

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

IN THE MATTER OF THE PROTEST OF
WALTER BURKE D/B/A/ WALTER BURKE CATERING **NO. 99-05**
ID. NO. 02-150869-00 0, PROTEST TO
ASSESSMENT NOS. 2237616, 2249837 AND 2249838

DECISION AND ORDER

This matter came on for formal hearing on January 28, 1999 before Gerald B. Richardson, Hearing Officer. Walter Burke d/b/a/ Walter Burke Catering, hereinafter, “Taxpayer”, was represented by its President and Treasurer, Mr. Walter Burke. The Taxation and Revenue Department, hereinafter, “Department”, was represented by Monica M. Ontiveros, Special Assistant Attorney General. Based upon the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Department audited the Taxpayer, commencing in February, 1997. The audit was not completed for over a year, even though the Taxpayer made its books and records available to the Department’s auditors from the outset of the audit.
2. As a result of the audit, the Department issued three assessments to the Taxpayer.
3. Assessment No. 2237616 was issued on March 31, 1998 for \$2,555.81 of gross receipts tax, \$255.59 of penalty and \$1,416.74 of interest for the reporting periods of January, 1994 through December, 1994.

4. Assessment No. 2249837 was issued on April 30, 1998 for \$6,297.23 of gross receipts tax, \$629.73 of penalty and \$2,003.20 of interest for the reporting periods of January, 1995 through December, 1996.

5. Assessment No. 2249838 was issued on April 30, 1998 for \$50.00 of franchise tax, \$5.00 of penalty and \$23.75 of interest for the period of January, 1994 through December, 1994.

6. On April 30, 1998, the Taxpayer filed a timely, written protest to the interest and penalty portion of Assessment No. 2237616.

7. On May 29, 1998, the Taxpayer filed timely, written protests to the interest and penalty portions of Assessment Nos. 2249837 and 2249838.

8. At the hearing, the Taxpayer withdrew its protest to Assessment No. 2249838.

9. The underreporting of gross receipts tax which was assessed as a result of the Department's audit was due to the Taxpayer's failure to understand how the gross receipts tax applied to catering services the Taxpayer performed for various governmental and non-profit organizations from which the Taxpayer had accepted nontaxable transaction certificates.

10. Although the Taxpayer had its monthly CRS-1 returns upon which it reported its gross receipts taxes to the Department prepared by its certified public accountant, the Taxpayer did not receive advice from its accountant with regard to whether it could claim a deduction for catering services provided to governmental and non-profit organizations.

DISCUSSION

The Taxpayer disputes the assessment of penalty and interest on the Department's gross receipts tax assessments. The Taxpayer's dispute was based upon the fact that although he made his books and records available to the Department at the commencement of its audit, it took the

Department more than one year to complete the audit and to issue the assessments at issue. After the assessments were issued, the Taxpayer apparently agreed with the Department's determination that it had erroneously claimed a deduction for its receipts from selling catering services to non-profit organizations and governmental entities which the nontaxable transaction certificates the Taxpayer had from these entities did not cover.¹ The Taxpayer paid the assessments but protested the assessment of penalty and interest because of the Department's delay in issuing the assessments at issue.

Section 7-1-67(A) NMSA 1978 addresses 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.

While the Department offered no explanation as to why its audit took so long and I share the Taxpayer's concern with the amount of time that it took, unfortunately, the Department's delay in issuing the assessments does not provide a defense to the imposition of interest. As

¹ The deductions found at Sections 7-9-54 and 7-9-60 NMSA 1978 only cover the sales of tangible personal

noted above, the statute contemplates no exceptions to the imposition of interest. Additionally, the Taxpayer's argument essentially 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. Under our self reporting tax system, the responsibility for determining the correct amount of tax to be reported and paying that tax when due is placed upon taxpayers. 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.

The imposition of penalty is governed by the provisions of Section 7-1-69(A)NMSA 1978 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. Thus, there is no contention that the failure to report and pay taxes was based upon any desire of 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.

property and not services to such entities.

In this case the Taxpayer's underpayment of taxes was based upon Mr. Burke's failure to understand how the gross receipts tax applied to transactions with governmental and non-profit entities. As noted above, 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).

The Department does recognize that where a taxpayer proves that the failure to pay tax was caused by reasonable reliance on the advice of tax counsel or an accountant as to the taxpayer's liability after full disclosure of all relevant facts, that this may indicate that a taxpayer was not negligent and provides a basis to abate the penalty. *See*, Regulation 3 NMAC 1.11.11. In this case, although the Taxpayer had its monthly returns prepared by an accountant, the Taxpayer was not able to establish that its accountant had full disclosure of the facts pertinent to the transactions which were not taxed, or that the Taxpayer had actually received advice from its accountant as to how to treat the sale of catering services to governmental and non-profit entities. In the absence of such advice, the Taxpayer failed to carry its burden of proving that it was not negligent in underreporting its taxes. *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989).

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 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, even completely honest taxpayers, such as the Taxpayer herein, would have no incentive to ensure that they understand how taxes apply to their business so that mistakes in reporting do not happen.

With respect to the delay in completing the Department's audit and issuing the assessments in this case, it should be noted that the Department's delay did not result in the accrual of additional penalty. This is because the negligence penalty, which accrues at 2% of the underreported taxes per month, maximizes at 10% of the taxes. Thus, within five months of the month that a return was due on which taxes were not fully paid, the penalty has maximized. In this case, since the audit covered reporting periods through December of 1996, any penalty on unpaid taxes would have maximized by May of 1997, for the last reporting period covered by the audit, December of 1996. Even had the Department completed its audit more expeditiously, by the time the audit was completed and had gone through the Department's internal review process prior to issuing the assessment, it is highly unlikely it would have been assessed prior to May of 1997.

CONCLUSIONS OF LAW

1. The Taxpayer filed timely, written protests to Assessment Nos. 2249837, 2249838 and 2237616 and jurisdiction lies over both the parties and the subject matter of this protest.
2. The Taxpayer withdrew its protest to Assessment No. 2249838.
3. Interest was properly imposed pursuant to Section 7-1-67 NMSA 1978.
4. Penalty was properly imposed pursuant to Section 7-1-69(A) NMSA 1978.

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

DONE, this 1st day of February, 1999.