

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

**IN THE MATTER OF THE PROTEST OF
SHOTBLAST SOUTHWEST INC.
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L1643377600**

NO. 12-08

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on January 24, 2012, before Sally Galanter, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Peter Breen, staff attorney. Mt. Tom Dillon, Protest Auditor, testified on behalf of the Department. Shotblast Southwest Inc. was represented by its President, Mr. Kyd Kendrick (“Taxpayer”). Ms. Marita Marie Chavez-Smith, friend and retired bookkeeper, testified on behalf of Taxpayer. In addition to the documents contained in the administrative file articulated at the beginning of the hearing, the following documents are admitted into the record: Taxpayer Exhibits #1 through #5 and the Department’s Exhibits A and B. As the parties agreed to an adjustment to the taxes due, based on evidence presented during the hearing, the record was held open to allow the Department to submit a late filed exhibit, Department C, which was timely received and admitted into the record. Taxpayer was provided an opportunity to submit a response to the documents and accompanying emails. Nothing additional was received. Administrative notice was taken of Department pamphlet FYI-240 titled, “Transactions with Government Agencies”. Based on the evidence and arguments presented, **IT IS DECIDED AND ORDERED AS FOLLOWS:**

FINDINGS OF FACTS

1. Taxpayer is an “S” Corporation organized in New Mexico as Shotblast Southwest Inc.

2. Mr. Kyd Kendrick is the President of Shotblast Southwest Inc.
3. The Department audited Taxpayer for tax periods, January 31, 2002 through March 31, 2008. The Department issued an assessment on September 28, 2009, for Gross Receipts Taxes in the principal amount of \$44,186.60, interest through the date of assessment, in the amount of \$19,750.57 and penalty in the amount of \$8,848.98.
4. On October 23, 2009, Taxpayer filed a written protest to the assessment. The protest was received and accepted as timely by Department letter dated October 29, 2009.
5. Taxpayer shotblasts commercial concrete flooring with sand size steel pellets. The process leaves a profile on the concrete so that the flooring can be layered with an industrial coating of epoxy or urethane. Taxpayer completes both the shotblasting and the urethane covering for a percentage of customers, completes the shotblasting for other customers and repairs similar floors for still other customers.
6. Taxpayer provides services for airplane hangars, warehouse floors, and commercial kitchens and showers where it is necessary that fluids not be able to seep into the concrete flooring.
7. During tax years 2001 through 2004, Taxpayer experienced a costly contentious divorce and several debilitating medical issues. Additionally, significant business income was lost due to miss-management and theft of business property by both his general manager and his brother. Taxpayer filed personal bankruptcy in 2003. During these years Taxpayer's gross business income declined from approximately \$800,000.00 per year to approximately \$100,000.00 per year.
8. After both the general manager and Taxpayer's brother quit the business, Taxpayer's wife assumed control of the business until Taxpayer had recovered from his medical conditions.

Taxpayer's wife, a high school graduate, was unfamiliar with the tax requirements of maintaining records and paying gross receipts tax.

9. Taxpayer had a business accountant however the accountant was not involved in the day-to-day activities of running the business nor was the accountant involved in submitting the monthly gross receipts documentation to the Department.

10. The Department made adjustments to the original assessment based on taxpayer's submission of proof of allowable deductions. [Department Exhibits A, B and C].

11. Mr. Tom Dillon audited Taxpayer's file and prepared an accounting of the outstanding gross receipts principal, outstanding interest and penalty due the Department taking into account all of the adjustments. As of the date of the hearing, the amount of tax due includes Gross Receipts Tax in the principal amount of \$37,813.28, interest through the date of hearing in the amount of \$19,198.11 and penalty in the amount of \$7,562.67. [Department Exhibit C].

