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

IN THE MATTER OF THE PROTEST OF
EDWARD R. MARSHALL JR.
TO ASSESSMENTS ISSUED UNDER
LETTER ID NO. L1771057216 **No. 11-01**

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on December 7, 2010, before Sally Galanter, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Peter Breen, Special Assistant Attorney General. Mr. Thomas Dillon appeared as a witness on behalf of the Department. Mr. Edward Marshall Jr. (“Taxpayer”) appeared representing himself. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. In 2006, Taxpayer, moved to New Mexico and worked for a start up business selling water treatment services in Santa Fe.

2. The Taxpayer earned approximately $26,000.00 working for this start up business in Santa Fe.

3. During the same year Taxpayer earned income in Nebraska.

4. For tax year 2006, Taxpayer filed his Federal personal income tax return indicating gross receipts on Schedule C, filed an income tax return in Nebraska, but was a non-filer in New Mexico. (Taxpayer Exhibit 1).

5. The tape match system, based on tax information supplied from the Internal Revenue Service (IRS), revealed the discrepancy between the federal and New Mexico state tax

returns.

6. On July 23, 2008, as a result of the tape-match information obtained from the IRS, the Department mailed to Taxpayer a notice of limited scope audit concerning the Personal Income Tax discrepancy or non-filed return for tax year 2006. (Taxpayer Exhibit 1)

7. Upon receipt of the notice of limited scope audit of personal income tax, Taxpayer spoke with Department employees about the situation. Based on these conversations, Taxpayer determined that he should have filed and paid personal income tax for Tax Year 2006. Taxpayer thus paid personal income tax, penalty, and interest for the outstanding tax year 2006 income tax.

8. The discussions between the Department and Taxpayer related only to the Taxpayer's potential liability for personal income tax under the notice of limited scope audit of personal income taxes. There was no discussion at that point about gross receipts taxes relating to services performed by the Taxpayer's Santa Fe business. .

9. On November 25, 2009, the Department sent to Taxpayer a Notice of Limited Scope Audit commencement for failure to pay gross receipts based on the Schedule C information obtained from the IRS. (Taxpayer Exhibit 2)

10. On December 9, 2009, the Department assessed Taxpayer project gross receipts tax in the amount of $1,801.16 in principal, $360.24 in penalty and $497.94 in interest for a total of $2,659.34 for tax period ending December 31, 2007. (Department Exhibit A)

11. Taxpayer timely filed a written protest to the assessment on December 21, 2009.

(Taxpayer Exhibit 4)

12. In the protest letter, Taxpayers acknowledged owing the gross receipts tax but protested the assessment for penalty and interest. (Taxpayer Exhibit 4)

13. On December 30, 2009, Mr. Dillon, the Department's Protest Auditor, responded by letter to Taxpayer's issues in his protest letter notifying Taxpayer of the statutorily mandatory nature of penalty and interest and that interest accrues until the principal is paid. (Taxpayer Exhibit 3)

14. On January 4, 2010, Taxpayer paid the principal gross receipts tax. (Department Exhibit B)

DISCUSSION

The primary issue to be decided is whether Taxpayer is liable for penalty and interest assessed for gross receipts due to the non-reporting of gross receipts for services in the tax period ending December 2006. Taxpayer paid the principal gross receipt tax but seeks abatement of penalty and interest. Taxpayer's claim for abatement of penalty and interest is that the Department's employees who initially helped him should have alerted him to his potential gross receipts tax liability. Had these employees notified him that he had a potential liability for gross receipts tax, he would have paid the gross receipt tax liability in 2008 when he paid the personal income tax liability.

Burden of Proof. NMSA 1978, §7-1-17(C) (2007) provides that any assessment of tax by the Department is presumed to be correct. Regulation 3.1.6.12 (A) NMAC explains that once

an assessment is mailed to a taxpayer that the presumption of correctness attaches and that therefore the taxpayer has the burden to dispute the correctness with evidence. Also NMSA 1978, §7-1-3 NMSA (2009) 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 *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989). See also, Regulation 3.1.6.13 NMAC. Accordingly, the presumption of correctness applies to the assessment of principal tax, to the penalty and interest, and it is Taxpayer's burden to present evidence and legal argument to establish that they are not liable for the gross receipts tax and are entitled to an abatement of interest and penalty.

Gross Receipts Tax Due. NMSA 1978, § 7-9-4 (1990) imposes an excise tax on the gross receipts of any person engaging in business in New Mexico. The definition of "engaging in business" is very broad including "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." NMSA, 1978, § 7-9-3.3 (2002). The statute makes no distinction between activities engaged in by large corporations and activities engaged in by individuals.

