STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
KINSEY CONSTRUCTION **No. 16-30**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L2147275312

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on March 29, 2016 before Brian VanDenzen, Esq., Chief Hearing Officer, in Santa Fe. At the hearing, Carlos Kinsey appeared for Kinsey Construction ("Taxpayer"). Staff Attorney Elena Morgan appeared representing the State of New Mexico Taxation and Revenue Department ("Department"). Protest Auditor Veronica Galewaler appeared as a witness for the Department. Department Exhibits A-D were admitted into the record. All exhibits are more thoroughly described in the Administrative Exhibit Coversheet. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On January 20, 2016, under letter id. no. L2147275312, the Department assessed Taxpayer for $59,393.08 in gross receipts tax, $11,878.62 in penalty, and $7,071.02 in interest for the CRS reporting periods between January 1, 2011 and December 31, 2012.

2. On February 1, 2016, Taxpayer protested the Department's assessment.

3. On February 9, 2016, the Department's protest office acknowledged receipt of a valid protest.

4. On February 26, 2016, the Department filed a request for hearing in this matter with the Administrative Hearings Office.

5. On March 7, 2016, the Administrative Hearings Office sent Notice of Administrative Hearing, scheduling this matter for a merits hearing on March 29, 2016, within 90-days of the Department's acknowledgment of receipt of a valid protest.

6. Taxpayer is in business in New Mexico, providing construction services.

7. Taxpayer began its business in 2002.

8. On September 26, 2011, the Department informed Taxpayer under letter id. No. L117456441 that it would have to switch from the quarterly reporting method to the monthly reporting method because its monthly income exceeded $200. [Dept. Ex. A-1].

9. Taxpayer was also required to switch from the paper reporting method to the electronic reporting method.

10. Although Taxpayer continued to file the CRS returns, because of these changes, Taxpayer struggled to accurately report and pay gross receipts tax on those returns.

11. Eventually, in 2012, Mr. Kinsey hired a tax professional to assist with preparing his personal income tax returns but not Taxpayer's CRS returns.

12. Through its Schedule C mismatch program with the IRS, the Department detected that Mr. Kinsey had reported more gross receipts business income on its Federal Schedule C than was reported by Taxpayer on its CRS returns in New Mexico during the relevant period.

13. Taxpayer only reported a total of $418,381.09 in gross receipts for the year ending December 31, 2011 on its CRS-1 returns, but Mr. Kinsey's federal income tax Schedule C reported gross receipts totaling $976,614.00, a discrepancy exceeding 25%. [Dept. Ex. C-2].

14. Taxpayer only reported a total of $23,324.15 in gross receipts for the year ending December 31, 2012 on its CRS-1 returns, but Mr. Kinsey's federal income tax Schedule C reported gross receipts totaling $249,896.00, a discrepancy exceeding 25%. [Dept. Ex. C-2].

15. Based on this mismatch, the Department issued its assessment described in finding of fact #1.

16. As of the date of hearing, Taxpayer owed $58,888.09 in tax, $11,878.83 in penalty, and $7,409.44 in interest. [Dept. Ex. D].

DISCUSSION

Taxpayer challenged the assessment of penalty and interest, particularly given what Taxpayer believed was a lengthy delay in the Department's assessment. The only issues at protest then are the timeliness of the Department's assessment, the assessment of interest, and the assessment of civil penalty.

Presumption of Correctness.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessment issued in this case is presumed correct. Consequently, Taxpayer has the burden to overcome the assessment. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428. Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, §7-1-3 (X) (2013). Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department's assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight).

Timeliness of Assessment.

The Tax Administration Act ("TAA") places limitations on the Department's ability to assess a tax. Generally, under NMSA 1978, Section 7-1-18 (A) (2013), the Department has "three years from the end of the calendar year in which payment of the tax was due" to assess a tax

liability, unless otherwise expressly allowed in the remaining subparagraphs of that section. Potentially pertinent to this case is Section 7-1-18 (D), where if a taxpayer underreports a tax liability by more than 25%, the Department has six years from the end of the calendar year in which payment of the tax was due to issue an assessment.

When pressed about the timeliness of its assessments in the face of Taxpayer's concerns about pre-assessment delay, the Department's protest auditor confusingly testified that Taxpayer did not underreport its tax liability by more than 25% percent. After taking a recess to review the statute of limitations provision, Department's counsel indicated her belief that the Department was proceeding only under the general three-year statute of limitations (argument of counsel is not evidence). However, Department Ex. C-2 clearly shows that Taxpayer underreported its gross receipts tax liability by far more than 25%. In the face of this admitted exhibit, Taxpayer presented no evidence to overcome the presumption of correctness of the assessment regarding the 25% underreported tax liability. Thus, because the Department's January 20, 2016 assessment was made within six-years of the end of the calendar year in which the tax was due, the assessment was timely under the Section 7-1-18 (D)'s statute of limitations for an underreported tax liability exceeding 25%.