DISCUSSION

The issue to be decided is whether Taxpayer is liable for the gross receipts taxes, civil penalty and continuing interest assessed based on the Department's audit for tax years 2002 through March 2008. Taxpayer claimed that what he provided was a service and repairs rather than construction. Taxpayer also claimed that he should not be responsible for taxes that he cannot collect as while he includes the tax in the billing, businesses and the government have refused to pay the tax deducting it prior to paying the balance of the bill. Taxpayer also asked for consideration of the penalty and interest due to extreme financial hardship.

Burden of Proof.

NMSA 1978, §7-1-17 (C) (2007), states that any assessment of taxes made by the Department is presumed to be correct. *Holt v. New Mexico Department of Taxation & Revenue*,

2002-NMSC-34, ¶4, 133 N.M. 11, 59 P.3d 491. NMSA 1978, §7-1-3 (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 also El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P. 2d 982 (Ct. App. 1989). Accordingly, it is Taxpayer’s burden to come forward with evidence and legal documents to establish that he is entitled to an abatement of the assessment, in full or in part.

Gross Receipts Tax Due.

Pursuant to NMSA 1978, Section § 7-9-4 (2010), any person or entity “engaging in business in New Mexico” is subject to payment of gross receipts tax. 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 term “gross receipts” as defined, in NMSA 1978, §7-9-3.5(A) (1) (2007), “means the total amount of money...received...from performing services in New Mexico.” Moreover, there is a statutory presumption that all receipts of a person engaging in business in New Mexico are subject to gross receipts tax. NMSA 1978, Section 7-9-5 (2002). A taxpayer claiming the receipts are not taxable must carry the burden of proving the assertion. *TPL Inc. v. Taxation and Revenue, Dept.*, 2000-NMCA-083, ¶18, 129 N.M. 539, 10 P.3d 863. When a Taxpayer presents sufficient evidence to rebut the presumption, the burden shifts to the Department to show that the assessment is correct. *See MPC Ltd v. New Mexico Taxation and Revenue Dep’t*, 2003-NMCA-021, ¶12, 133 N.M. 217, 62 P.3d 308.

Taxpayer argued that the work completed was for government agencies and that it was not construction providing copies of some NTTC’s. However, Taxpayer also provided a letter from a contractor stating that Taxpayer completed work as a subcontractor on construction projects and that

all subcontractors are tax exempt when working on construction projects. This evidence contradicts Taxpayer's claim of not being involved in construction projects. Recognizing the contradiction in evidence, New Mexico law is specific as to when a deduction is allowed on sales made to government agencies.

NMSA 1978, §7-9-54 (2003) provides for a deduction from gross receipts tax on tangible personal property sold to government agencies but specifically excludes receipts from selling construction materials or receipts from performing a service. There was no evidence that Taxpayer sold tangible personal property. There was no evidence presented that the gross receipts taxes resulted from sales made solely to government agencies. There was no evidence that the work completed by Taxpayer fit within any of the exceptions for deductions on sales to government entities or that Taxpayer's sales fit within any exception allowing an exemption from paying gross receipts tax.

Taxpayer acknowledged that he was providing a service although he testified that much of the work was "repairs." The term "service" is defined in NMSA 1978, §7-9-3 (M) (2007) to mean "all activities engaged in for other persons for a consideration, which activities involve predominately the performance of a service as distinguished from selling or leasing property... 'Service' includes construction activities and all tangible personal property that will become an ingredient or component party of a construction project." The evidence clearly established that the shotblasting and the epoxy/urethane covering of the floors was predominately the performance of a service provided by Taxpayer to its customers. Therefore the receipts were subject to gross receipts tax. Taxpayer did not overcome his burden to show that his receipts were not subject to gross receipts. Consequently, the Department's assessment for gross receipts tax for tax years 2002 through 2008 was proper.

Responsibility to Pay Gross Receipts Tax.

Pursuant to NMSA 1978, Section §7-9-4 (2010), Gross Receipts tax is imposed on the person engaged in business in New Mexico not the purchaser of such products and services. While often the seller is permitted to and, in most cases, does pass the tax on to the purchaser, the seller is ultimately responsible for the payment of the gross receipts taxes. This includes when the seller performs services in New Mexico.

