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

IN THE MATTER OF THE PROTEST OF
TERRY AND EVA CAPEHART
TO ASSESSMENTS ISSUED UNDER
LETTER ID NO. L2099463040

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on October 25, 2010, before Sally Galanter, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Carolyn Wolf, Special Assistant Attorney General. Mr. Terry Capehart appeared representing himself and his wife, Ms. Eva Capehart, who did not appear ("Taxpayers"). All documents proposed for admittance during the hearing were admitted into the record. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Taxpayers have an ownership interest in AMII [Aero Mechanical Industries] a New Mexico company situated in Rio Rancho, New Mexico. [Department Exhibit C]

2. In 2006, Taxpayers were paid $56,938.00 in consulting fees from AMII. [Department Exhibit C]

3. Taxpayers filed their Federal income tax return for 2006 and reported the consulting fee on the Schedule C after receiving a Form 1099 from AMII.

4. However, when filing their 2006 New Mexico tax return, Taxpayers' did not report the consulting fees. [Department Exhibit C]

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

6. On February 18, 2009, as a result of the information obtained from the IRS, the Department mailed Taxpayers notification of a limited scope audit concerning the discrepancy for 2006 tax year.

7. Upon receipt of the notification of the audit, Taxpayers immediately contacted their forensic Certified Public Accountant (CPA) in Arizona.

8. On March 13, 2009, Taxpayers' CPA mailed the Department an acknowledgment of

Taxpayer's receipt of two notices from the Department in reference to tax years 2005 and 2006.

9. On April 18, 2009, Taxpayers paid the principal balance due for the 2006 taxes.

10. On May 6, 2009 the Department assessed Taxpayers gross receipts tax in the amount of $3,571.86 in principal, $714.38 in penalty and $897.45 in interest for a total of $5,183.69 for tax period ending December 31, 2006. [Department Exhibit B]

11. On June 1, 2009 Taxpayers' CPA formally protested the amount of penalty and interest assessed to Taxpayer's and requested abatement of any penalty and interest stating his understanding that the principal tax must be paid prior to requesting abatement of the penalty and interest based on Taxpayer's understanding that the fees were for a service to their privately owned partnership and therefore non-taxable. Taxpayers claimed they had not owed taxes for similar transactions while residents in other states. [Department Exhibit A]

DISCUSSION

The issues to be decided are whether Taxpayers are liable for the civil penalty and interest due to the non-reporting of gross receipts received for consulting fees resulting from their ownership interest in a partnership for the tax year 2006. Taxpayers acknowledged their responsibility for payment of the principal amount of tax due. Taxpayers argue that the penalty and interest should be abated because they were unaware they owed the tax and when they became aware that they owed the tax they immediately paid it. Taxpayers also argue that the penalty and interest should be abated because they attempted numerous times to contact the Department to resolve the penalty issue without receiving any return calls, and do not feel they owe or should owe the penalty and interest based on their actions versus the Department's actions.

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 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.

The Department argued that despite Taxpayers raising the penalty issue in its protest, unless a taxpayer makes a specific argument as to the impropriety of the calculation of penalty that a Hearing Officer does not have the authority to raise the issue of calculation of penalty. The Department further argues that the presumption of correctness applies to penalty and interest and in essence prevents the Hearing Officer from discussing the calculation the amount unless the taxpayer raises that specific argument. The Department's reading of the presumption of correctness is an extremely narrow reading and there is no legal support for this position. The Department avers that the Taxpayers' generally protested the imposition of any penalty. However under the Department's narrow view of the protest, in conjunction with the presumption of correctness, the Hearing Officer may only decide whether imposition of penalty is warranted, not the amount of that penalty because of the absence of a specific challenge to the 10% versus 20% maximum penalty cap in the protest letter. Prior to dealing with the issue of penalty, the first issue to be addressed is whether interest is properly imposed.

Interest. NMSA 1978, § 7-1-67 (2007) 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 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).

Civil Penalty.

