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

IN THE MATTER OF THE PROTEST OF
TIMOTHY AND DIANE L. TUTTLE No. 99-13
ASSESSMENT NO. 724568

DECISION AND ORDER

A formal hearing on the above-referenced protest was held February 9, 1999, before Margaret B. Alcock, Hearing Officer. Timothy Tuttle appeared on behalf of himself and his wife, Diane L. Tuttle ("Taxpayers"). The Taxation and Revenue Department ("Department") was represented by Bruce J. Fort, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Timothy and Diane Tuttle filed joint federal and New Mexico personal income tax returns for calendar year 1994.

2. The Tuttles were first-year residents of New Mexico in 1994, having moved to New Mexico from the state of Washington.

4. For tax year 1994, payment of New Mexico personal income taxes was governed by the Income Tax Act, Sections 7-2-1, *et seq*., NMSA 1978 (1990 Repl. Pamp.). Section 7-2-3 of the Act imposes a tax on the "net income of every resident individual...."

5. Section 7-2-11(C) allows taxpayers such as the Tuttles, who have net income from both New Mexico and non-New Mexico sources, to claim a credit for that portion of tax attributable to income earned outside the state.

6. When filling out his 1994 New Mexico income tax return, Mr. Tuttle found the forms and instructions confusing and did not understand the statutory method used to calculate tax due on his New Mexico income.

7. Mr. Tuttle, who is a certified public accountant, did not consult any of the national publications available on state income tax to clarify New Mexico's reporting requirements.

8. Mr. Tuttle did not contact anyone at the Taxation and Revenue Department to ask about the specific parts of the forms and instructions he found confusing.

9. Instead of seeking outside advice, Mr. Tuttle devised his own personal method of allocating income, exemptions and deductions between New Mexico and non-New Mexico income.

10. New Mexico's 1994 Form PIT-1 directs taxpayers to report their federal adjusted gross income on Line 7. The Tuttles' federal adjusted gross income was $140,310. They reported only $59,731, which represented the the Tuttles' New Mexico income and did not include the income they earned in Washington.

11. New Mexico's 1994 Form PIT-1 directs taxpayers to report their federal exemption amount on Line 12. The Tuttles' federal exemption amount was $12,250. They reported only $5,202, which represented Mr. Tuttle's allocation of the federal exemption between New Mexico and Washington based on the number of days he lived in each state.

12. On April 17, 1995, the Tuttles filed their 1994 state income tax return reporting an income tax liability of $2,092 and New Mexico state withholding of $3,210. The return requested a refund in the amount of $1,118.

13. The Tuttles did not notify the Department, either on the return itself or by a separate memorandum or letter, that they had devised their own method of calculating their income tax liability to New Mexico

14. The Department employee who reviewed the Tuttles' 1994 return noticed the federal exemption amount was incorrect based on the number of dependents shown on the return. The Department recalculated the Tuttles' tax liability based on the correct exemption amount, which increased their refund by $497.68.

15. At the time the refund adjustment was made, the Department had no way of knowing that the incorrect exemption amount reflected Mr. Tuttle's attempt to allocate the federal exemption between New Mexico and Washington. Nor did the Department have any way of knowing that Mr. Tuttle had improperly excluded income earned in Washington from the federal adjusted gross income reported on Line 7 of his New Mexico PIT-1.

16. In July 1995, the Department sent the Tuttles a refund check in the amount of $1,594.24, together with a recomputation notice showing the adjustment made in the federal exemption amount.

17. Mr. Tuttle received the refund check but does not remember receiving the recomputation notice. Although Mr. Tuttle noticed the refund was $497.68 higher than he had claimed on his return, he did not call the Department or make any other attempt to determine the basis for the increased refund.

18. In 1997, the Department discovered the discrepancy between the federal adjusted gross income the Tuttles reported to the IRS on their 1994 federal income tax return and the federal adjusted gross income shown on their New Mexico income tax return. This discovery was made through a computer tape-match program that compares information reported to state and federal tax authorities.

19. Based on the information received from the IRS, the Department recalculated the Tuttles' tax liability using the tax rate applicable to the Taxpayers' net income from both New

Mexico and non-New Mexico sources and then giving the Taxpayers a credit for that portion of the tax attributable to the out-of-state income.

20. On September 28, 1997, the Department issued Assessment No. 724568 to the Tuttles in the amount of $1,170.00 tax principal, representing the underreporting created by the Taxpayers' erroneous method of computing their 1994 state income taxes, plus $166.85 penalty and $604.88 interest. The interest and penalty was computed from April 16, 1995.