Pursuant to NMSA 1978, §7-9-3.5 (A) (1) (2007), gross receipts "means the total amount of money…received…from performing services in New Mexico." Specifically Regulation 3.2.1.18 (P) (3) NMAC states,

> Receipts from providing day care for children in a situation where a person provides day care for children in a residence and the care for all these children is paid for by the state of New Mexico are subject to gross receipts tax.

In this case, Taxpayer earned approximately $26,000.00 income in New Mexico assisting a business in its start up operations but failed to file a New Mexico Income Tax Return. Because this activity is included in "engaging in an activity" with the result of receiving a monetary benefit and because Taxpayer was performing this service in New Mexico, Taxpayer is liable for gross receipts tax on his income from those services.

Negligence. Taxpayer's initial claim of negligence by the Department is based on the length of time taken by the Department to initially notify Taxpayer that he did not file a tax return for income earned in New Mexico and that he owed taxes based on his earned income. In his December 30, 2009 letter to Taxpayer, Mr. Dillon explained that it takes the IRS approximately two years to share information with the state. Mr. Dillon further explained that the IRS initially provides information as to personal income tax returns and in a different program separately provides information as to Schedule C business income for all New Mexico filers.

New Mexico has a self-reporting tax system with the legislature placing the obligation on taxpayers to determine their tax liabilities and accurately report those liabilities to the state. NMSA 1978, §7-1-13 (2007). The self-reporting system requires taxpayers to, after determining their tax liability, to voluntarily report and pay their tax liabilities to the state. "Every person is charged with the reasonable duty to ascertain the possible tax consequences of his action." *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). Therefore the taxpayer is bound to

determine when his/her taxes are due, accurately report same to the Department and pay the taxes. It is not an excuse that the Taxpayer was unaware that he/she owed taxes.

According to NMSA 1978, §7-2-12 (A) (2003):

> Every resident of this state and every individual deriving income from any business transaction, property or employment within this state and not exempt from tax under the Income Tax Act [7-2-1 NMSA 1978] who is required by the laws of the United States to file a federal tax return shall file a complete tax return with the department in form and content as prescribed by the secretary. Except as provided in Subsection B of this section, the return required and the tax imposed on individuals under the Income Tax Act are due and payment is required on or before the fifteenth day of the fourth month following the end of the taxable year.

The individual/entity with the knowledge as to income earned and what taxes are owed is the individual taxpayer. Because the Taxpayer was a non-filer, the Department had no knowledge about the possibility that Taxpayer might owe taxes until it was notified by the IRS. It is the responsibility of each taxpayer to properly report income and pay taxes. The fact that Taxpayer was a non-filer for income earned in New Mexico was the primary reason for delay in the Department knowing that any tax was owed and in particular gross receipts taxes. Further, the initial information obtained from the IRS provided the state information only as to personal income tax but did not provide information as to specifically Schedule C reported income. Mr. Dillon explained that due to the large number of taxpayers involved and the two separate programs from the IRS providing different information and noting the limited resources of the Department it is logical that it would take some time for the Department to determine the tax

liability of an individual Taxpayer.

NMSA 1978, §7-1-18 A (1994) allows the Department up to three years "from the end of the calendar year in which payment of the tax was due" to issue an assessment. In this matter, the taxes would have been due April 15, 2007 and the assessment was issued well within the legislatively mandated time period on December 9, 2009.

Taxpayer's additional claim of negligence by the Department is based on the Department's employees not notifying him during the limited scope audit of his personal income tax that he would owe gross receipts tax on the income he earned in New Mexico. According to Mr. Dillon's letter to Taxpayer part of the problem stems from the fact that the IRS provides information through two separate programs the initial one being for personal income tax and the subsequent program providing information as to income reported on Schedule C of the federal return. It would appear that the state employees may not have had full knowledge as to how the income was earned and therefore would have not been in a position to notify Taxpayer of the potential gross receipts tax liability.

Mr. Dillon explained that, it is regrettable that Taxpayer was not asked about potential Schedule C income when conducting the audit of personal income tax liability and regrettable that Taxpayer did not bring the matter to the Department employees' attention. Mr. Dillon speculated that perhaps because the initial audit was focused strictly on personal income tax liability that the gross receipts tax liability was overlooked. While it would have been helpful to the Taxpayer for the Departments' employees to have questioned him as to his potential gross

receipts liability, the evidence does not establish that the Department's employees had knowledge at the time of the personal income tax limited scope audit that gross receipts would be due and owing.