I. Whether Taxpayers properly raised the issue as to penalty.

There is no dispute that Taxpayers are protesting the issue of penalty. In Taxpayers protest, Taxpayer's CPA's letter of June 1, 2009 specifically identifies Taxpayers, notifies the Department that they are protesting the "assessment of penalties associated with the sales and use tax for tax year 2006: and requesting as affirmative relief that the penalties in the amount of $714.38 and any interest associated with these penalties be abated." 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.

Clearly Taxpayers' protest letter notified the Department that they challenged the penalty and interest assessed. Taxpayers' stated in their protest letter that penalty and interest were not warranted because of their belief that the partnership compensation from their privately owned partnership would not be considered as income subject to sales tax and further that they were unaware of the sale and use tax issue since it is unique to New Mexico. Taxpayers' reference their understanding that prior to requesting abatement of the penalties that they needed to pay the principal tax amount which they had already paid prior to the assessment being issued. While Taxpayers may not be in strict compliance with the requirements of §7-1-24 (A), they have substantially complied and certainly Taxpayers put the Department on actual notice that the amounts of both penalty and interest were at issue.

In addition at the hearing Mr. Capehart testified that he did not feel he should owe the penalty and interest as he paid the principal tax as soon as he realized he owed it. Additionally, Mr. Capehart testified

that he was not questioning the law in this regard but questioned whether or not he should owe the penalty. His questioning and filing of a formal protest to the penalty and interest raises the issue as to whether penalty is proper which further raised the issue as to the amount of penalty, if any, that is due.

Taxpayers specifically protested the imposition of penalty. The Department's position is that once the Hearing Officer has found in favor of the Department on the issue of tax, which includes penalty and interest, then the Hearing Officer has no authority to determine whether the Department erred in determining the amount of tax owed, whether it be principal, penalty or interest assessed. This narrow interpretation fails to consider the purpose of the hearing, especially in cases where a taxpayer is unrepresented by an attorney either because the taxpayer is unable to afford an attorney or due to the amount in dispute it is cost prohibitive to hire an attorney. If the Department is correct in interpreting the authority of a Hearing Officer, then the only body that can determine whether the calculations of the Department are correct is the Court of Appeals since all tax appeals go directly to the Court of Appeals.

Imposition of penalty is not a common law action, but comes from specific statutory requirements. In order to even consider the Taxpayers' broader protest of the assessment of any penalty, it is of course necessary first to review the relevant statutory requirements, and in the instance like here where there has been an amendment to that relevant statute during the period of time arguably in dispute, determine whether the amendment or the previous version of the statute controls the legal analysis. At the outset of any protest, a Hearing Officer must determine which specific statute is at issue. Since the penalty statute was amended between the time the tax was due and unpaid and the time of the Department's assessment, the Hearing Officer has no choice in the event of a protest of penalty but to determine which version of the statute is controlling for that protest. This is not an abuse of the Hearing Officer's authority, or a shifting the presumption of correctness, or an impermissible broadening of the protest, but part of the elemental obligation of any conscientious legal decision-maker: to identify the source of legal authority at issue in any dispute before turning to the analysis of that dispute in light of the evidence presented.

Additionally, even though Taxpayers carry the burden of overcoming the presumption of correctness, that burden of correctness should not punish a taxpayer if the calculations by the Department are inaccurate or not in accordance with the law. The Department's interpretation is not in accordance with the New Mexico Legislature. NMSA 1978, §7-1-4.1(2003) titled, "New Mexico taxpayer bill of rights created; purpose" explains that the purpose of the taxpayer bills of rights is to (A) ensure that the

rights of New Mexico taxpayers are adequately safeguarded and protected during the assessment, collection and enforcement of any tax administered by the department pursuant to the Tax Administration Act [7-1-1 NMSA 1978]." Also, NMSA 1978, §7-1-4.2 (2003) enumerates the rights afforded New Mexico taxpayers during the assessment, collection and enforcement of any tax administered by the department as set forth in the Tax Administration Act including:

> (F) the right to be provided with an explanation of the results of and the basis for audits, assessments or denials of refunds, that identify any amount of tax, interest or penalty due;
> (G) the right to seek review, through formal or informal proceedings, of any findings or adverse decisions relating to determinations during audit or protest procedures in accordance with Section 7-1-24 NMSA 1978;
> **(I) the right to abatement of an assessment of taxes determined to have been incorrectly, erroneously or illegally made, as provided in Section 7-1-28 NMSA 1978...** (emphasis added)

