTEREST ISSUED UNDER
LETTER ID NOS. L0771213568 & L0312936704**

No. 07-04

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on April 10, 2007, before Margaret B. Alcock, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Lewis J. Terr, Special Assistant Attorney General. Margaret Palumbo (“Taxpayer”) represented herself. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. In 2003, the Taxpayer filed a timely New Mexico personal income tax return for the 2002 tax year, showing a refund due of \$183. The Department processed the Taxpayer’s return as filed and sent her the refund she requested.

2. In completing her 2002 federal income tax return, which is used as the basis for calculating tax due to New Mexico, the Taxpayer failed to include distributions she received from an IRA account. This was based on her erroneous belief that IRA distributions were not subject to tax after a taxpayer had reached a certain age.

3. Upon review of the Taxpayer’s 2002 federal return, the Internal Revenue Service (“IRS”) notified the Taxpayer that she was not entitled to exclude her IRA distributions and owed additional federal tax on this income.

4. As a result of the error on her federal return, the Taxpayer had underreported her 2002 New Mexico income tax by \$1,072.

5. The Taxpayer did not realize that she was required her to amend her New Mexico income tax return within 90 days of the date her federal tax return was adjusted, even though this information is contained in the state's tax laws and the Department's instruction packet.

6. It was not until August 2005, when the Taxpayer received a notice concerning the same error on her 2001 New Mexico income tax return, that she realized she had to amend her 2002 New Mexico return to include the distributions from her IRA.

7. On September 4, 2005, the Taxpayer sent a letter to the Department acknowledging receipt of the notice concerning her 2001 return and notifying the Department that the same error appeared on her 2002 return. The Taxpayer asked whether she could pay the additional tax due in installments and concluded: "I look forward to receiving the paper work required to file an amended return for Tax Year 2002. I will make certain that the matter is resolved as soon as possible."

8. The Taxpayer did not receive a response to her September 4, 2005 letter.

9. In January 2006, the Taxpayer completed and filed an amended New Mexico income tax return for the 2002 tax year showing \$949 of tax due and enclosing a partial payment of \$313. The Taxpayer made additional payments in February and March 2006 to pay off the balance of the tax shown on her amended return.

10. The Department subsequently discovered an error in the Taxpayer's calculations and adjusted the liability shown on her 2002 amended return from \$949 to \$1,072.

11. On April 28, 2006, the Department assessed the Taxpayer for the additional \$123 of tax due for 2002, plus penalty and interest on her total underpayment of \$1,072.

12. On May 9, 2006, the Department assessed the Taxpayer for the \$183 excess refund she received at the time she filed her original 2002 return, plus penalty and interest on that amount.

13. On May 20, 2006, the Taxpayer filed a written protest to the Department's assessments of penalty and interest. The Taxpayer has paid and does not dispute the amount of tax principal.

DISCUSSION

The issue to be decided is whether the Taxpayer is liable for the Department's assessments of penalty and interest on her underpayment of 2002 New Mexico income tax. At the administrative hearing, the Taxpayer stated that she is not protesting the amount of penalty and interest that accrued between April 15, 2003 (the original due date of her 2002 tax) and September 4, 2005 (the date she notified the Department of the error on her 2002 return and asked them to provide her with the paper work needed to file an amended return). The Taxpayer is protesting the penalty and interest that accrued after September 4, 2005 because she believes the Department was at fault in failing to respond to her requests for information.

Burden of Proof. NMSA 1978, § 7-1-17 provides that any assessment of tax by the Department is presumed to be correct. NMSA 1978, § 7-1-3 defines "tax" to include not only the amount of tax principal imposed but also, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." *See also, El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989). Accordingly, the assessments issued to the Taxpayer are presumed to be correct, and it is the Taxpayer's burden to present evidence and legal argument to show that she is entitled to an abatement.

Assessment of Penalty. NMSA 1978, § 7-1-69 provides that when a taxpayer fails to pay taxes due to the state as a result of negligence or disregard of rules and regulations, a penalty "shall

be added” to the amount of the underpayment. The term “negligence” as used in § 7-1-69 is defined in Regulation 3.1.11.10 NMAC to include both “inadvertence” and “erroneous belief or inattention.” Here, the Taxpayer erroneously believed that she was not liable for tax on her IRA distributions. This error meets the definition of negligence set out in Department regulations and in New Mexico case law. *See, C & D Trailer Sales v. Taxation and Revenue Dept.*, 93 N.M. 697, 699, 604 P.2d 835, 837 (Ct. App. 1979) (a taxpayer's mere belief that he is not liable to pay taxes is tantamount to negligence within the meaning of the statute); *El Centro Villa Nursing Center v. Taxation & Revenue Department*, 108 N.M. 795, 797, 779 P.2d 982, 984 (Ct. App. 1989) (§ 7-1-69 is designed specifically to penalize unintentional failure to pay tax.).

