

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

IN THE MATTER OF THE PROTEST  
OF *WILSON T. AND FRANCES J. LUNDY*,  
PROTEST TO ASSESSMENT NO. 564818.

No. 96-15

**DECISION AND ORDER**

This matter was heard on March 27, 1996 by Julia Belles, Hearing Officer. Mr. and Mrs. Wilson Lundy, (Taxpayers), were represented by Mr. Wilson Lundy. Frank D. Katz, Special Assistant Attorney General, represented the Taxation and Revenue Department (Department).

Based upon the evidence and arguments presented, IT IS DECIDED AND ORDERED as follows:

**FINDINGS OF FACT**

1. The Taxpayers were a residents of New Mexico who paid personal income tax in 1987, 1988, 1989 and 1990 .
2. In 1987 and 1988, the Taxpayers included federal military retirement income in determining their tax liability.
3. The Taxpayers did not include their federal military retirement income when determining their 1989 tax liability.
4. In 1989, the United States Supreme Court ruled that states could not treat state and federal retirement benefits differently for income tax purposes.
5. The New Mexico Legislature amended the law in 1990 to eliminate the disparate treatment of state and federal retirement income and required both state and federal retirement benefits be included as income for the 1990 tax year.
6. The Taxpayers did not include their federal retirement benefits when they calculated their 1990 tax and filed their 1990 PIT return. The Taxpayers 1990 PIT return was timely filed on or before April 15, 1991.

7. In 1993, the Taxpayers received Notice of Assessment No. 530430 assessing taxes, interest and penalty for tax year 1989. The assessment was based on the deduction of federal retirement income. The Taxpayers timely protested Assessment No. 530430 and it was later abated.

8. Around April or May of 1993, the Taxpayers requested a refund for the taxes they incorrectly paid on their federal military retirement income for the 1987 and 1988 tax years. The Department did not respond to the request for a refund.

9. The Taxpayers continued to write to the Department to request a hearing on their claim for refunds. The Department finally responded with continual requests for documents the Taxpayer had already sent to the Department.

10. On February 7, 1994, the Department issued Notice of Assessment No. 564818 which assessed \$2,379.57 in personal income tax, \$1,011.31 in interest and \$237.95 penalty for the 1990 tax year.

11. The Assessment was based upon information the Department received from the Internal Revenue Service pursuant to an information sharing agreement. That information revealed that the Taxpayers received federal retirement benefits which were not reported as income when they filed their 1990 New Mexico Personal Income Tax (PIT) return.

12. On March 4, 1994, the Taxpayers timely filed a written protest to Assessment No. 564818.

13. On January 28, 1995 the Taxpayers amended their 1987, 1988, 1989 and 1990 tax returns. They asked that the taxes incorrectly paid in 1987 and 1988 be used to pay Assessment No. 564818.

### **DISCUSSION**

The Taxpayers do not dispute the correctness of Assessment No. 564818 but argue that the taxes they overpaid in 1987 and 1988 should be applied to the underpayment of their 1990

taxes. The reason there was a hearing on this assessment was because of the way the Department mishandled the Taxpayer's claim for a refund. The Taxpayers requested a refund for their 1987 and 1988 taxes in 1993. Initially, The Department did not respond to the request. When prompted by the Taxpayers to respond, the Department responded with repeated requests for information and documents the Taxpayers had already provided to the Department. It is likely that had the Department courteously, diligently and quickly responded to the Taxpayers's claim for a refund there would not have been a hearing on Assessment No. 564818.

The Taxpayers argued, in their March 4, 1994 protest letter, that the assessment was not timely and that interest and penalty should be abated because of the change in how federal retirement benefits were treated. At the hearing, the Taxpayers also argued that the taxes incorrectly paid in 1987 and 1988 should be used to pay the assessment.

Assessment No. 564818 was issued on February 7, 1994, after the Department received information from the IRS indicating that the Taxpayers received federal retirement benefits in 1990 but did not include that income when filing their 1990 PIT return. Section 7-1-18(A) NMSA 1978 (1995 Repl.) allows the Department to assess taxes three years from the end of the calendar in which the tax was due. The 1990 tax was due on April 15, 1991 so the Department had until December 31, 1994 to issue the assessment. Assessment No. 564818 was timely issued.

The Taxpayers argued that the penalty and interest should not be assessed because of the confusion over how states taxed federal retirement benefits. In 1987 and 1988, New Mexico allowed an exemption of up to \$3,000 for taxpayers who received federal military retirement. See, Section 7-2-5.1 NMSA 1978 (1986 Repl.). It also exempted from taxation retirement benefits paid to New Mexico retirees under the Public Employees Retirement Act and the Educational Retirement Act. The Taxpayers' did not take the deduction but included all their retirement benefits when calculating the tax due. In 1989, the United States Supreme Court held

that states must treat federal and state retirement benefits equally for taxation purposes. *Davis v. Michigan Dept. of Treasury* 489 U.S. 803, 103 L.Ed.2 891, 109 S.Ct. 1500 (1989). The Department decided to give the *Davis* decision retroactive effect and allowed taxpayers to file claims for refunds for tax years within the statutory limitation period for claiming refunds of tax if those taxpayers had included federal retirement benefits when calculating their taxable income.