In addition, there is no provision within the regulations which allows for abatement of the negligence penalty because a Department employee failed to alert a Taxpayer of potential tax consequences that he or she may not have known about. NMSA 1978, Sec 7-1-69 (A) governs the imposition of a civil penalty for "failure due to negligence or disregard of department rules and regulations" to pay a tax when due. While this statute was modified in 2007 to increase the amount of penalty from 10% to 20%, effective January 1, 2008, the wording of this portion of the statute was not modified by the 2007 amendment. NMSA 1978 Sec. 7-1-69 provides that when a taxpayer fails to pay taxes due 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 (2001) as:

> (A) failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
> (B) inaction by taxpayers where action is required;
> (C) inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

Taxpayer testified that he was careless in not filing a New Mexico tax return, that he was unaware that gross receipts taxes would be due as such tax is unique to only a few states including New Mexico, and that he immediately paid the principal amount of the tax when notified and having verified that such was due. Taxpayer erroneously believed that he would not be liable for

any taxes owed to the state based on the gross receipts. 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, P.797, 779 P.2d 982, 984 (Ct. App. 1989) (§ 7-1-69 is designed specifically to penalize unintentional failure to pay tax.).

Additionally, Taxpayer acknowledged that he failed to file his gross receipts returns for 2006. By statute negligence includes inaction when action is required. Whether or not employees should or could be held to a higher standard, an employee cannot be held to have knowledge of information that can only be obtained from either Taxpayer or the IRS when the Department does not have access to that information as Taxpayer has not provided that information nor has it been obtained from the IRS at the time of the audit. Therefore the evidence does not establish that the Department was negligent based on its employees not notifying Taxpayer of a potential gross receipts tax liability at the time of the personal income tax limited scope audit.

Amount of Civil Penalty. Taxpayer's protest includes the amount of penalty applied to the principal amount of tax. In Taxpayer's protest letter of December 21, 2009, he specifically notifies the Department that he is protesting the assessment of penalty and interest and he is requesting as affirmative relief that the penalty and interest be waived. NMSA 1978, S7-1-24 (A)

(2003) allows a taxpayer to dispute an assessment as to "any amount of tax, the application to the taxpayer of any provisions of the Tax Administration Act… by filing with the secretary a written protest against the assessment…" with the statute enumerating that the protest must identify the taxpayer, the grounds for the protest and the affirmative relief requested.

The next determination to be made is the amount of penalty to be assessed. Taxpayer's tax liability is based on taxes not paid in 2006 and January 2007. In 2007, the legislature amended the penalty statute to increase the amount of penalty from 10% to 20%, effective as of January 1, 2008. It must be determined whether the penalty should be capped at 10% pursuant to the law in effect when the tax was due or 20% pursuant to the law in effect as of January 1, 2008.

NMSA 1978 Section 7-1-69 (2003, prior to amendments through 2007), in effect prior to January 1, 2008 states,

> A. Except as provided in Subsection C of this section, in the case of failure due to negligence or disregard of department rules and regulations, but without intent to evade or defeat a tax, to pay when due the amount of tax required to be paid, to pay in accordance with the provisions of Section 7-1-13.1 NMSA 1978 when required to do so or to file by the date required a return regardless of whether a tax is due, there shall be added to the amount assessed a penalty in an amount equal to the greater of: (1) two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed ten percent of the tax due but not paid.

NMSA 1978 Section 7-1-69 (2007) states,

> A. Except as provided in Subsection C of this section, in the case of failure due to negligence or disregard of department rules and regulations, but without intent to evade or defeat a tax, to pay when due the amount of t ax required to be paid, to pay in accordance with the provisions of Section 7-1-13.1 NMSA 1978 when required to do so or to file by the date required a return regardless of whether a tax is due, there shall be added to the amount assessed a penalty in an amount equal to the greater of: (1)

> two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed twenty percent of the tax due but not paid.

The only modification in the statute from the 2003 version as compared to the 2007 version is simply the increase in penalty from 10% to 20%.

When determining the meaning of a statute the primary concern "is to implement the intent of the legislature…In determining this intent, we look primarily to the language of the act and the meaning of the words, and when they are free from ambiguity, we will not resort to any other means of interpretation." *Security Escrow Corp. v. State Taxation & Revenue Dept.* 107 N.M. 540, 543, 760 P.2d 1306, 1309. *State of New Mexico ex rel Shell Western E & P. Inc. v. John J. Chavez, Secretary Taxation & Revenue,* 2002-NMCA-5, 131 N.M. 445. 38 P/3d 886, ¶7. In determining legislative intent it is critical to consider the statute as a whole.