21. On October 14, 1997, the Taxpayers filed a protest to the Department's assessment.

DISCUSSION

In their original protest, the Tuttles questioned the method the Department used to recalculate their 1994 income tax liability. At the February 9, 1999, hearing on the protest, Mr. Tuttle conceded that the Department's methodology was correct. Mr. Tuttle continues to dispute the Department's assessment of penalty, as well as its assessment of interest on $497.68, the amount by which the Department increased the refund the Tuttles originally claimed on their 1994 income tax return.

Assessment of Interest. Section 7-1-67(A) NMSA 1978 (1995 Repl.Pamp.) governs the imposition of interest on late payments of tax[1] during the period at issue:

> 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).

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, 105, 560 P.2d 167, 169 (1977). The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid

revenues. Although Mr. Tuttle argues he should not have to pay interest on the portion of the refund resulting from the Department's adjustment, the fact remains that the Tuttles—not the state—had the use of these funds from July 1995 forward.[2]

It should also be noted that the increase in the Tuttles' refund was directly attributable to Mr. Tuttle's failure to either follow the instructions set out in the Department's forms or notify the Department that he had devised his own method of calculating tax on his New Mexico income. At the time the refund adjustment was made, the Department had no way of knowing that the incorrect exemption amount reflected Mr. Tuttle's decision to allocate the federal exemption between New Mexico and Washington. Nor did the Department have any way of knowing that Mr. Tuttle had improperly excluded income earned in Washington from the federal adjusted gross income reported on Line 7 of his New Mexico PIT-1.

When Mr. Tuttle received his refund check, he did not question the reason for the $497.68 increase in the refund requested on his return. Had Mr. Tuttle made inquiry of the Department, his erroneous reporting methodology would have been brought to light. This would have resulted in an immediate adjustment to the Taxpayers' 1994 tax liability and avoided the accrual of additional interest. Responsibility for the Taxpayers' liability for interest on the erroneous refund of 1994 income tax rests solely with Mr. Tuttle. No adjustment is warranted.

Assessment of Penalty. Section 7-1-69 NMSA 1978 (1995 Repl. Pamp.) governs the imposition of penalty during the period at issue in this protest. Subsection A imposes a penalty of two percent per month, up to a maximum of ten percent:

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[1] Section 7-1-3(U) NMSA 1978 (1995 Repl. Pamp.) defines the term "tax" to include "any amount of any credit, rebate or refund paid...to any person contrary to law."

[2] At the hearing, the Department acknowledged that interest should accrue from July 1995, not April 1995 as shown on the assessment. The Department agreed to credit the Tuttles for the three months additional interest.

> 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...

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, Mr. Tuttle's failure to properly calculate his 1994 state income tax meets all three definitions of negligence.

New Mexico has a 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 (1995 Repl. Pamp.). When Mr. Tuttle realized he did not understand the Department's 1994 income tax forms and instructions, it was his obligation to seek advice from the Department or from a tax preparer who was familiar with the state's tax laws. Alternatively, given Mr. Tuttle's training as a CPA, he could have done additional research on his own. Instead of pursuing either of these alternatives, Mr. Tuttle devised his own unauthorized method of calculating his New Mexico income tax. In doing so, he ignored the Department's instructions to report federal adjusted gross income on Line 7 of the New Mexico PIT-1 and reported only his New Mexico income, resulting in an underpayment of tax.

The facts establish that Mr. Tuttle failed to exercise the ordinary business care and prudence a reasonable taxpayer—much less a taxpayer who is also a CPA—would exercise in like circumstances. He failed to take action to obtain professional tax advice when it was needed. As a direct result of his

indifference to the requirements of New Mexico law, Mr. Tuttle adopted an erroneous reporting method that led to an underpayment of his tax liability to the state. The negligence penalty was properly imposed.

CONCLUSIONS OF LAW

1. The Taxpayers filed a timely, written protest to Assessment No. 724568, and jurisdiction lies over the parties and the subject matter of this protest.

2. Pursuant to Section 7-1-67(A) NMSA 1978 (1995 Repl.Pamp.), interest was properly assessed against the Taxpayers on the underpayment of their 1994 state income taxes.

3. Pursuant to Section 7-1-69(A) NMSA 1978, the Taxpayers were negligent in underreporting their 1994 state income taxes and penalty was properly imposed.

For the foregoing reasons, the Taxpayers' protest IS DENIED.

February 12th, 1999.