Clearly the legislature intended in its clearly stated purpose that the taxpayer bill of rights would afford New Mexico taxpayers a process by which they would have confidence that their rights were adequately safeguarded and protected during the assessment, collection and enforcement of any tax administered by the department pursuant to the Tax Administration Act including the assessment of penalty and interest. In particular, (I) specially gives a taxpayer the right to abatement of an assessment of taxes determined to have been incorrectly, erroneously, or illegally made. This specific right under the Taxpayer Bill of Rights certainly suggests that the legislature did not intend a Hearing Officer, whom is to be a fair and impartial arbiter of the protest proceeding, to sit silent in the face of incorrectly, erroneously, or an illegally made assessment merely because a pro se Taxpayer does not go beyond his clear broad challenge to imposition of the assessment in the first place and detail a mathematical challenge as to the specific amount of the challenged assessment. Our courts have mandated that a Hearing Officer is required to decide cases based on the facts and the law, but is not limited to a word-for-word consideration of the parties' arguments. *See TPL, Inc. v. N.M. Taxation and Revenue Dep't.*, 2000-NMCA-083, ¶ 19, 129 N.M. 539, 10 P.3d 863, *rev'd on other grounds TPL, Inc. v. N.M. Taxation and Revenue Dep't.*, 2003-NMSC-007, 133 N.M. 447, 64 P.2d 474 (filed December 19, 2002). The issue as to penalty and its correct calculation was raised by Taxpayers and therefore properly an issue before the Hearing Officer.

Department's counsel in her argument as to the propriety of the Hearing Officer considering the correctness of the penalty assessed by the Department argued that the Hearing Officer could not consider whether the 10% or 20% penalty should be applied as the taxpayer did not raise this specific issue in his protest letter, that the letter speaks for itself and that NMSA 1978, §7-1-24 (2003) prevents the taxpayer from modifying his protest. First of all, §7-1-24 (A) is flexible and allows a taxpayer to supplement the protest statement at any time prior to ten days before the hearing is conducted. Secondly, there is no statutory authority that provides that a taxpayer has to set out every legal argument in his or her protest. In addition, the Department is likewise not required to set out in its Request for Hearing every legal argument that it intends to make at the hearing. However as explained above Taxpayers substantially complied with the statute and put the Department on actual notice of its protest as to penalty and interest and their claim that both should be abated.

A more interesting issue arises when arguably the Department has assessed penalty not in accordance with the law in effect when the penalty was due. If the Taxpayer properly and legally objects to the imposition by the Department of penalty and interest and requests a hearing and the Hearing Officer determines that the amount is inaccurate the Department would assert that there is no recourse to the Taxpayer and that whatever amount the Department assesses, correct or incorrect, the Taxpayer must pay. This is clearly neither in compliance with the spirit and meaning of the law nor in compliance with the Taxpayer bill of rights as stated above. Clearly the legislature intended that Taxpayers would be protected from intentional or unintentional inaccuracies by the Department.

II. Whether Taxpayers are liable to pay penalty due to negligence

NMSA 1978, S 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. 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 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 (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.

Mr. Capehart testified that he was unaware that the fees would be taxed in New Mexico and upon receipt of the notice of limited scope audit and confirmation by his CPA that the tax was owed he immediately paid the principal amount of the tax on April 18, 2009 before the assessment was issued. Taxpayers erroneously believed that they were not 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.). While the evidence established that Taxpayers attempted to follow the law when notified of their non-compliance, the New Mexico self-reporting system obligates Taxpayers to ensure awareness of current relevant law, to report accurately all taxes owed and to pay same. The unintentional failure to pay taxes when due is the exact instance of failure to pay that the legislature intended be penalized. *See Arco Materials Inc. v State of New Mexico, Taxation and Revenue Dept.,* 118 N.M.12, 87 P.2s 330 (Ct. App 1994) ("A Taxpayer has an affirmative duty to keep informed about changes in the tax law that might affect its liability") and *Sonic Industries Inc. v. State,* 2000-NMCA-087, P.38, 129 N.M. 657,11 P.3d 1219 (Taxpayer determined to be negligent based on Taxpayer's failure due to "lack of knowledge and her erroneous belief that tax was not due on certain transactions). Therefore Taxpayers are liable to pay a penalty based on their failure to timely report tax when due and pay same.

