BEFORE THE HEARING OFFICER

OF THE TAXATION AND REVENUE DEPARTMENT

OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST OF

NEWMAN OUTDOOR ADVERTISING NO. 97-28

PROTEST TO ASSESSMENT NOS. 1969487 & 1969462

DECISION AND ORDER

This matter came on for formal hearing before Gerald B. Richardson, Hearing Officer, on June 13, 1997. Newman Outdoor Advertising of New Mexico, Inc., hereinafter, "Taxpayer", was represented by Charles H. Coll, Esq. of Sanders, Bruin, Coll & Worley, P.A. The Taxation and Revenue Department, hereinafter, "Department", was represented by Frank D. Katz, Chief Counsel. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is a family owned corporation based in North Dakota and which also operates in Texas, Minnesota and New Mexico.

2. The Taxpayer is in the billboard business. It owns billboards and rents out space on those billboards to advertisers. Sometimes the billboard space is rented directly to a customer advertising its own business and sometimes the billboard space is rented to advertising agencies who wish to have ads for their customers placed on the billboards. Sometimes the Taxpayer's customers provide their own printed billboard advertising message to be placed on the billboards and sometimes the Taxpayer arranges to have the advertising material printed. In all cases, it is the Taxpayer who physically affixes the advertising message to the billboard.

3. The Taxpayer has two offices in New Mexico. It acquired its first office in Roswell in 1978 when it purchased the business of the Pecos Valley Sign Company, which owned billboards in the region. The Taxpayer opened an office in Las Cruces in 1980.

4. In March and April of 1995, the Department audited the Taxpayer. As a result of the audit, the Department issued two assessments to the Taxpayer. On October 19, 1995 it issued Assessment No. 1969462 with respect to the Taxpayer's Las Cruces office, assessing $45,258.94 in gross receipts tax, $2,891.26 in compensating tax, $21,705.51 in interest and $4,815.10 in penalty. On that same date, the Department issued Assessment No. 1969487 with respect to the Taxpayer's Roswell office, assessing $48,392.07 in gross receipts tax, $878.38 in compensating tax, $23,116.77 in interest and $4,927.10 in penalty. The audit period covered by each assessment in January, 1989 through December, 1994.

5. On November 13, 1995 the Taxpayer wrote the Department requesting additional time to file a protest to the assessments. In response, the Department granted the Taxpayer's request for additional time in which to file a protest, allowing until January 17, 1997 to so file.

6. On January 8, 1997, the Taxpayer filed a written protest to Assessment Nos. 1969487 and 1969462.

7. The Department's assessments of gross receipts tax were the result of the Department's disallowance of certain deductions from gross receipts tax which the Taxpayer had claimed in reporting its monthly gross receipts to the Department. The Department's auditors had allowed the deductions claimed by the Taxpayer which were supported by type 3 and 5 non-taxable transaction certificates (NTTCs) received from advertising agency customers, because those NTTCs can be given when a service is being resold or property is being leased for re-leasing to another party. The Department disallowed deductions for which the Taxpayer produced type 2, type 9 or type 14 NTTCs because those NTTCs only support a claim for deduction for the purchase of tangible personal property in different circumstances, and the sale of billboard space, but it is not the sale of tangible personal property. The Department also disallowed deductions claimed by the Taxpayer for which the Taxpayer could produce no NTTC to support its claim of deduction.

8. The Taxpayer no longer disputes the assessments of gross receipts tax, compensating tax, or interest, and those amounts have been paid. The Taxpayer also does not dispute the imposition of penalty with respect to the assessment of compensating tax. It does, however, dispute the penalty assessed with respect to the gross receipts taxes assessed. The approximate amount of penalty in dispute with respect to Assessment No. 1969462 is $4,526. The approximate amount of penalty in dispute with respect to Assessment No. 1969487 is $4,839.

9. The 1992 series NTTCs contain a statement on the face of the NTTC which states, "The seller must accept this certificate in good faith that the buyer will employ the property or service transferred in a nontaxable manner." The back side of the 1992 series NTTC contains a listing of the types of NTTCs issued by the Department with a detailed statement with respect to each type of NTTC setting forth the conditions under which the NTTC may be issued or executed by purchasers. The earlier series NTTC forms were specific to each type of NTTC and contained the detailed statement about the conditions under which the NTTC could be issued on the face of the NTTC.

10. When the Taxpayer acquired Pecos Valley Sign Company, it followed the same procedures and accounting methodologies as were already in place for determining which transactions were taxable and which were deductible for purposes of reporting gross receipts taxes.

11. The Taxpayer never consulted a professional tax advisor concerning how the gross receipts tax applied to its business operations in New Mexico prior to being audited by the Department.

DISCUSSION

The sole issue to be determined herein is whether penalty was properly assessed under the facts and circumstances of this case. The imposition of penalty is governed by the provisions of NMSA 1978, Section 7-1-69(A) (1995 Rep. Pamp.), which imposes a penalty of two percent per month, up to a maximum of ten percent:

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 or to file by the date required a return regardless of whether any tax is due,....