In response to *Davis*, the New Mexico Legislature amended the state's tax law to eliminate the disparate treatment of state and federal retirement income. It did this by repealing the exemption for state retirement benefits and repealing the \$3,000 exemption for federal military retirement benefits. Thus, for the 1990 tax year, the Taxpayers were required to include their federal military retirement benefits as income when determining tax liability.

Penalty is assessed when the failure to pay a tax is due to a taxpayer's negligence.

Section 7-1-69 NMSA 1978 (1995 Repl.) Taxpayer "negligence" is defined in Regulation TA

69:3 to mean:

- 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, careless, erroneous belief or inattention.

The Taxpayers were negligent. Every person is charged with the reasonable duty to ascertain the possible tax consequences of his actions. *Tiffany Construction Company v. Bureau of Revenue* 90 N.M. 16 (App. 1976); *cert. denied* 90 N.M. 255 (1977). Nothing in the 1990 New Mexico Personal Income Tax instructions addressed or authorized the Taxpayers to exempt their federal retirement income nor did they present any evidence that they sought clarification of this matter from a tax advisor or the Department. The Taxpayers were erroneous in their belief that their retirement income was not taxable and were inattentive in not seeking clarification of this issue

before failing to report this income. Although there was litigation over this issue, the issue was resolved by the time the Taxpayers 1990 PIT return was due. The penalty was properly assessed. Additionally, the interest was properly assessed as the tax was due on April 15, 1991 and has not been paid. Section 7-1-67 NMSA 1978 (1995 Repl.).

The Taxpayers argued that the taxes they incorrectly paid, by not taking a deduction for federal retirement benefits in 1987 and 1988, should be refunded and applied to their 1990 liability. The Taxpayers requested a refund of their 1987 and 1988 taxes around April or May of 1993. Section 7-1-26(B) NMSA 1978 (1995 Repl.) informs taxpayers how to claim a refund and requires that any claim for refund must be made within three years from the end of the calendar year in which the overpayment was made. The overpayment of 1987 taxes was made on or before April 15, 1988. The claim for refund needed to be made by December 31, 1991. The overpayment of 1988 taxes was made on or before April 15, 1989. Any claim for refund for 1988 PIT had to be requested by December 31, 1992. The Taxpayers attempted to perfect their claim for a refund by amending and refileing their 1987 and 1988 PIT returns. The filing of an amended returns acted as a claim for a refund but still needed to be filed within time set forth in Section 7-1-26(B). The Taxpayers are not entitled to refunds since their claims were not timely filed.

The Taxpayers have not met their burden of showing that Assessment No. 564818 was incorrect. In fact, at the hearing it was clear that the Taxpayers do not really dispute that they owed the taxes assessed for the 1990 tax year but they strongly objected to the manner in which the assessment and their claims for refund were handled by the Department. The Taxpayers are justified in their frustrations with the Department. This case provides an example of how the Department has created work for itself and wasted its own resources, the resources of the hearing officer, and the time and resources of the Taxpayers because of its careless and inattentive handling of the Taxpayers' original refund claims. If the Department had promptly and

courteously responded to the Taxpayers' refund claim and explained that it must be denied on the basis of untimeliness rather than on the basis of the merits of their claim, chances are the Taxpayers would have accepted the basis for their refund denial. It would also have been an excellent opportunity for the Department to explain how the tax treatment of federal retirement benefits evolved as a result of both litigation and the legislature's response. This would have given the Taxpayers the opportunity to understand that they had improperly filed for 1990 without the necessity of the assessment at issue herein. They would have had the opportunity to file an amended return and to avoid the imposition of additional interest. Instead, the Taxpayers were treated with indifference and carelessness. While I am sympathetic to the Taxpayers' frustrations with the Department's handling of their refund claim, nonetheless, the Department must follow the mandates of the Legislature with respect to when such claims must be filed. The claims were filed beyond the statute of limitations and cannot be granted to offset the Taxpayers' liability for the 1990 tax year.

With respect to the assessment at issue, it is simply not a defense that other matters were mishandled by the Department. Obviously, it would have been best if the Department had quickly and adequately responded to the Taxpayers' original requests for a refund. This does not, however, overcome the fact that the Taxpayers improperly claimed an exemption for their federal retirement income for the 1990 tax year. Assessment No. 564818 correctly assessed tax, penalty and interest based upon the Taxpayers' erroneous 1990 tax filing and the Taxpayers' protest must be denied.

## CONCLUSIONS OF LAW

1. The Taxpayers timely filed a written protest, pursuant to Section 7-1-24 NMSA 1978 (1995 Repl.), to Assessment No. 5564818 and, therefore, jurisdiction lies over the parties and the subject matter of this protest.
2. The Taxpayers erroneously failed to include their 1990 federal military retirement benefits in their income reported to the Department for the 1990 tax year.
3. The Taxpayers were negligent in not including federal military retirement benefits received in 1990 when determining their 1990 tax liability.
4. The Taxpayers' claim for refund for overpayment of 1987 and 1988 taxes was not filed within the time limitations of Section 7-1-26(B) NMSA 1978 and, consequently, the Taxpayers are not entitled to a refund of such taxes.
5. The Department's gross mishandling of the Taxpayers' claim for a refund for the 1987 and 1988 tax years does not excuse the Taxpayers from liability for the taxes owed for the 1990 tax year.

For these reasons, the Taxpayers' protest is hereby denied.

Done this 24th day of April, 1996.