

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

IN THE MATTER OF THE PROTEST OF  
**HYDRO CLEAN**, ID. NO. 02-155809-00 8  
PROTEST TO DENIAL OF CLAIM  
FOR REFUND

No. 96-25

**DECISION AND ORDER**

This matter came on for hearing on October 24, 1996 before Gerald B. Richardson, Hearing Officer. Hydro Clean, hereinafter, "Taxpayer," was represented by its owner, Ms. Elke Foster. The Taxation and Revenue Department, hereinafter, "Department," was represented by Bridget A. Jacober, Special Assistant Attorney General. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

**FINDINGS OF FACT**

1. The Taxpayer operates a residential cleaning service as a sole proprietorship.
2. Ms. Foster began the business in 1991.
3. Although Ms. Foster was aware that she would have to pay income tax on the income she earned through her business, she did not know or understand that New Mexico imposes a gross receipts tax on the receipts of persons or businesses who perform services in New Mexico.
4. Ms. Foster keeps scrupulous business records of all of her receipts from performing cleaning services.
5. After the end of 1991, Ms. Foster presented her business records to her bookkeeper, Ms. Betty Childress (now Ms. Betty Zwilling) to prepare her taxes.
6. Ms. Childress prepared 1991 state and federal income tax returns for Ms. Foster and her husband. The federal tax returns included a Schedule C, wherein Ms. Foster's receipts from her

cleaning business were reported.

7. When presenting her records to Ms. Childress, Ms. Foster inquired whether there was anything else she needed to do and Ms. Childress informed her that there wasn't. Ms. Foster did not ask about any other type of state taxes and Ms. Childress did not inform Ms. Foster about gross receipts taxes.

8. The Department and the Internal Revenue Service (IRS) have an information sharing agreement whereby they share tax information. Pursuant to this agreement, the IRS provides the Department with information from the federal returns of New Mexico residents. As a result of information received from the IRS, the Department contacted Ms. Foster in May of 1995 to inquire about the discrepancy between the fact that business receipts were reported for 1991 to the IRS, but the Department had no record that Ms. Foster's business had reported gross receipts tax on its receipts that year.

9. Ms. Foster promptly contacted the Department and met with its representatives. This was the first time that she was informed about New Mexico's gross receipts tax and that she was liable for such tax on her receipts from her cleaning business.

10. The Department issued an assessment to the Taxpayer for gross receipts taxes, penalty and interest for 1991 and the Taxpayer paid this assessment.

11. On November 27, 1995 the Taxpayer submitted a claim for refund, requesting a refund in the amount of \$453.92 in penalty and interest paid on the assessment of taxes for 1991.

12. On January 11, 1996, the Department denied the Taxpayer's claim for refund.

13. On January 26, 1996 the Taxpayer filed a written protest to the Department's denial of its claim for refund.

### **DISCUSSION**

The Taxpayer is a scrupulously honest taxpayer who simply did not understand that it was subject to gross receipts tax, failed to inquire of the Department about applicable taxes when the

business was started, and was not informed by its bookkeeper about gross receipts taxes when it requested the bookkeeper to prepare its income tax returns. The Department imposed penalty and interest due to the Taxpayer's failure to timely file returns reporting and paying gross receipts taxes on its receipts. Ms. Foster is protesting the penalty and interest because she does not feel that it is fair to be penalized for something she didn't know.

I have no doubt that Ms. Foster would have accurately and timely paid her gross receipts taxes had she been aware of her obligation to do so. However, Ms. Foster's contentions misapprehend the nature of the imposition of interest and fail to account for the tax policy reasons behind the legislative determination to impose penalty when taxes are not reported and paid when they are supposed to be.

Section 7-1-67(A) NMSA 1978 addresses the imposition of interest on tax deficiencies and provides as follows:

- 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)

It is a well settled rule of statutory construction that the use of the word "shall" in a statute indicates that the provisions are intended to be mandatory rather than discretionary, unless a contrary legislative intent is clearly demonstrated. *State v. Lujan*, 90 N.M. 103, 560 P.2d 167 (1977). Applying this rule to Section 7-1-67, the statute requires that interest be paid to the state on any unpaid taxes and no exceptions to the imposition of interest are countenanced by the statute. Thus, it doesn't matter why taxes were unpaid. Interest is imposed for the period of time that they are unpaid.