This statute imposes penalty based upon negligence (as opposed to fraud) for failure to timely pay tax. Thus, there is no contention that the failure to report and pay taxes was based upon any conscious attempt by the Taxpayer to underreport taxes. 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 3 NMAC 1.11.10 (formerly 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.

The Department's assessment of gross receipts tax was based upon its disallowance of certain deductions which had been claimed by the Taxpayer in reporting its gross receipts taxes. The Department disallowed claimed deductions in four different circumstances. First, the Taxpayer had claimed deductions based upon its possession of type 9 NTTCs issued to it by some of its customers. Type 9 NTTCs support deductions authorized under either NMSA 1978 § 7-9-54 or § 7-9-60. Section 7-9-54 authorizes a deduction for sales of tangible personal property to charitable and educational organizations which have been granted exemption from federal income tax under Section 501(C)3 of the Internal Revenue Code. Second, the Taxpayer had claimed deductions for tangible personal property sold to a purchaser for resale. Third, the Taxpayer had claimed deductions based upon its possession of type 2 NTTCs issued to it by some of its customers. Type 2 NTTCs support deductions authorized under NMSA 1978 § 7-9-47, which authorizes a deduction for tangible personal property sold to a purchaser for resale. Third, the Taxpayer had claimed deductions based upon its possession of type 14 NTTCs from some of its customers. Type 14 NTTCs support deductions for the sale of tangible personal property to state or federal credit unions. Fourth, the Taxpayer had claimed deductions for which it did not have a NTTC in its possession to support the deduction as is required by NMSA 1978, § 7-9-43.

The Taxpayer does not now dispute that the Department properly denied these claimed deductions because it understands that the rental of billboard space is treated as an advertising service and is not the sale of tangible personal property. Nonetheless, the Taxpayer argues that it was not negligent in relying upon these certificates for the purchase of tangible personal property or for claiming deductions for which it did not have NTTCs based upon the following four circumstances.

First, the Taxpayer was following the same tax reporting and bookkeeping procedures which its predecessor, Pecos Valley Sign Company, had in place when it was acquired by the Taxpayer. Second, the Taxpayer argues that as a North Dakota based company which operated in three other states, it was not familiar with New Mexico's tax system, which unlike the other states it does business in, taxes the sale of services in addition to taxing sales of property. Third, the Taxpayer's customers who provided NTTCs insisted that they were not taxable.

Fourth, the Taxpayer relied upon the language on the face of the NTTC which states that, "[T]he seller must accept this certificate in good faith that the buyer will employ the property or service transferred in a nontaxable manner. The Taxpayer understood this language to mean that it must accept the certificate, not that it must accept the certificate with a good faith belief that the buyer will use the property in a nontaxable manner. The Taxpayer argues that while each one of these circumstances, standing alone, might not be sufficient to overcome the presumption of correctness which attaches to an assessment of penalty, that when viewed together, they demonstrate that the Taxpayer exercised that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances, so as to have met its burden of demonstrating that it was not negligent.

At first blush, considering the cumulative effect of these factors, it appears that the Taxpayer has made a good case for the abatement of penalty. Examining each factor individually, however, reveals that they often don't hold up to scrutiny.

With respect to the first factor, that the Taxpayer was simply following the existing business practices of its predecessor, Pecos Valley Sign Company, the Taxpayer's general manager, Barbara Isler admitted that while she knew that the previous owners had accepted NTTCs from customers, she did not know which types of NTTCs had been accepted. Thus, it is entirely possible that the predecessor only accepted the type 5 and type 3 NTTCs which can be properly accepted and which the Department allowed the Taxpayer upon audit. While I found Ms. Isler to be quite honest and credible in her testimony, she did not become the manager of the Taxpayer's New Mexico operations until 1986, eight years after the Pecos Valley Sign Company was acquired. Her testimony was based upon an apparently general review of old business records, but her inability to distinguish between the types of NTTCs which had been accepted by the predecessor sign company and the overall general nature of her testimony on this issue was insufficient to establish that the Taxpayer was following its predecessor's business practices with respect to claiming deductions based upon receipt of NTTCs for the sale of tangible personal property or where the customer provided no NTTC.

The Taxpayer's second factor, that it was a North Dakota based company which does business in three other states, New Mexico being the only one which taxes services, is similarly unpersuasive. In the first place, even though New Mexico may be the only state which imposes a tax on the type of advertising services the Taxpayer provides, the Taxpayer was well aware that New Mexico imposes a tax on its activities because it paid substantial amounts of gross receipts taxes to the Department all along. It simply claimed more deductions than were authorized because of its acceptance of NTTCs which did not apply to the services it sold or because it lacked NTTCs to support the deductions. Additionally, 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). In this case, the Taxpayer admitted that it never consulted a professional tax advisor concerning how it should be handling its gross receipts tax reporting. Given the significant amount of business the Taxpayer conducts in New Mexico, as well as the fact that the Taxpayer has been in business here since 1978, ordinary business prudence would suggest that when commencing business activities in a new taxing jurisdiction that some sort of inquiry be made, and the Taxpayer's failure to consult a tax professional, inquire of the Department or take other measures to ensure that it understood how New Mexico's taxes would apply to its business activities establishes that the Taxpayer was negligent for purposes of imposition of penalty under § 7-1-69.