Taxpayer claimed that he should not be forced to pay the tax when he properly billed the customers having included the charges for gross receipts tax. Taxpayer claimed that the customers often deducted the tax and just paid the principal due claiming they were exempt from payment of gross receipts tax. Taxpayer claimed it is the customer's responsibility to pay the gross receipts tax since the customers wrongfully deducted the tax prior to submitting payment for the work completed. Taxpayer misunderstands who has the responsibility for the payment of gross receipts tax. Taxpayer, selling the service, had the responsibility to pay gross receipts taxes. In the event, he was unable to pass the tax onto his customers he still remained responsible to pay the tax based on the "privilege of engaging in business in New Mexico." Section 7-9-4. Taxpayer could not evade his responsibility to pay the tax by delegating that responsibility to his customers. *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 799, 779 P.2d 982, 986 (Ct. App. 1989). Taxpayer remained responsible to pay gross receipts tax.

Interest Due on Unpaid Principal.

NMSA 1978 Section 7-1-67 (2008) 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 regardless of the explanation provided by the taxpayer. *State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). *See also*, NMSA 1978, §12-2A-4 (1997) of the Uniform Statute and Rule Construction Act (the words "shall" and "must" express a duty, obligation, requirement or condition precedent). The language of the statute also makes it clear that interest being to run from the original due date of the tax and continues until the tax principal is paid in full.

Taxpayer testified that he had no choice as he was medically unable to take care of his business and after returning to work had no funds to pay the taxes due. The inability to pay an assessment is not grounds to find that the assessment should not be paid. While the evidence established that Taxpayer did not intend to avoid paying his proper share of taxes, Taxpayer's argument misapprehends the nature of interest. The legislature has directed the Department to assess interest whenever taxes are not timely paid. Interest is not a penalty and the assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Even taxpayers, who obtain a formal extension of time to pay tax, are liable for interest from the original due date of the tax to the date the principal balance is paid in full. NMSA 1978, §7-1-13(E) (2007).

Interest must be assessed on tax that is due and unpaid. In the acknowledgment letter of October 29, 2009, the Department notified Taxpayer that interest would continue to accrue on any unpaid balances of principal. The letter also informed Taxpayer that he could pay the

principal to stop the accrual of interest. In this matter, Taxpayer failed to pay gross receipts taxes due and owing. Therefore, while acknowledging Taxpayer's medical and financial difficulties, it is also acknowledged that Taxpayer had a legal duty to pay the gross receipts tax. Therefore the state did not have use of its legally due funds. As the tax was not paid when it was statutorily due, interest was appropriately charged and continues to be charged until the gross receipts tax principal is paid in full to the Department.

Penalty due for failure to pay tax.

NMSA 1978 Section 7-1-69 (A) (2007) provides in regard to the imposition of a penalty for failure to pay tax due:

A. in the case of failure due to negligence or disregard of rules and regulations, but without intent to defraud, to pay when due any amount of tax required to be paid...there *shall be added* to the amount as penalty 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... (emphasis added).

Regulation 3.1.11.10 NMAC (01/15/2001) defines negligence 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;" or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." The statute imposes a penalty based on negligence for failure to timely pay a tax due. The good faith of a Taxpayer is not at issue. What is to be determined is whether Taxpayer was negligent in failing to report his taxes properly.

In this matter Taxpayer failed to timely pay gross receipts taxes on income earned while performing services in New Mexico. Taxpayer had an accountant completing work for him during

the times covered by the assessment. Taxpayer had a prior business in New Mexico and therefore arguably was familiar with tax reporting responsibilities in New Mexico. Taxpayer acknowledged that he knew taxes were due as he sent bills to his customers including the gross receipts taxes. Taxpayer failed to ensure that the taxes were properly reported and paid.