III. Whether 10% or 20% is the correct amount of penalty pursuant to NMSA 1978, §7-1-69 (2003) or pursuant to NMSA 1978, §7-1-69 (2007).

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 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 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% with the 2007 amendment effective as of January 1, 2008.

In order to determine which statute is applicable in a situation where the time the tax was due and not paid falls under the previous version of the statute and time of assessment falls under the amended version of the statute, a determination must be made of the legislative intent. 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. The relevant provisions of the inquiry are whether Taxpayers were negligent, whether they failed to pay when due and how the penalty is calculated. It is the latter question that is currently 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. 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. Regulation 3.1.2.10 NMAC, titled, "Due dates and timeliness" explains,

> A taxpayer becomes liable for tax as soon as the taxable event occurs; payment is not due however, until on and after the date established by tax acts for the payment of tax…If the tax is not paid when it becomes due or if a report is not filed when due because of negligence of the taxpayer or taxpayer's representative, the taxpayer will also become liable for penalty." (2007).

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.

Therefore Taxpayers' responsibility to pay taxes for tax year 2006 became due on April 15, 2007. Pursuant to the self reporting system Taxpayers were obligated to report and pay tax on that date. Having acknowledged in the hearing that they were unaware taxes were due and upon notification that such taxes were legally due, Taxpayers acknowledged their liability and paid the principal amount of the tax only questioning whether or not they owed the penalty and interest "When due" based on our self reporting system and §7-1-13 and §7-2-12 obligated Taxpayers to know the amount and when the tax was due with the statute indicating tax is due on fifteenth of fourth month following the end of the taxable year. 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 taxes for 2006 were due April 15, 2007 the statute in effect at that time was the 2003 version of the statute. The assessment of penalty was calculated as two percent per month or any fraction of a month commencing when the tax was due. Therefore pursuant to §7-1-69 (2003) the penalty would be calculated as follows: two percent for the balance of April 2007, two percent for May 2007, two percent for June 2007, two percent for July 2007 with the ten percent capping out as of August 2007. Once Taxpayers reached the maximum penalty cap in August 2007, the tax remained due but not paid, but the "not to exceed" language of the statute prohibited any further imposition of penalty against the still due and not paid principal tax. Because the penalty provision had already been exhausted by the time the new amendment became law January 1, 2008, because the Department failed to articulate a clear intent by the legislature that the new penalty provision was intended to apply retroactively to instances where the penalty provision had already been exhausted, and because the statute does not clearly state that the statute should be applied retroactively, the Department is precluded by the plain language of the 2003 statute from exceeding the ten percent penalty cap once reached even though the tax factually remains due and not

paid.

There is also a distinction to be made between the Taxpayers bearing the burden to establish that they were not negligent or in disregard of the Department's rules and regulations in failing to pay the taxes and the burden forcing the Taxpayers to accept whatever calculations the Department makes even if those calculations are erroneous and based on the misapplication of a statute. The Taxpayer bill of rights clearly states that the legislature intended to protect Taxpayers to ensure that their rights are safeguarded and protected during the assessment, collection and enforcement of any tax administered by the Department.

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.

Based on NMSA 1978, S 7-2-12 which requires each Taxpayer to self calculate, self report and pay taxes timely, the amount of tax due but not paid is determined as of April 15, 2007 before the 2007 amendment took effect on January 1, 2008. The Department's analysis ignores the language in the statute that provides that civil penalty cannot "exceed ten percent of the tax due but not paid."

IV. <u>If the 2007 amendment were deemed applicable, would applying §7-1-69 (2007) amount to a retroactive application to taxes that were due and owing prior to January 1, 2008?</u>

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 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… *Psomas v. Psomas,* 99 N.M. 606, 609, 661 P.2d 884, 887 (1982) (operation of statute is prospective unless retroactive effect clearly intended by the legislature."