I find the third factor, that the Taxpayer's customers who provided the wrong type of NTTCs were insistent that they were not subject to tax, to be puzzling, at best. If the Taxpayer had a policy of accepting any type of NTTC which was provided by a customer, I don't really understand why there would have even been any discussion about taxability. If, on the other hand, the Taxpayer did question the applicability of certain NTTCs, then that undercuts its argument that it did not know or understand that the improper NTTCs would not support a deduction from tax. This factor was simply not adequately explained to be persuasive on this issue.

The fourth factor, the Taxpayer's reliance upon the language on the face of the NTTC, which it understood to mean that it must accept the NTTC, is, on the face, perhaps the most compelling argument posited by the Taxpayer. The Department conceded that the language is ambiguous and can be interpreted in more than one way. The Department's regulations under § 7-1-69 do provide that one indication of non-negligence is when a taxpayer proves that it was affirmatively misled by a Department employee. See, 3 NMAC 1.11.11 (formerly TA 69:4). By inference, if a Taxpayer is misled by a Deportment form, this could also indicate non-negligence.

The Department argues that even though the language on the form is ambiguous, that this is not sufficient to be considered misleading, since the back of the form contains detailed explanations about how forms may properly be used, which would explain what would be required to establish good faith acceptance of the NTTC. The Department argues that given the ambiguity of the language on the front of this form, a prudent taxpayer would seek clarification by reading the back of the form.

In this case, there is no need to determine whether the Department's form is sufficiently misleading to negate the Taxpayer's negligence in accepting improper NTTCs. This is because the form with the ambiguous language was only in effect for the last two years of the audit period. Although the Department's earlier version NTTC forms were not put into evidence, this decision maker has seen hundreds of such forms in the course of his duties and judicial notice is taken of the fact that the earlier NTTCs were issued by type, and each separate type NTTC had the language explaining their proper use on the face of each NTTC form. The audit years covered in this case go back to 1989, and the Taxpayer was in business in New

Mexico for at least a decade before that. It is simply difficult to believe that this Taxpayer could have been so misled by the language of the 1992 series NTTC when it accepted improper NTTCs for the earlier audit years which would not be considered misleading because there was language on their face informing taxpayers about the conditions for their use.

Thus, when carefully examined, the cumulative effect of the factors argued by the Taxpayer simply don't amount to sufficient evidence to establish that the Taxpayer was not negligent in claiming deductions which were not authorized by law. No doubt, the Taxpayer considers this ruling unduly harsh. After all, there is no question here that the Taxpayer had no intention to avoid its obligation to pay taxes. Additionally, the Taxpayer has paid all of the taxes assessed as well as a substantial amount of interest. Surely, this should be enough.

These considerations, however, do not take into account the strong policy reasons for the legislative decision to impose penalty when a taxpayer fails to properly determine and report its taxes. 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, plus interest to compensate the state for not having the taxes it was entitled to at the time they were due, it would always advantage a taxpayer to be casual about assuring it was correctly reporting taxes and if, upon audit, underreporting is established, to pay the taxes it owed.

The facts of this case bear out the policy reasons for the imposition of penalty. Assuming that, as the Taxpayer's evidence suggests, that the Taxpayer reported its taxes the same way since it started business in New Mexico in 1978, presumably, it also claimed improper deductions for the years prior to the years covered by this audit, 1989-1994. Those taxes cannot be assessed or collected because of the statute of limitations. The legislature also adopted tax policy by imposing such a limitation upon the authority of a tax collector to go back in time to look for underreporting of tax. But given the limitation on the Department's authority to assess back taxes, the legislature has also provided, in the form of a negligence penalty, a financial incentive for taxpayers to correctly report their taxes, so that the state, to the greatest extent possible, collects the taxes which are due. This is not to say that penalty is imposed in lieu of unpaid taxes, the collection of which is barred, but it serves to illustrate the rationale for providing a financial incentive to ensure the proper reporting and payment of tax.

CONCLUSIONS OF LAW

1. The Taxpayer filed timely, written protests to Assessment Nos 1969487 and 1969462, and jurisdiction lies over both the parties and the subject matter of this protest.

2. The Taxpayer was negligent, pursuant to NMSA 1978, § 7-1-69, in claiming deductions which were not authorized by law, and thus penalty was properly imposed.

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

DONE, this 29th day of July, 1997.