It also should be noted that penalty accrues at the rate of two percent per month, “not to exceed ten percent of the tax due but not paid.” NMSA 1978, § 7-1-69. Based on this formula, the penalty assessed against the Taxpayer reached its maximum of ten percent in September 2003, five months after the April 2003 due date and two years before the Taxpayer first contacted the Department concerning the error on her 2002 tax return. Because the Taxpayer stated that she is not challenging the penalty and interest that accrued prior to September 4, 2005, there is no basis for abating penalty.

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

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

The legislature’s use of the word “shall” indicates that the assessment of interest is mandatory rather than discretionary. *State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. In this case, the Taxpayer made an honest mistake on her 2002 tax return and did not

intentionally underreport taxes due to the state. The fact remains, however, that the State of New Mexico would have received an additional \$1,072 payment if the Taxpayer had completed her return correctly. As a result of the Taxpayer's mistake, the state was deprived of the use of this money for the period between the original due date in April 2003, and date the final tax payment was made in 2006. For this reason, interest was properly assessed.

Estoppel. The Taxpayer maintains that she should not be required to pay the interest that accrued on her unpaid taxes after September 4, 2005, the date she notified the Department of her underpayment and asked the Department to send her the paper work needed to complete an amended return. In effect, the Taxpayer is raising an estoppel issue, arguing that the Department should be estopped from enforcing the collection of interest that would otherwise be due.

Estoppel is rarely applied against the state, and then only in exceptional circumstances where there is "a shocking degree of aggravated and overreaching conduct or where right and justice demand it." *Wisznia v. State of New Mexico, Human Services Department*, 1998-NMSC-11, ¶17, 125 N.M. 140, 958 P.2d 98. In determining whether estoppel is appropriate, the conduct of both parties must be considered. *Gonzales v. Public Employees Retirement Board*, 114 N.M. 420, 427, 839 P.2d 630, 637 (Ct. App.), *cert. denied*, 114 N.M. 227, 836 P.2d 1248 (1992).

The facts presented in this case do not support a finding of estoppel. At the time the IRS adjusted the Taxpayer's federal return in 2005, she was on notice that she had underreported the income on her 2002 federal and state income tax returns. Pursuant to NMSA 1978, § 7-1-13(C), taxpayers are required to file an amended New Mexico return within 90 days of the date of any adjustment to the taxpayer's federal return. In addition, the Department's instruction packet for the 2002 tax year (and every year thereafter), which is a public record of the Department, contains a clearly marked section on the filing of amended returns. These instructions advise taxpayers that: "An

amended return is REQUIRED by law to be filed within 90 days of the date any adjustment to your federal return becomes final.” (capitalization in the original). The instructions also set out the specific forms and information needed to file an amended return.

New Mexico has a self-reporting tax system, and it is up to taxpayers to determine their tax liabilities and accurately report those liabilities to the state. NMSA 1978, § 7-1-13. In this case, New Mexico’s Income Tax Act provided the Taxpayer with legal notice of her obligation to amend her 2002 New Mexico income tax return within 90 days after the adjustment to her federal return. While it is unfortunate that the Taxpayer was not aware of this requirement—and apparently did not notice the instructions for filing amended returns set out in the Department’s personal income tax packet—this does not excuse her from timely payment of her tax liability or the interest that accrued on that liability.

Finally, the Taxpayer argues that interest should be waived because the Department did not respond to her request to pay her additional tax liability in installments. The fact that the Taxpayer did not receive formal approval of her installment payments did not, however, affect the accrual of interest. Pursuant to NMSA 1978, §§ 7-1-13 and 7-1-167, even taxpayers who obtain a formal extension of time to pay tax are liable for payment of the interest that accrues during the extension period.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely, written protest to the assessment of penalty and interest issued under Letter ID Nos. L0771213568 & L0312936704, and jurisdiction lies over the parties and the subject matter of this protest.

B. Pursuant to NMSA 1978, § 7-1-69, the Taxpayer is liable for the penalty that accrued between the due date of her 2002 personal income taxes in April 2003 and the date the penalty reached its maximum of ten percent in September 2003.

C. Pursuant to NMSA 1978, § 7-1-67, the Taxpayer is liable for the interest that accrued between the due date of her 2002 personal income taxes in April 2003 and the date the final payment was made in 2006.

D. The Department is not estopped from collecting the penalty and interest that accrued on the Taxpayer's late payment of her 2002 tax liability.

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

DATED April 12, 2007.