In its letter acknowledging Taxpayer's timely protest, the Department notified Taxpayer that "if applicable, penalty will continue to accrue at a rate of 2% per month or part of a month (to a maximum of 20%)...until such tax is paid." Taxpayer had sufficient notice that a penalty would be assessed due to non-payment of the principal tax due. In this matter, Taxpayer's inaction and failure to pay constitutes "negligence" as set out in the regulation. Under New Mexico self-reporting tax system, every person is charged with the reasonable duty to ascertain the possible tax consequences of his actions. NMSA 1978, §7-1-13 (B) 2007) and *Tiffany Construction Co. v. Bureau of Revenue*, 90 N.M. 16, 558 P.2d 1155 (Ct. App. 1976), *cert. denied*, 90 N.M. 255, 561 P.2d 1348 (1977). A taxpayer's failure to ascertain his tax obligations amounts to negligence. *See id.*

While Taxpayer credibly explained that it was not a conscious choice not to pay but rather lack of funds and due to circumstances involving his divorce, bankruptcy and medical issues, the mistake in this matter was Taxpayer not ensuring that his wife contacted his accountant such that accurate reporting and payment could be finalized. Recognizing that some of Taxpayer's problems were legitimate and beyond his control, it is also recognized that Taxpayer's actions from 2005 through the end of the assessment period do not illustrate any action by Taxpayer to rectify the failure to pay gross receipts or to make arrangements to pay the tax. Taxpayer failed to act until the assessment had been issued.

Although Taxpayer may not have felt he had any alternative, based on lack of funds, Taxpayer's actions do not form a reasonable basis under the law to excuse the civil negligence

penalty. Taxpayer failed to carry his burden to establish that he was not negligent in not paying his gross receipts taxes and is therefore liable for the civil penalty. Taxpayer failed to pay the tax when due. Therefore Taxpayer is liable for the penalty assessment. *See 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.).

Financial Hardship.

The Taxpayer asks that interest and penalty be waived in consideration of his personal and medical issues as payment of these amounts created an extreme financial hardship for him as he attempts to keep his business going and pay his employees. While certainly empathizing with Taxpayer, unfortunately, this is not a matter that the Hearing Officer can consider.

Department Regulation 3.1.6.14 NMAC specifically states that the Secretary “may not compromise a taxpayer’s liability because of the taxpayer’s inability to pay.” Nor does the Hearing Officer have authority to relieve a taxpayer of his statutory liability for tax, penalty, or interest. In *State ex rel. Taylor v. Johnson*, 1998-NMSC-015 ¶ 022, 961 P.2d 768, 774-775, the New Mexico Supreme Court held that “the Legislature, not the administrative agency, declares the policy and establishes primary standards to which the agency must conform” and an “administrative agency’s discretion may not justify altering, modifying or extending the reach of a law created by the Legislature.” The assessment was proper as gross receipts tax was not timely paid. The assessment of interest is proper and continues to be due until the principal tax owed is paid in full. The assessment of penalty is proper based on negligence.

CONCLUSIONS OF LAW

- A. Taxpayer filed a timely, written protest to the assessments of gross receipts tax, penalty and interest issued under Letter ID No. L1634377600 and jurisdiction lies over the parties and the subject matter of this protest.
- B. Taxpayer was engaged in the business of providing services to his customers and was subject to gross receipts tax on the payments he received from his customers.
- C. Taxpayer did not qualify for any deduction or exemption.
- D. Taxpayer adjusted gross receipts principal balance due is \$37,813.28.
- E. By failing to pay the Gross Receipts tax due Taxpayer is responsible for interest on the gross receipts tax remaining due and owing until such time as the principal tax is paid in full., pursuant to NMSA 1978, §7-1-67. The amount of interest due through the date of hearing is of \$19,198.11.
- F. The amount of civil penalty, \$7,562.6, added to the principal tax was correctly added and assessed pursuant to NMSA 1978, §7-1-69(A) (1).

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

Dated: February 27, 2012.

SALLY GALANTER