

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

IN THE MATTER OF THE PROTEST OF
KENT R. AND GAIL K. CARTER,
PROTEST TO ASSESSMENT
NOS. 98094, 98095, 98096 AND 98097

NO. 02-32

DECISION AND ORDER

This matter came on for formal hearing on November 18, 1999 before Gerald B. Richardson, Hearing Officer. Kent and Gail Carter, hereinafter, "Taxpayers", failed to attend the scheduled hearing after receiving notice of said hearing. The Taxation and Revenue Department, hereinafter, "Department", was represented by Mónica M. Ontiveros, Special Assistant Attorney General. Subsequent to the hearing, the Department filed a Motion to Supplement the Record and served a copy on the Taxpayers. The Taxpayers filed no response. Because of my concerns that parties be prepared to present all relevant evidence at the time of the formal hearing, the Motion to Supplement the Record is denied. Based upon the information and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Kent R. Carter holds a license under the name, Kent Carter Builders, from the New Mexico Construction Industries Division of the Regulation and Licensing Department as a general building contractor. The license was issued to him on January 21, 1985 and it remains an active license.

2. The address of Kent Carter Builders as reflected in the records of the Construction Industries division is PO Box 5033, Carlsbad, New Mexico, 88220.

3. Kent Carter Builders has been registered with the Department under Taxpayer Identification No. 02-007165-00 5 for purposes of reporting gross receipts, compensating and withholding taxes since July 20, 1984.

4. Kent Carter Builders files monthly reports with the Department, reporting and paying gross receipts taxes.

5. For tax years 1989, 1990, 1991 and 1992, Kent R. Carter filed New Mexico personal income tax returns as a head of household, claiming one dependent, and reporting his income and expenses from his construction business. In years in which he had sufficient income in excess of expenses so as to owe personal income tax to the Department, he paid personal income tax.

6. For tax year 1993, Kent R. and Gail K. Carter filed a New Mexico resident personal income tax return as married persons filing jointly and claiming two dependents. In that year, the Carters reported and paid \$213 in New Mexico personal income taxes to the Department.

7. The Taxpayers have not filed or reported personal income taxes to the Department for tax years 1994, 1995, 1996, 1997 and 1998.

8. The Taxpayers did file a federal personal income tax return with the Internal Revenue Service ("IRS") in 1994. Through its information sharing agreement with the IRS, the Department learned that the Taxpayers had reported \$50,101 in federal adjusted gross income to the IRS.

9. Using the information from the IRS, the Department adjusted upwards by 10% per year, the Taxpayers' federal adjusted gross income for tax years 1995-1998, gave them credit for the standard federal deduction and for four exemptions to calculate an estimate of the amount of personal income tax the Taxpayers owed the Department for tax years 1995-1998.

10. Based upon these estimates, on July 16, 1999, the Department issued to the Taxpayer the following assessments in the following amounts:

<u>Assmt. No.</u>	<u>Year</u>	<u>Income Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
98094	1995	\$ 1,681.00	\$ 840.50	\$ 819.49	\$ 3,340.99
98095	1996	\$ 2,385.00	\$1,192.50	\$ 804.94	\$ 4,382.44
98096	1997	\$ 3,279.00	\$1,639.50	\$ 614.81	\$ 5,533.31
98097	1998	\$ 4,487.00	\$2,243.50	\$ 168.26	\$ 6,898.76

11. In response to the Department's assessments, on August 13, 1999, the Department received from the Taxpayers a 15 page document entitled "Notice of Defense, Demand to Quash Notice of Amount Due For Lack Of Jurisdiction and Discharge for Fraud; Demand for Adjudicatory Hearing of Record, if Denied". This document purports to dispute the Taxpayers liability for tax, including income tax, it disputes the Department's personal and subject matter jurisdiction over the Taxpayers, it disputes the validity of the federal income tax upon which the New Mexico income tax is calculated, it alleges that the Department's assessment was not properly authorized or executed and generally it raises numerous defenses to the Department's assessments and demands that they be quashed. In the alternative, the Taxpayers demanded an impartial adjudicatory special hearing of record to afford the Taxpayers an opportunity to learn the basis for the assessment, to confront witnesses and to require the Department to substantiate its claim of jurisdiction to tax and jurisdiction over the Taxpayers. The document also contains administrative interrogatories, a demand to cease and desist collection activities, an affidavit contesting jurisdiction, and a document purporting to revoke the Taxpayers' signatures on previously filed Federal W-4 forms, 1040 forms and state income tax forms.

