

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

IN THE MATTER OF THE PROTEST
OF HAROLD AND BETTY BURRIS
ASSESSMENT NO. 703160

98-12

DECISION AND ORDER

This matter came on for formal hearing on February 27, 1998 before Margaret B. Alcock, Hearing Officer. Harold D. Burris appeared by telephone on behalf of himself and Mrs. Burris ("Taxpayers"). The Taxation and Revenue Department ("Department"), was represented by Bruce J. Fort, Special Assistant Attorney General. At the close of the hearing, it was agreed that the record would be kept open for a period of one week to give Mr. Burris time to review Department's Exhibit A and submit any objection to the exhibit to the hearing officer. No objection having been filed, the Taxpayers' protest to Assessment No. 703160 was submitted for decision on March 6, 1998. Based on the evidence in the record and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Harold and Betty Burris filed timely federal and New Mexico personal income tax returns for calendar year 1993.
2. In preparing the Taxpayers' 1993 income tax returns, Mr. Burris failed to report \$5,074.35 of social security income because he believed this income was exempt from tax.
3. In July 1994, the Internal Revenue Service ("IRS") notified the Taxpayers that additional tax was due on the social security income omitted from their 1993 federal return. In late 1994 or

early 1995, after several months of correspondence, the Taxpayers agreed to the IRS adjustment and paid the additional tax due.

4. The Taxpayers did not realize that they were required to amend their state return to reflect the change in their federal adjusted gross income. Accordingly, the Taxpayers did not take any action to correct the error in their 1993 New Mexico income tax return resulting from the omission of social security income on their original federal return.

5. In 1997, the Department discovered the discrepancy between the income reported to the IRS and the amount shown on the Taxpayers' state return through a computer "tape match" that compares information reported to state and federal tax authorities.

6. On May 23, 1997, the Department issued Assessment No. 703160 in the amount of \$771.92, representing \$490.11 of additional income tax for calendar year 1993, penalty of \$49.01 and interest of \$232.80.

7. On May 30, 1997, the Taxpayers filed a protest of the Department's assessment of penalty and interest.

DISCUSSION

At issue is whether the Taxpayers are liable for interest and penalty assessed on their underpayment of state income tax for calendar year 1993. The Taxpayers object to the assessment because the Department did not notify them of the error in their state return until more than three years after the return was filed and more than two years after the IRS discovered the error in the Taxpayers' federal income tax return.

Assessment of Interest. Section 7-1-67 governs the imposition of interest on late payments of tax and provides, in pertinent part:

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 a regard to any extension of time or installment agreement, until it is paid... (emphasis added).

The legislature's use of the word "shall" indicates that the assessment of interest is mandatory rather than discretionary. *State v. Lujan*, 90 N.M. 103, 560 P.2d 167 (1977). Thus, the legislature has directed the Department to assess interest whenever taxes are not timely paid and has provided no exceptions to the mandate of the statute.

The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Thus, the reason for a late payment of tax is irrelevant to the imposition of interest. Even taxpayers who obtain a formal extension of time to pay tax are liable for interest from the original due date of the tax to the date payment is made. While one may argue that the rate of interest is excessive in comparison with current market rates, that is a matter within the sound discretion of the legislature. The Department does not have authority to substitute its own judgment for that of the legislature in setting the rate of interest to be imposed.

Assessment of Penalty. Section 7-1-69, NMSA 1978 (1995 Repl.Pamp. and 1996 Supp.) governs the imposition of penalty during the periods at issue in this protest. Subsection A 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...

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

There is no contention on the part of the Department that the Taxpayers' failure to report and pay tax on their social security income was the result of bad faith or fraud. What remains to be determined is whether the Taxpayers 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 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 their social security income on their original federal and state returns was due to Mr. Burris' erroneous belief that his social security income was not subject to tax. The Taxpayers' failure to amend their New Mexico tax return once the reporting error was discovered by the IRS was due to the Taxpayers' lack of knowledge of New Mexico's tax laws.

The Taxpayers argue that the Department should have notified them of the error in their 1993 income tax return in a more timely manner. This argument misapprehends the nature of New Mexico's self-reporting tax system. It is the obligation of taxpayers, who have the most accurate and direct knowledge of their activities, to determine their tax liabilities and accurately report those liabilities to the state. *See*, Section 7-1-13(B), NMSA 1978. There are insufficient government resources available for the Department to continually audit every taxpayer to determine whether he or she has fully complied with state tax laws.¹ Thus, the New Mexico courts have held that every person is charged with the reasonable duty to ascertain the possible tax consequences of his or her actions, and the failure to do so constitutes negligence for purposes of Section 7-1-69(A). *Tiffany Construction Co. v. Bureau*

¹ Although the Department performs periodic "tape matches" that compare information reported to the IRS with information reported to the state, there is a delay of one to two years before the federal tape match information is made available to the Department. Under Section 7-1-18 NMSA 1978, the Department has three years from the end of the calendar year in which a tax is due to issue an assessment.

of Revenue, 90 N.M. 16, 558 P.2d 1155 (Ct. App. 1976), *cert. denied*, 90 N.M. 255, 561 P.2d 1348 (1977).

While there is no question that the Taxpayers' underreporting of tax in this instance was inadvertent and unintentional, it still remains that the Taxpayers were in the best position to know whether their tax return was complete and accurate at the time it was filed. Even if the mistake was not realized immediately, the Taxpayers discovered there was a problem when they were assessed additional tax by the IRS. Since both the Department and the IRS use the same starting point in determining taxable income, *i.e.*, federal adjusted gross income, the adjustment to income by the IRS should have alerted the Taxpayers to the need to amend their state tax return. Section 7-1-13(C) NMSA 1978 specifically requires a taxpayer whose federal adjusted gross income has been changed as a result of an IRS audit to file an amended state return and pay additional tax due within 90 days of the federal adjustment. The Taxpayers' lack of awareness of their legal obligations constitutes negligence for purposes of the civil penalty imposed by Section 7-1-69(A).

Finally, it should be noted that the penalty imposed by Section 7-1-69(A) reaches a maximum of 10 percent after five months from the original due date of the tax. Even if the Department had issued its assessment at the time the Taxpayers accepted the IRS adjustment to income in late 1994 or early 1995, the amount of penalty assessed at that time would have been exactly the same as it was in 1997. Thus, the delay between the IRS assessment and the state assessment had no effect on the Taxpayers' liability for New Mexico's civil penalty on the late payment of their 1993 income tax.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 703160 pursuant to Section 7-1-24 NMSA 1978, and jurisdiction lies over the parties and the subject matter of this protest.

2. Pursuant to Section 7-1-67(A) NMSA 1978, interest was properly assessed against the Taxpayers for late payment of a portion of their 1993 personal income taxes.

3. Pursuant to Section 7-1-69(A) NMSA 1978, the Taxpayers were negligent in underreporting their 1993 personal income taxes and penalty was properly imposed.

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

DONE, this 11th day of March 1998.