In this matter the Department imposed a 20% civil penalty on the principal of the gross receipts tax not timely reported and paid. (Department Exhibit B). 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." As the effective date of the legislative change increasing the amount of penalty from ten to twenty percent, pursuant to NMSA 1978, §7-1-69 (2007), was January 1, 2008, and the taxes at issue are 2006, the total amount of penalty assessed to taxpayer is determined to cap at 10% of the principal amount in August 2007.

There was no retroactivity provision within this statute allowing for an additional civil penalty of 10% to be applied to past due principal tax balances due as of January 1, 2008 that had already exceeded the maximum rate applied. There is no provision in the statute allowing the Department to charge 10% penalty through August 2007, stop assessing penalty and then starting January 1, 2008 again start charging penalty at 2% per month for an additional five months. This determination is based not only on *Kewannee* but also on long standing precedent in New Mexico including *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) and *Bradbury Stamm Construction v. Bureau of Revenue,* 70 NM 226, 373 P.2d (1962). In the absence of a clear intent by the legislature to apply a new or amended statute retroactively, a statute operates prospectively. *Psomas* at 609, 887 Nothing on the face of the statute indicates a clear intent by the legislature for retroactive application of NMSA 19778, §7-1-69 (2008). Therefore the statute operates

prospectively. With the use of the words "not to exceed", the clear language of both statutory provisions not only establishes a maximum penalty but precludes the application of an additional amount of penalty once Taxpayer has reached and been charged the maximum amount of penalty at two percent per month from the date the tax was due and not paid until the penalty reaches the statutory limit. Here Taxpayers reached the statutory limit August 2007 and before the 2007 amendment took effect. Under both versions of the statute no additional penalty can accrue after Taxpayer reached the statutory penalty cap since the penalty was assessed from the date the taxes were due with the principal remaining unpaid until the month before the assessment was issued. The fact that the Department continually points to—that the tax remains due and not paid at the time of the effective date of the amended statute—is of no consequence because under either version of the statute at question, once the penalty has reached the specified maximum cap, no more penalty may be added under the "not to exceed" language even though the following month the tax still may factually remain due and not paid. In other words, the significance of the due and not paid language of the penalty statute ends once the "not to exceed" condition has been met, because no matter how many more months the principal tax may be due and not paid no additional penalty may be assessed against a taxpayer.

The rule on penalty is that penalty is applied at the time the tax is due but not paid. As explained previously in this matter the date the tax was due was April 15, 2007 months before the effective date of January 1, 2008. There is no notation in the statute that the legislature intended for penalty to be calculated based on when the Department determines to assess a Taxpayer for not paying taxes. Nor does the statute allow for a partial calculation of penalty and months later an additional calculation of penalty but rather requires sequential penalty of two percent per month from the date tax was due multiplied by tax liability not to exceed ten percent of tax due but not paid.

In the absence of clear language in the statute specifying retroactivity, not present in either version of §7-1-69, the relevant inquiry to determine the maximum amount of penalty is not the date when the principle tax was assessed but rather when the principal tax was due but not paid. As that date was before January 1, 2008, Taxpayers are subject to a maximum penalty of 10%. Therefore Taxpayers should only be liable for a penalty capped at 10% pursuant to the law in existence when the tax was due but not paid, April 15, 2007. Therefore applying the 2007 amendment that did not go into effect until January 1, 2008 against 2006 taxes that were due on April 15, 2007 would be a retroactive application of the statute and unauthorized by the legislature.

While it is determined that the clear language of the statute answers the question as to whether the 2007 amendment should be applied to tax not paid but due prior to January 1, 2008, our Court of Appeals has recently issued a decision in regard to determining the retroactivity of a statute when it is not clear on its face whether the legislature intended the statute to be retroactive. In *Wood,* the Court of Appeals considered the issue as to whether an amendment to a statute should be applied retroactively based on argument that it was simply a "clarification" of the statute with the court determining that the amendment is to be applied prospectively only.