12. The Department treated this document as a valid protest to the assessments at issue herein and on August 30, 1999 it wrote to the Taxpayers informing them that it was doing so and that the matter had been referred to the Department's Legal Services Bureau.

13. On October 7, 1999, the Department's Hearing Officer mailed a letter by certified mail to the Taxpayers informing them that a formal hearing of their protest would be held on November 18, 1999 at 9:00 A.M. at the Department's offices in Santa Fe.

14. On October 22, 1999, Kent R. Carter signed for and acknowledged receipt of the certified mail notice of the formal hearing in this matter.

15. The Taxpayers did not appear for the formal hearing.

DISCUSSION

Section 7-1-17(C) NMSA 1978 provides that "Any assessment of taxes or demand for payment made by the department is presumed to be correct." "Tax" is defined at Section 7-1-3(U) NMSA 1978 to include the amount of any interest and penalty relating to taxes assessed pursuant to the provisions of the Tax Administration Act unless the context of the statutory provision requires otherwise. Thus, the presumption of correctness also attaches to the interest and penalty portions of assessments unless there is something in the context of the statute at issue to indicate otherwise. Because of the presumption of correctness, the burden of proof is upon any taxpayer protesting an assessment to present evidence contesting the factual correctness of the assessment or legal arguments challenging the legal basis of the assessment which clearly overcome the presumption of correctness. *Archuleta v. O'Cheskey*, 84 N.M. 428, 504 P.2d 638 (Ct. App. 1972). Having failed to appear to present evidence or argument in support of their protest, the Taxpayers have not met their burden of proof in this case and the presumption of

correctness that attaches to the Department's assessments establishes the Taxpayers' liability for personal income tax and interest.

With respect to the penalty assessed, the Taxpayers were assessed a penalty in the amount of 50% of the tax assessed for tax years 1995 through 1998. The penalty statute was amended during the years covered by the Department's assessments, but under either version of the statute, the event triggering the imposition of penalty is the "failure...to pay when due any amount of tax required to be paid..." Thus, we must look to the due date for the taxes in question to determine which version of the penalty statute to apply for a given tax year. Under the Income Tax Act, Chapter 7, Article 2 NMSA 1978, taxes are due, "on or before the fifteenth day of the fourth month following the end of the taxable year." Section 7-2-12 NMSA 1978. Because the Taxpayers reported and paid income taxes in the years in which they did report and/or pay taxes on a calendar year basis, the Taxpayers' tax payments were due on April 15 of the year following the tax year. Because the payment of tax for the 1995 and 1996 tax years would have been due on April 15, 1996 and 1997, respectively, the Taxpayers were assessed penalty pursuant to the earlier version of the statute, § 7-1-69(B) NMSA 1978 (1995 Repl. Pamp.), which provided:

In the case of failure, *with intent to defraud the state*, to pay when due any amount of tax required to be paid, there shall be added to the amount fifty percent of the tax or a minimum of twenty-five dollars (\$25.00), whichever is greater, as penalty.
(emphasis added).

This provision was amended by Laws 1997, ch. 67, § 8, effective July 1, 1997, to read:

In the case of failure, *with willful intent to evade or defeat any tax*, to pay when due any amount of tax required to be paid, there shall be added to the amount fifty percent of the tax or a minimum of twenty-five dollars (\$25.00), whichever is greater, as penalty.
(emphasis added).

Section 7-1-69(C) NMSA 1978 (1997 Cum. Supp.) This version of the penalty statute would be applicable to the assessments for tax years 1997 and 1998.

Section 7-1-78 NMSA 1978 addresses the burden of proof in certain circumstances.

Specifically, it provides:

In any proceeding involving the issue of whether any person has been guilty of fraud or corruption, the burden of proof in respect of such issue shall be upon the director or the state.

The earlier version of the penalty statute, Section 7-1-69(B), imposed the 50% penalty in the case of failure to pay “with intent to defraud the state”. Although as amended, the new version of the 50% penalty provision, § 7-1-69(C), does not specifically use the words “fraud” or “corruption”, it does no violence to the concept of the statute to characterize it as a fraud penalty. It requires that the failure to pay be due to a willful intent to evade or defeat a tax. This language closely tracks the provisions of § 7-1-72 NMSA 1978, which provides a criminal penalty under the following circumstances:

Any person who *willfully attempts to evade or defeat any tax* or the payment thereof is, in addition to other penalties provided by law, guilty of a felony and, upon conviction thereof, shall be fined not less than one thousand dollars (\$1,000) nor more than ten thousand dollars (\$10,000), or imprisoned not less than one year nor more than five years, or both such fine and imprisonment, together with the costs of prosecution. (emphasis added).