The recent Court of Appeals case of *Wood v. State of New Mexico Educational Retirement Board,* filed November 10, 2010, Docket No. 29,680 provides a thorough review of the process of interpreting a statute with the court explaining that the goal is to give "primary effect to the intent of the legislature" by looking to the wording of the statute and attempt to apply "the plain meaning rule, recognizing that a statute contains language which is clear and unambiguous, we must give effect to that language and refrain from further statutory interpretation… Moreover, unless the Legislature expresses a contrary intent, we are to give statutory words 'their ordinary meaning' and this Court is prohibited from reading 'into a statute…language which is not there…'"¶ 12. Clearly, if the plain meaning of the statute requires a certain action an alternative opposite meaning cannot be applied.

In considering the plain meaning of the statute and the statute as a whole to determine legislative intent, §7-1-69 has several different factors all of which are important including the percent of penalty due and owing at issue in this case and other cases that the Department has appealed. The Department's position is that so long as a taxpayer has not paid his or her assessment as of January 1, 2008, the Department has the legal authority to recalculate the penalty and add an

additional 10% penalty. The entire statute must be considered in total in order to make this determination. Since all the factors for imposition of a penalty were present, the law requires that penalty be added to the amount assessed in principal.

The determination as to the amount of penalty is based on an amount equal to the greater of two percent per month or any fraction of a month from the date the tax was due. In determining what the legislature meant by "when the tax was due" consideration is given to other statutes in effect at the time. As discussed New Mexico's self-reporting system places the obligation on taxpayer to determine his tax liabilities and accurately report those liabilities to the state. NMSA 1978, §7-1-13 (2007). *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). The due date for the filing of the return and payment of tax would have been on or before the 25th of the month following the month in which the taxable event occurs. NMSA 1978, Section 7-9-11 (1969).

Pursuant to the self-reporting system Taxpayer was obligated to report and pay tax on that date. Having acknowledged in the hearing that he was unaware taxes were due and upon notification that such taxes were legally due, Taxpayer acknowledged his liability and paid the principal amount of the tax only questioning whether or not they owed the penalty and interest "Therefore any penalty due to negligence shall be equal to "two percent per month or any fraction of a month from the date the tax was due."

As the gross receipts taxes for 2006, they were due on multiple dates. The statute in effect at that time was the 2003 version of the statute. The assessment of penalty should be calculated as two percent per month or any fraction of a month commencing when the tax was due. Once Taxpayer reached the maximum penalty cap for all reporting periods in January 2007, the "not to exceed" language of the statute prohibited any further imposition of penalty against the still unpaid principal tax due. Because the penalty provision had already been exhausted by the time the new amendment became effective January 1, 2008, the Department could not apply an additional 10% penalty to the principal amount of tax. The intent of the Legislature was that the new penalty provision apply prospectively and not retroactively.

In addition, the Taxpayer bill of rights specifically entitles Taxpayers to seek review of any adverse decisions relating to determinations made during the audit or protest procedures and further entitles Taxpayers to abatement of **any** assessment determined to have incorrectly, erroneously or illegally made (emphasis added). In *Sonic Industries Inc. v. State,* 2000-NMCA-087,129 N.M. 657, 11 P.3d 1219, the court explained that if a taxpayer ignores its tax obligations and consults with counsel only after an assessment is issued such cannot establish a diligent protest and "does not provide a bias for avoiding a penalty" citing *Phillips Mercantile Co. v Taxation & Revenue,* 109 N.M. 487, 491, 786 P.2d 1221, 1225 (Ct. App. 1990). Clearly, such action does not clear the Taxpayer of an obligation to pay penalty. However such penalty must be the correct amount of penalty pursuant to New Mexico law. A Taxpayer is not required to pay a miscalculated or incorrect amount of penalty. When the Department errs in its calculation of penalty the Taxpayer bill of rights requires the Department to only charge Taxpayer in accordance with the statute and not a cent more.