The Taxpayer's argument essentially conceives of interest as a penalty imposed to punish a taxpayer for the late payment of taxes. This argument misapprehends the nature of the assessment of interest. Interest is imposed to compensate the state for the lost value of having tax revenues at the time they are required to be paid. Those tax revenues could have been invested by the state and interest earned upon those revenues, until the state needed to use the money to meet its obligations. While one may disagree with the rate of interest set by the legislature, as being excessive in

comparison with market rates of interest, that is a matter within the sound discretion of the legislature, and the Department is without authority to substitute its own judgment for that of the legislature in setting the rate of interest to be imposed.

The imposition of penalty is governed by the provisions of Section 7-1-69(A) NMSA 1978 (1990 Repl. Pamp.), which provides as follows:  
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 two percent per month or a fraction thereof...not to exceed ten percent of the tax...as penalty,....

This statute imposes penalty based upon negligence (as opposed to fraud) for failure to timely pay tax.

Thus, the good faith of the Taxpayer in fairly reporting its taxes is not at issue. What remains to be determined is whether the Taxpayer was negligent in failing to report its taxes properly. Taxpayer

"negligence" for purposes of assessing penalty is defined in Regulation TA 69:3 as:

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

In this case, the Taxpayer's failure to report and pay taxes was based upon Ms. Foster's lack of knowledge about New Mexico taxes. New Mexico has a self-reporting tax system which requires that taxpayers voluntarily report and pay their tax liabilities to the state. Because of this, the case law is well settled that every person is charged with the reasonable duty to ascertain the possible tax consequences of his actions, and the failure to do so has been held to amount to negligence for purposes of the imposition of penalty pursuant to Section 7-1-69 NMSA 1978. *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).

Although the imposition of penalty is intended to penalize taxpayers who fail to report and pay taxes in a timely manner, there are sound policy reasons behind the imposition of penalty. A

self-reporting tax system relies upon taxpayers accurately reporting their tax liabilities to the government. There are insufficient government resources to audit every taxpayer periodically to otherwise assure tax compliance. The imposition of penalty provides taxpayers with an incentive to understand the tax consequences of their actions and to accurately report their taxes. Otherwise, if the only consequence of an audit and determination of underpayment of tax was the payment of the tax which was owed, it would always advantage a taxpayer to simply underreport taxes and to pay them if they were found out.

In this case, Ms. Foster failed to inquire of the tax authorities if she might have any tax liability in addition to income tax, on her business activities. The time to make such inquiry is at the time of commencement of a business. Although she did consult with a tax advisor, this was not done until after the end of the first calendar year that the business was commenced, and her bookkeeper only understood her engagement to be for the preparation of income taxes, a normal year-end activity.

Given Ms. Foster's apparent naiveté about taxes in general, her bookkeeper should have asked Ms. Foster if she understood about gross receipts taxes, especially when Ms. Foster's records failed to indicate that they were being charged to her customers or paid to the Department. Ms. Foster's gross receipts taxes would still have been late, but it would have minimized the amount of interest and penalty imposed. In spite of Ms. Foster's good intentions in this matter, she was negligent in failing to determine her obligation for taxes on her business, and the imposition of penalty was proper.

#### **CONCLUSIONS OF LAW**

1. The Taxpayer filed a timely, written protest, pursuant to Section 7-1-24 NMSA 1978 and jurisdiction lies over both the parties and the subject matter of this protest.
2. Interest was properly imposed due to the Taxpayer's failure to timely pay gross receipts taxes.
3. Penalty was properly imposed due to the Taxpayer's negligence in failing to ascertain the tax consequences of its business activities, resulting in the untimely payment and reporting of

gross receipts taxes.

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

DONE, this 4th day of November, 1996.