Because both the civil and criminal penalties for tax evasion now require a willful intent to evade or defeat the payment of tax, it appears that the legislature was merely conforming the language for the imposition of the civil and the criminal penalties for tax evasion. It is hard to discern any real difference in the standard for the imposition of the penalty under either version of the 50% penalty statute. Since the earlier version clearly refers to fraud, I believe that under either

provision § 7-1-78 places the burden upon the Department to establish the propriety of its assessment of the 50% penalty.

Section 7-1-78 does not specify the standard or degree of proof required for the state to meet its burden of proof. The common law rule in New Mexico, however, is that proof of fraud in a civil action must be established by clear and convincing evidence. *First National Bank in Albuquerque v. Abraham*, 97 N.M. 288, 291, 693 P.2d 575 (1982). That standard will be applied to determine whether the 50% penalty was properly assessed under the circumstances of this case.

At the formal hearing, the only evidence the Department presented with respect to the fraud penalty was that the Taxpayers had filed New Mexico personal income tax returns and paid New Mexico income tax for tax years 1989 through 1993, and that from 1994 forward, they had failed to file returns or report income tax even though Mr. Carter continued to report and pay gross receipts tax on his construction business. From this, the Department infers that the Taxpayers were familiar with the income tax filing requirements and their failure to continue to file and report income taxes was due to a willful intention to evade or defeat the imposition of tax.

As noted above, the Taxpayers failed to attend the formal hearing in this matter. Thus, we have no testimony or other explanation in the record to explain their change of heart with respect to filing and reporting income taxes with the Department. We do have their protest document, which raises many of the standard “tax resister” arguments to the imposition of income tax, but we do not have evidence as to when the Taxpayers became aware of these arguments, whether they hold a sincerely held belief as to their validity, or any other circumstances surrounding their failure to report and pay income taxes to the Department.

Without more, this is insufficient to establish by clear and convincing evidence the Taxpayers' intention to evade or defeat the imposition of New Mexico personal income taxes. After the formal hearing was concluded, the Department sought to supplement the record with documents from the United States District Court of the District of New Mexico showing that in early 1999, the Taxpayers sued the Department for a declaratory judgment that the Department's filing of a lien violated their civil rights, that the Taxpayers' suit had been dismissed and that the Department had been awarded attorney's fees pursuant to 42 U.S.C. 1988 as a prevailing party based upon the frivolous nature of the Taxpayers' lawsuit. This evidence was not admitted because of my concerns that parties be prepared to present all relevant evidence at the time of the formal hearing with respect to their position on any contested matter. The Department failed to explain why this evidence was not presented at the time of the formal hearing. Even if it had been admitted, it was too scanty to meet the clear and convincing evidence standard. The intent of the Taxpayers with respect to their failure to report and pay state income taxes must be determined at the time they failed to report and pay the tax. Thus, the dismissal of a lawsuit, which occurred after the due date for the tax returns for any of the relevant tax periods would not be probative of the intention of the Taxpayers and their understanding of the law with respect to their obligation to report and pay income taxes at the time their return was due. For these reasons, the Department has failed to meet its burden of showing by clear and convincing evidence the Taxpayers' intention to evade or defeat the imposition of New Mexico personal income tax with respect to the tax assessments at issue.

CONCLUSIONS OF LAW

1. The Taxpayers filed a timely, written protest, pursuant to § 7-1-24 NMSA 1978 to Assessment Nos. 98094, 98095, 98096 and 98097 and jurisdiction lies over both the parties and the subject matter of this protest.

2. The Taxpayers failed to present any evidence to overcome the presumption of correctness which attached, pursuant to § 7-1-17 NMSA 1978, to the assessment of tax and interest pursuant to Assessment Nos. 98094, 98095, 98096 and 98097 and thus those assessments of tax and interest are presumptively correct.

3. The burden of proof with respect to the assessment of fraud penalty pursuant to § 7-1-69(C) NMSA 1978 (1997 Cum. Supp.) and § 7-1-69(B) (1995 Repl. Pamp.), is upon the Department.

4. The standard of proof with respect to the assessment of fraud penalty pursuant to § 7-1-69(C) NMSA 1978 is clear and convincing evidence.

5. The Department has failed to meet its burden of proof with respect to the assessment of fraud penalty.

For the foregoing reasons, the Taxpayers' protest IS HEREBY GRANTED with respect to the assessment of fraud penalty and IS HEREBY DENIED with respect to the assessment of tax and interest.

DONE, this 30th day of December, 2002.