The Court explained that only where a plain language analysis does not clearly determine legislative intent than a review of other statutes can be utilized to determine legislative intent. Using that plain language analysis, the Court of Appeals found that in the case of ERB the plain language of the statute in effect at the time did not include a provision for paying interest on unpaid balances due an employee or his estate. As the Court of Appeals explained its holding, "we cannot read into the statute any meaning other than what is stated in the plain language…we are mindful that we should not read language into the statute because we believe the Legislature would have wanted the language there but for some reason forgot to add it." ¶17, 19.

The Court reviewed the law on when a statute is to be applied retroactively, stating, "The general rule is that statutes apply prospectively unless the Legislature manifest clear intent to the contrary… 'A statute or rule operates prospective only unless the statute or rules expressly provides otherwise or its context requires that it operate retrospectively…a statute or regulation is considered retroactive if it impairs vested rights acquired under prior law or requires new obligations, imposed new duties or affixes new disabilities to past transactions.¶21 The court, in determining that the statute was to operate prospectively only concluded, "Had the Legislature intended to simply correct an existing oversight in the law, or clarify what the law was always meant to say, it should have expressly provided for retroactive application in the amendment's text…Given the Legislature's presumed knowledge of our canons of statutory interpretation, its silence on the question of retroactivity with regard to the 1999 amendment… the court concluded that the statute must apply prospectively only. ¶28.

A plain reading of the statute determines that the penalty, if rightfully due, is to commence at "two percent per 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." Therefore as the tax was due April 15, 2007 and capped out under the "not to exceed" limit at ten percent in August 2007. Since the statute does not specify retroactivity, there is no ability for the Department to add an additional ten percent after the "not to exceed" penalty limit

had been reached before the effective date of the amended statute [January 1, 2008]even if the tax had not yet been paid by January 1, 2008. The legislature had not manifested a clear intent for the statute to operate retroactively nor does the context of the state require that it operate retroactively. Clearly, the 2007 amendment impairs vested rights of taxpayers, requires new obligations and affixes new disabilities to past transactions as it requires Taxpayers to pay additional penalty based on not having timely and accurately reported gross receipts taxes due as of December 31, 2006. Applying the 2007 amendment to these taxpayers would be applying the statute retroactively without legislative authority.

V. Whether the contract Hearing Officer's decision in GEA Integrated Technology is persuasive as to increasing the amount of penalty based on the 2007 amendment.

Department's counsel argued that the determination made by another Hearing Officer in the prior administrative hearing of GEA should persuade this Hearing Officer that the Department was entitled to assess the additional ten percent based on the 2007 amendment because of the Hearing Officer's conclusion that §7-1-69 (2007) allowed an additional 10% maximum penalty against taxes owed prior to January 1, 2008 but not paid and not assessed until after the January 1, 2008, the effective date of that amended statute. It is worth noting that the Hearing Officers of the Hearing Bureau have all reached the same conclusion regarding the statutory interpretation of how penalty should be calculated for taxes owed prior to 2008. While there is certainly a value in consistency of position from Hearing Officer to Hearing Officer, the GEA Hearing Officer is free to reach his own conclusion. There is no legal authority that gives binding precedential or authoritative weight to an administrative tax decision and order. While this alone may not be enough to disregard the GEA analysis, it certainly is a factor to consider in determining how much authoritative weight to afford the decision.

In GEA, the Hearing Officer discussed two prior decisions--Alamo and Cloutier—written by two different Hearing Officers each of whom had each concluded that penalty on taxes where the maximum not to exceed penalty limit had already been reached before the January 1, 2008 effective date of the 2007 amendment, could not be retroactively increased under that amendment to the twenty percent penalty.[1].