Interest.

When a taxpayer fails to make timely payment of taxes due to the state, "interest *shall* be paid to the state on that amount from the first day following the day on which the tax becomes due...until it is paid." NMSA 1978, § 7-1-67 (2007) (italics for emphasis). Under the statute, regardless of the reason for non-payment of the tax, the Department has no discretion in the imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22,

146 N.M. 24. The language of Section 7-1-67 also makes it clear that interest begins to run from the original due date of the tax until the tax principal is paid in full. In this case, the Department has no discretion under Section 7-1-67 and must assess interest against Taxpayer from when the tax was originally due until Taxpayer pays the gross receipts tax principal in this matter.

Penalty.

When a taxpayer fails to pay taxes due to the State because of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, NMSA 1978 Section 7-1-69 (2007) requires that

> 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.

(*italics* added for emphasis).

The statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meets the legal definition of "negligence." *See Marbob Energy Corp* , ¶22 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary).

Regulation 3.1.11.10 NMAC defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required"; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." Under New Mexico's self-reporting tax system, "every person is charged with the reasonable duty to ascertain the possible tax consequences" of his or her actions. *Tiffany Construction Co. v. Bureau of Revenue,* 1976-NMCA-127, ¶5, 90 N.M. 16. In New Mexico inadvertent error constitutes the civil negligence subject to penalty under Section 7-1-69. *See El Centro Villa Nursing Center v.*

Taxation and Revenue Department, 1989-NMCA-070, 108 N.M. 795. In this case, Taxpayer was negligent under Regulation 3.1.11.10 (B) & (C) NMAC because Taxpayer did not report and pay an accurate amount of tax in the remaining assessed period. This inadvertent error constituted negligence under *El Centro Villa Nursing Center*.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception: "[n]o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." Here, there is no evidence that Taxpayer made an informed judgment or determination based on reasonable grounds. Consequently, this mistake of law provision of Section 7-1-69 (B) does not mandate abatement of penalty in this case. The other grounds for abatement of civil negligence penalty are found under Regulation 3.1.11.11 NMAC, none of which are applicable to the facts of this protest. While Mr. Kinsey eventually used a tax professional to prepare his personal income tax returns, since that person did not prepare CRS-1 returns, there could be no reasonable reliance on that person that would justify abating penalty in this case. The Department's assessment of penalty and interest in this matter was appropriate.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Department's assessment, and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing was timely set and held within 90-days of protest under NMSA 1978, Section 7-1B-8 (2015).

C. Because Taxpayer underreported its tax liability by more than 25%, the Department's January 20, 2016 assessment was timely made within six-years of when the tax was

due, satisfying NMSA 1978, Section 7-1-18 (D)'s statute of limitations for an underreported tax liability exceeding 25%.

D. Taxpayer did not overcome the presumption of correctness on the assessed penalty and interest under NMSA 1978, Section 7-1-17 (C) (2007), NMSA 1978, §7-1-3 (X) (2013), Regulation 3.1.6.13 NMAC, and *Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428.

E. Under NMSA 1978, Section 7-1-67 (2007)'s mandatory "shall" language, Taxpayer is liable for accrued interest under the assessment. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24.

F. Under NMSA 1978, Section 7-1-69 (2007), Taxpayer is liable for civil negligence penalty because Taxpayer's failure to accurately report and pay gross receipts tax in the assessed period met the definition of civil negligence under Regulation 3.1.11.10 NMAC. *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, 108 N.M. 795.

G. Taxpayer did not establish a good faith, mistake of law made on reasonable grounds that would allow for abatement of penalty under Section 7-1-69 (2007).

H. None of the indicators of nonnegligence found under Regulation 3.1.11.11 NMAC allow for abatement of penalty in this protest.

For the foregoing reasons, the Taxpayers' protest **IS DENIED** As of the date of hearing, Taxpayer owed $58,888.09 in tax, $11,878.83 in penalty, and $7,409.44 in interest. Interest continues to accrue under Section 7-1-67 until tax principal is satisfied.

DATED: June 27, 2016.

Brian VanDenzen
Chief Hearing Officer
Administrative Hearings Office
P.O. Box 6400
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NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), the parties have the right to appeal this decision by *filing a notice of appeal with the New Mexico Court of Appeals* within 30 days of the date shown above. *See* Rule 12-601 NMRA. If an appeal is not filed within 30 days, this Decision and Order will become final. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may being preparing the record proper.