

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

IN THE MATTER OF THE PROTEST OF
JIM AND MARGARET TILGHMAN
PROTEST TO ASSESSMENT NO. 719596

NO. 98-15

DECISION AND ORDER

This matter came on for formal hearing on March 24, 1998, before Gerald B. Richardson, Hearing Officer. Mr. and Mrs. Jim Tilghman, hereinafter, "Taxpayers" or "the Tilghmans" were represented by Mr. Jim Tilghman. The Taxation and Revenue Department, hereinafter, "Department", was represented by Monica M. Ontiveros, Special Assistant Attorney General. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Mr. Tilghman is an electrical engineer who, during tax year 1994, had income from wages earned in both Arizona and New Mexico. During most of the year, the Tilghmans resided in New Mexico, but before the end of 1994, they moved their residence to New Mexico.
2. Line 7 of the 1994 New Mexico personal income tax return form is the starting point for reporting and calculating taxpayer's 1994 New Mexico personal income taxes. It calls for taxpayers to fill in their federal adjusted gross income from line 31 of federal form 1040, line 10 from federal form 1040A or line 3 from federal form 1040EZ, depending upon which federal form a taxpayer used.

3. In filling out the Tilghman's 1994 New Mexico personal income tax return, Mr. Tilghman filled in Line 7 with the amount of his New Mexico wages as reported on his federal W-2 form instead of filling in the amount of his federal adjusted gross income. Mr. Tilghman did this because knowing that New Mexico does not have the power to impose its income tax upon his Arizona income, he did not think it was correct to start the return with federal adjusted gross income which included his wages earned in Arizona.

4. The New Mexico personal income tax filer's kit contains both tax return forms and instructions as to how to fill out those forms. Mr. Tilghman admitted to having those instructions available when he filled out his 1994 New Mexico personal income tax return. Those instructions inform first year residents who have moved to New Mexico during the tax year and were nonresidents in the prior year that they are required to file their New Mexico personal income taxes using forms PIT-1 and PIT-B to allocate and apportion income from within and outside of New Mexico.

5. The PIT-B form provides the mechanism for imposing income tax in a method by which only New Mexico wages are considered when determining the amount of income tax to be imposed upon individuals with income from wages earned both within and without New Mexico. Rather than directly allocating income between in state and out of state, the total wages are taken into consideration in determining the tax rate to be applied and to arrive at a calculation of tax. Then the tax is allocated in proportion to the ratio between New Mexico and non-New Mexico wages to arrive at the amount of income tax to be imposed.

6. Line 25 of the 1994 New Mexico personal income tax return, form PIT-1, calls for taxpayers who file a PIT-B form to enter on that line the amount of tax imposed as a result of the calculations on the PIT-B form.

7. Line 26 of the 1994 New Mexico personal income tax return, form PIT-1, calls for taxpayers who filled in Line 25 with the tax calculation from their PIT-B form to enter the amount from Line 25 on Line 26.

8. Mr. Tilghman did not consult the instruction packet when filling out his 1994 PIT-1 return and did not file or fill out a PIT-B form when originally filing his 1994 New Mexico personal income taxes.

9. Mr. Tilghman skipped over Lines 25 and 26 when filling out his 1994 New Mexico PIT-1 return, leaving them blank.

10. The Department has an information sharing agreement with the Internal Revenue Service (“IRS”) whereby the IRS provides federal income tax return information to the Department with respect to New Mexico residents.

11. The Department has a “tape-match” program where it compares the information provided to the IRS and that provided to the Department, with respect to persons filing New Mexico personal income tax returns.

12. As a result of its tape match program, the Department noticed the discrepancy between the Tilghman’s federal adjusted gross income as reported to the IRS and to the Department and requested an explanation. As a result of the discussions which ensued between Mr. Tilghman and the Department, on July 21, 1997 Mr. Tilghman, with assistance from a Department employee, filed an amended 1994 New Mexico personal income tax return, including a PIT-B form. The amended return reported that the Tilghman’s owed the Department an additional \$1,094 in personal income taxes for the 1994 tax year.

13. On that same date, July 21, 1997, Mr. Tilghman paid the Department the additional \$1,094 in taxes.

14. On August 13, 1997, the Department issued Assessment No. 719596 to the Tilghmans, assessing \$109.40 in penalty and \$382.90 in interest with respect to the Tilghman's underpayment of their 1994 income taxes as originally filed.

15. On September 5, 1997, the Tilghman's filed a timely, written protest to Assessment No. 719596.

DISCUSSION

The issues to be determined herein are whether the Taxpayers are liable for the assessment of interest and penalty for failing to pay the full and correct amount of personal income tax for tax year 1994 in a timely manner. Mr. Tilghman has raised several arguments against the imposition of interest and penalty. With respect to interest, Mr. Tilghman argued that the amount of interest assessed was excessive because approximately two years elapsed from the time he filed his 1994 personal income tax return and when the Department notified him of the discrepancy in reporting tax. Mr. Tilghman paid the tax promptly as soon as he was notified of the problem, and had he been notified sooner, he would have paid sooner to avoid the imposition of interest as occurred in this case. Additionally, Mr. Tilghman feels that it is unfair to assess either penalty and interest before a taxpayer is notified of its error and given an opportunity to promptly correct the problem.