[1] The GEA Hearing Officer's factual basis for his legal determination is incorrect as he states that in each case that tax was due and unpaid prior to the effective date of the amendment but the taxes were assessed after the effective date of the amendment (page 4 and 5 – GEA decision). *In the Matter of the Protest of Alamo True Value Home Center,* No. 09-02, July 2, 2009 the assessment was actually issued on March 26, 2007, some eight months before the effective date of the amendment penalty provision. Since the Department assessed prior to the effective date of the 2007 amendment, even under the GEA analysis and legal conclusion which the Department relies on so heavily, the Department was prohibited in Alamo from applying the amended penalty statute against a prior unpaid tax

The GEA Hearing Officer also determined that applying the 2007 amendment, which became effective on January 1, 2008, to taxes that were due for prior years is not retroactive application of the amendment as the Department is "simply applying the version of the statute which is applicable under the circumstances." The GEA decision maker acknowledged that the only change to the statute by the 2007 amendment is the increase in penalty from ten to twenty percent explaining that the application of the 2007 amendment to taxes owed prior to January 1, 2008 is not retroactive as the statute states, "there shall be added to the amount assessed a penalty…" concluding that "penalty is imposed only when an amount of unpaid tax has been assessed." If it were true in that penalty is imposed only after an assessment then why wouldn't the legislature have clearly stated that penalty is exacted when the assessment is issued rather than state as the statute does, "from the date the tax was due"? This rationale ignores portions of the §7-1-69 and totally ignores §7-1-13, §7-2-12 and Regulation 3.1.2.10.

The GEA decision fails to take into consideration the §7-1-69 requirement that the two percent civil negligence penalty commences beginning the date the taxes are due and not paid and is to continue to accrue at two percent per month each month thereafter until reaching the statutorily imposed "not to exceed" percentage cap. There is no allowance in the statute for the Department to calculate the penalty at two percent for five months, cease calculating penalty and then months later to commence calculating penalty for an additional five months. While it is true that often a taxpayer and the Department will only become aware of the existence of penalty upon an assessment, the GEA Hearing Officer's interpretation is nevertheless contrary to the clear language of the statute, which specifies that the penalty begins to accrue at two-percent per month beginning at the time the principal tax was due and not paid. Also, there is no availability in either version of §7-1-69 that allows for additional penalty to be added based on the fact that the principal tax has not been paid once the penalty has reached the maximum "not to exceed" cap specified by the statute.

While the GEA decision cites *Bradbury & Stamm Construction Co. v. Bureau of Revenue,* 70 N.M. 226, 372 P.2d 808 (1962) to support the ultimate conclusion that the 2007 amended version of §7-1-69 is not being applied retroactively the decision fails to even cite or discuss the more pertinent and on point New Mexico Supreme Court decision in *Kewanee Industries. Kewanee* deals specifically with the penalty statute and specifically with the retroactivity of the statute. Citing the *Bradbury* decision construing interest and its proper application to determine a penalty issue presupposes that interest and penalty are essentially the same.

---

obligation as it was assessed before the effective date of the amended penalty statute.

Unlike the statutory provisions on negligence penalty, the legislature did not impose either a cap in the cumulative interest or in the length of time interest is to accrue under NMSA 1978, §7-1-67 (2008) but rather requires payment of interest until the principal tax is paid. Both before and after the amendments to the penalty and interest statutes, the negligence penalty statute and the interest statute operated independently of each other. As the legislature promulgated an interest statute with distinct provisions and applications and also promulgated a penalty statute with distinct provisions and applications, providing different methods for calculating the amount and length of each respective concept, clearly the legislature intended that the interest statute and the negligence penalty statute have distinct purposes and distinct applications. Therefore, since *Bradbury* is focused on the distinct interest statute while *Kewanee* is focused on issues under the distinct civil penalty statute, the *Kewanee* case is controlling on issues related to the civil penalty statute.

The Hearing Officer in GEA determined that the interpretation of the statute as to "there shall be added to the amount assessed a penalty" concluding that such means that the "penalty is imposed only when there has been an amount of unpaid tax which has already been assessed." Such reasoning is not in line with the construction of the statute and the self reporting nature of the New Mexico tax system. The penalty statute by its sheer nature implies that a tax was owed, a tax was not paid and therefore a penalty attaches for Taxpayers who do not comply with their obligation to self report accurately and pay. Taxpayers are bound to know what taxes are owed and report and pay same. While an assessment comes after the fact that the taxes are due and owing, the obligation to pay the tax and penalty arises from the date the taxes are due. The assessment is merely the Departments notification to Taxpayers that they have not complied with their legal obligation to accurately report and pay when due their outstanding taxes. The legislature has determined that if a Taxpayer does not follow through with their self reporting obligation then properly a penalty and interest are imposed.