The Department argued that 20% penalty should apply. The Department's calculation of the penalty is not correct. The amount of negligence penalty added to the underlying principal tax liability by the Department is not in accordance with the meaning of §7-1-69 (2003, prior to amendments through 2007). §7-1-69 (A) (1) provides that if the tax required to be paid when due is not paid, the Department may add civil penalty in an amount "…**not to exceed** ten percent of the tax due but not paid." There was no retroactivity provision within this statute allowing for an additional civil penalty of ten percent (10%) to be applied to past due principal tax balances due as of January 1, 2008 that had already exceeded the maximum rate applied. This determination is based on *Phelps Dodge Corp. v. Revenue Division of the Taxation and Revenue Dept of the State of New Mexico,* 103 NM 20, 702 P.2d 10 (Ct. App. 1985), which following *Worman v. Echo Ridge Homes Cooperative, Inc.* 98 NM 237, 647 P.2d 870 (982) states, "new legislation must not alter the clear language of a prior statute if it is to be applied retroactively." Additionally, in *State v. Padilla,* 78 NM 702, 437 P.2d 163 (Ct. App. 1968), affirmed in *Psomas v. Psomas,* 99 NM 606, 661 P.2d 884 (1982), the court stated, "it is presumed that statutes will operate

prospectively only, unless an intention on the part of the legislature is clearly apparent to give them retroactive affect." See also *Karpa v. Commission of Internal Revenue,* 909 F.2d 784 (1990).

Our Supreme Court addressed the issue of prospective versus retroactive application of this penalty statute in *Kewanee Industries Inc. V. State Taxation & Revenue,* 114 N.M. 784, 845 P.2d 1238 (1993). The Department was attempting to apply certain regulations in assessing penalty. Our Supreme Court determined that as the regulations were not in effect during the tax years at issue determining that the regulations could not be applied to the taxpayer as it would be a retroactive application of the regulation. The court explained, "A regulation promulgated by an administrative agency shall be construed to have retroactive effect only if it is clearly and manifestly intended" The court cited *Psomas* as authority for prospective application only unless clear intent by the legislature to require retroactive application. Sec. 7-1-69 (2007) does not establish clear intent by the legislature to require retroactive application. Therefore penalty is capped at 10%.

Interest. NMSA 1978, § 7-1-67 governs the imposition of interest on the late payments of tax 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... (emphasis added).
> B. Interest due to the state under Subsection A or D of this section shall be at the rate of fifteen percent a year, computed on a daily basis;…

Subsection A determines the period for which interest is due and Subsection B directs that the interest be calculated at a rate of 15% per year, computed on a daily basis. The use of the word "shall" indicates that the provisions of the statute are mandatory rather than discretionary. *State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). With limited exceptions that do not apply here, the New Mexico Legislature has directed the Department to assess interest whenever taxes are not timely paid until such time as the principal tax is paid in full. The assessment of interest is

not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Here, the Taxpayer failed to pay gross receipts tax due to the state. In effect, the Taxpayer had a loan of state funds during the time taxes were owed but not paid. Therefore continuing interest is due until such time as the principal tax due is paid. The statutory rate is mandatorily set by the legislature, and neither the Department nor its Hearing Officer has the authority to adjust interest based on the financial or personal situations of individual taxpayers. See, *State ex rel. Taylor v. Johnson*, 1998-NMSC-015 ¶ 022, 961 P.2d 768, 774-775 (the legislature, not the administrative agency, declares the policy and establishes primary standards to which the agency must conform). Taxpayer's claim that he was not negligent does not assist him in abating interest as interest is not determined or forgiven based on non-negligence but rather of non-payment of taxes due. Therefore interest is due and owing by Taxpayer based on his non-payment of gross receipts tax.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the assessment of gross receipts tax issued under Letter ID No. L1771057216 with Taxpayer specifically protesting the assessment of penalty and interest and requesting abatement of both. Jurisdiction lies over the parties and the subject matter of this protest.

B. Taxpayer was negligent in failing to report gross receipts taxes in tax year 2006 and properly owed the principal amount of the gross receipts tax.

C. Taxpayer paid the principal amount of the assessment in January 2010.

D. The Department was not negligent in issuing the assessment for non-payment of gross receipts taxes.

E. The Department correctly assessed interest, pursuant to NMSA 1978, §7-1-67.

Taxpayer owes the interest which accrued until the principal amount was paid in full.

F. The amount of civil penalty added to the principal tax shall not exceed ten percent as provided in NMSA 1978, §7-1-69(A)(1)(2003, prior to amendments through 2007) and any amounts added or assessed in excess of the ten percent shall be abated.

For the foregoing reasons, the Taxpayer's protest IS GRANTED IN PART AND DENIED IN PART: the Department is ordered to abate ten percent of the penalty amount for tax year 2006.

DATED: January 7, 2011.