With respect to penalty, Mr. Tilghman argued that he never intended to underpay tax and that the underpayment was the result of unintentional error. He argued that the calculation of tax was complex for taxpayer's with income from both within and without the state and that he feels that persons of ordinary intelligence should be able to read and interpret the state tax forms and instructions. Mr. Tilghman also cited Deputy Secretary Gail Reese's comment to reporters for

the Albuquerque Journal when asked about an error in the Department's 1997 personal income tax returns. Ms. Reese had admitted the Department's error and had responded that "We are only human." Mr. Tilghman feels that taxpayers, as well as the Department should be given some allowance for human error with respect to the requirements for filing and reporting taxes. Finally, Mr. Tilghman argued that given the relatively small amount at issue herein, the fact he made an honest mistake with no intention to cheat the state of its taxes and that it is commonly known that there are many who are illegally refusing to report and pay taxes, that the Department should focus its resources on the really "bad guys" and give a break to honest taxpayers.

While I have no doubt whatsoever about the honesty and integrity of Mr. Tilghman and that his mistake was, indeed, an honest mistake, the Department is governed by the statutory directives of the legislature with respect to its administration of taxes. It is required to administer the tax statutes and to collect taxes when the statutes establish a taxpayer's liability for tax. The Department's authority to compromise or cut deals with respect to liabilities is quite constrained. Section 7-1-20(A) NMSA 1978 limits the Department secretary's authority to compromise the assessment of tax¹ to situations where there is a "good faith doubt" as to a taxpayer's liability for tax. This limits the Department's authority to compromise taxes to situations where there is a legal doubt about liability. As regulation 3 NMAC 1.6.14.1 provides:

The secretary may compromise the assessed liability of a taxpayer by entering into a written closing agreement *only if and when there is a good faith doubt as to the liability*. The written agreement must adequately protect the interests of the state and be approved by the attorney general. The secretary may not compromise a taxpayer's liability because of the taxpayer's inability to pay. *The secretary may not compromise a taxpayer's liability solely because of the threat of litigation or as an expedient means of disposing of*

¹ "tax" is defined at Section 7-1-3(U) NMSA 1978 to include any penalty or interest relating to taxes for which a taxpayer is liable

a controversy unless the secretary has a good faith doubt as to the liability. (emphasis added).

Thus, although it may not be cost efficient to take a case of this magnitude to formal hearing and decision, the Department does not have the authority to settle the case for reasons of expediency in order to focus its resources on cases involving taxpayer dishonesty or where larger amounts of liability may be in issue.

Section 7-1-67(A) NMSA 1978 governs 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 not paid in a timely manner. Interest is imposed any time that taxes are not paid when they are due, and for the period of time that they are unpaid.

There is an aspect of Mr. Tilghman's argument which 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.

In addition to lacking the authority to change the rate at which interest is imposed, the Department also lacks the authority to depart from the mandates of Section 7-1-67 with respect to the period for which interest must be imposed. The statute requires that interest be imposed from the due date for the taxes (in this case, April 1, 1995), until the tax is paid. Thus, the Mr. Tilghman must take his concerns about imposing interest before taxpayers are notified of a liability to the legislature which writes the tax statutes.

The imposition of penalty is governed by the provisions of NMSA 1978, Section 7-1-69(A)(1995 Repl. 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 a willful or fraudulent intent) for failure to timely pay tax. As stated above, there is no contention that the failure to report and pay taxes was based upon any conscious attempt by Mr. Tilghman to underreport taxes. What remains to be determined is whether the Tilghman's were negligent in failing to report their 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.

In this case the Taxpayers' failure to report and pay taxes was based upon Mr. Tilghman's failure to follow the Department's clear directives of its personal income tax return form and the instructions which accompany it. Mr. Tilghman argued that the way in which New Mexico calculates tax for those who have income from both within and without New Mexico is complex, arguing that it was too complex for ordinary individuals to follow. I find the instructions on the return which require taxpayers to begin with federal adjusted gross income to be quite clear. I also found the instructions in the instruction packet to be clear and unambiguous. Frankly, Mr. Tilghman's failure to calculate his taxes correctly was due much more to his failure to consult, read and follow the instructions contained in the return and instruction packet rather than the complexity of New Mexico's system. This qualifies as taxpayer negligence under pretty much any of the characterizations of taxpayer negligence contained in regulation 3 NMAC 1.11.10.

Mr. Tilghman's arguments that penalty and interest should not be imposed until the Department notifies a taxpayer of the error in how it reported taxes misapprehends the nature of this state's tax system. 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, to ensure that they understand how taxes are reported and calculated, and to accurately report their taxes. Thus, the statutes impose the primary responsibility upon taxpayers to report and pay their taxes accurately and in a timely manner. The Department's failure to catch a taxpayer's error does not act to shift this responsibility to the Department nor does it provide a defense to the imposition of penalty for the failure to report and pay the proper amount of taxes.

Finally, with respect to Mr. Tilghman's argument that Taxpayer's should be granted relief from penalty for human error, the standards of negligence specifically encompass such things as human error.

While it may seem unfair that taxpayers are held to higher standard of care than the tax collector, this is a legislative policy which reflects the importance the legislature places upon its requirement that taxpayers accurately report their taxes.

CONCLUSIONS OF LAW

1. The Taxpayers filed a timely, written protests to Assessment No. 719596 and jurisdiction lies over both the parties and the subject matter of this protest.

2. Because the Taxpayers did not pay tax the full amount of tax for which they were liable at the time it was due, interest was properly assessed pursuant to Section 7-1-67 NMSA 1978.

3. Mr. Tilghman was negligent in failing to follow the instructions with respect to how to report and file his 1994 personal income taxes, resulting in the underpayment of tax and penalty was properly assessed pursuant to Section 7-1-69 NMSA 1978.

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

DONE, this 27th day of March, 1998.