A Hearing Officer can only give weight to a decision of another Hearing Officer to the extent and degree that the decision follows New Mexico law. For the reasons stated this Hearing Officer rejects the legal argument made in the GEA decision.

VI. Whether the Bill Analysis and Fiscal Impact Report should be deemed persuasive and authoritative in the Hearing Officer's determination as to penalty.

The Department submitted into the record a Bill Analysis and Fiscal Impact Report is a report issued

by the then Secretary of the Taxation & Revenue Department to explain the proposed changes to the statutes and explain, in the Secretary's view, the impact on local governments and taxpayers and explain the policy issues behind the changes in the statutes. This document purports to explain the reason for the 2008 change to the penalty statute. The report combines the increasing of penalty and the decreasing of interest together. While the Secretary explained that the changes would hopefully impact a taxpayer's determination to timely pay his taxes and the reasoning behind her request for the changes it does not provide any indication of the legislative intent behind the enactment of the statutory changes, nor does it state that the penalty increase is to be applied to taxes due and owing prior to 2008. A Department Secretary's analysis is not determinative of legislative intent and therefore is not authoritative in the determination as to which statute should be applied in calculating penalty for taxes due from 2006. As explained above the analysis must be based on the statute itself and the legislative intent as discerned by statutory and case law.

VII. Whether the Department's financial spreadsheet indicating the loss of revenue from the Hearing Bureau's statutory interpretation of penalty is relevant.

The Department introduced a document showing the loss of revenue to the State of New Mexico based on the Hearing Bureau's position as to the calculation of penalty for taxes due and owing prior to 2008. It is unclear the relevance of this document. NMSA 1978, §7-1-24 (2003) sets out the procedure and protocol for hearings once a Taxpayer asserts his legal right to protest an assessment of the Department and request an administrative hearing. A Hearing Officer is mandated pursuant to §7-1-24 (F) to avoid involvement in any way in the areas of enforcement or formulation of general tax policy other than to conduct hearings. The legislature prohibits a Hearing Officer from formulation, discussion, or enforcement of tax policy in order to avoid the possibility that such policy considerations may affect the Hearing Officer's impartiality in applying the statutes to the facts of any particular protest.

Department's counsel submitted this exhibit, Exhibit G to notify the Hearing Officer of the total penalty that has been "posted" during the calendar years 2005 through 2009 arguing that while the present cases involves less than $800.00 in penalty "the impact of the Hearing Officer's decision and all Hearing Officer's decisions go far beyond a single taxpayer…the Department is facing the potential loss of anywhere between fifteen million and thirty million if the Court of Appeals upholds the Hearing Officer." While all citizens of New Mexico are aware of and concerned with the budget troubles of this State and certainly the Hearing Bureau has already been impacted by budget cuts, this argument is not a legal argument and runs

contrary to the purpose and nature of the hearing. Every decision a Hearing Officer makes has a financial impact on the State and the Department or the taxpayers. This does not change the primary mission of the Hearing Officer, which is to impartially apply the law as he or she understands it. The revenue projection exhibit is admitted but given absolutely no weight.

CONCLUSIONS OF LAW

A. Taxpayers paid the principal amount of the assessment in April 2009 prior to the assessment being issued May 2009.

B. Taxpayers filed, through their counsel a timely written protest to the assessment issued under Letter ID No. L2099463040 with the Taxpayers specifically protesting the assessment of penalty and interest by requesting an abatement. Jurisdiction lies over the parties and the subject matter of this protest.

C. Taxpayers were negligent in failing to report gross receipts taxes in tax year 2006 and properly owe the principal amount of the gross receipts tax.

D. The Department correctly assessed interest, pursuant to NMSA 1978, §7-1-67, and the Taxpayers owe the amount of interest accrued until the principal tax was paid in full.

E. The amount of civil penalty added to the principal tax shall not exceed ten percent as provided in §7-1-69(A)(1)(2003, prior to amendments through 2007) and any amounts added or assessed in excess of the ten percent (10%) 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: December 6, 2010.