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**IN THE COURT OF APPEALS  
OF THE STATE OF NEW MEXICO**

COURT OF APPEALS OF NEW MEXICO  
ALBUQUERQUE  
FILED

FEB 24 2011



GEA INTEGRATED COOLING  
TECHNOLOGY,

*Appellant,*

vs.

No. 30-790  
Tax and Rev ADM-10-13

NEW MEXICO TAXATION AND  
REVENUE DEPARTMENT,

*Appellee.*

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Appeal from the Tax Protest Hearing Office  
of the New Mexico Taxation and Revenue Department

Gerald B. Richardson, Hearing Officer

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**BRIEF IN CHIEF**

HUTCHINSON BLACK &  
COOK, LLC  
Adam W. Chase  
921 Walnut Street, Suite 200  
Boulder, CO 80302  
Telephone: (303) 441-7456  
Fax: (303) 442-6593

RODEY, DICKASON, SLOAN,  
AKIN & ROBB, P.A.  
R. Tracy Sprouls  
Post Office Box 1888  
Albuquerque, NM 887103  
Telephone: (505) 768-7355  
Fax: (505) 768-7395  
*Attorneys for Appellant*

*ORAL ARGUMENT IS REQUESTED*

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## **Introduction**

Section 7-1-69 of the New Mexico Tax Administration Act provides a single penalty for both the failure to pay a tax when due and the failure to timely file a return. This statute was amended in 2007, with an effective date of January 1, 2008, increasing the maximum penalty. The single issue for determination in this appeal is whether Appellant is subject to the lower, pre-amendment penalty or the higher, post-amendment penalty for unreported and unpaid taxes that accrued prior to the effective date of the amendment.

The Hearing Officer ruled in the administrative proceedings below that the applicability of the amendment is determined solely by the date on which the tax was assessed. Appellant contests this ruling on the grounds that (a) in the circumstances of the instant case, it requires an unauthorized retroactive application of the amendment and (b) it contravenes the manifest intent of the legislature to discourage both late filing and late payment. Rather, the post-amendment penalty should be assessed only for the failure to pay or to report taxes that accrued after the effective date of the amendment.

## **Statement of Facts and Proceedings**

In the period from June 1, 2006 to July 1, 2007, Appellant accrued a gross receipts tax liability which it did not report or pay until August 22, 2008. (Hearing Officer's Decision and Order ("Decision"), Finding of Fact No. 6.) During the

entire time period during which this tax liability was accruing, section 7-1-69(A) of the New Mexico Tax Administration Act provided, in relevant part:

- A. [I]n the case of failure due to negligence or disregard of department rules and regulations . . . to pay when due the amount of tax required to be paid, to pay in accordance with the provisions of Section 7-1-13.1 NMSA 1978 when required to do so or to file by the date required a return regardless of whether a tax is due, there shall be added to the amount assessed a penalty in an amount equal to the greater of:
- (1) two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed ten percent of the tax due but not paid; [or]
  - (2) two percent per month or any fraction of a month from the date the return was required to be filed multiplied by the tax liability established in the late return, not to exceed ten percent of the tax liability established in the late return;

In 2007, the New Mexico legislature amended section 7-1-69. The only change was to substitute the word “twenty” for the word “ten” in paragraphs (1) and (2), raising the cap from 10% to 20%. 2007 N.M. Laws, ch. 45, § 4. The effective date of the amendment was January 1, 2008. *Id.* § 16(A). Unfortunately, neither the pre-amendment statute, the amended statute, nor the enacting legislation provides any clear statement of whether the new cap was to be applied to existing tax liabilities and, if so, how.

On September 21, 2009, the New Mexico Department of Taxation and Revenue (“Department”) assessed Appellant a penalty of 20% of the tax that

accrued prior to January 1, 2008, which Appellant reported and paid late.

(Decision, Facts Nos. 4, 6, 7.) Appellant timely protested that assessment.

(Decision, Conclusion of Law No. 1.)

At the administrative level below, Appellant contended, as it does here, that the higher, 20% cap under the amended section 7-1-69 applies only to tax liabilities that accrued after the effective date of the amendment. The Hearing Officer ruled, however, that the higher cap applies to all taxes assessed after the effective date of the amendment, regardless of when the tax accrued. (See Decision, Conclusion No. 2.)

The Hearing Officer's ruling, which bases the applicability of the higher cap solely on the date of the assessment, is not only an unauthorized retroactive application of the amendment, but contravenes the intended effect of the amendment and should be reversed.

### **Argument**

*Standard of Review:* The sole issue presented by this appeal is one of statutory construction, which is subject to a *de novo* standard of review. E.g., TPL, Inc. v. State Taxation & Revenue Dep't, 2000-NMCA-03, ¶ 7, 129 N.M. 539, 10 P.3d 863, rev'd on other grounds, 2003-NMSC-007, 133 N.M. 447, 64 P.3d 474 (filed 2002).

*Preservation of Issue:* This issue was preserved by Appellant's protest of the penalty assessment on the ground that it constituted an improper, retroactive application of the statutory amendment and by the Hearing Officer's denial of the protest.

**I. The Hearing Officer's Decision Is an Unauthorized Retroactive Application of the 20% Penalty Cap.**

“A statute or regulation is considered retroactive if it impairs vested rights acquired under prior law or requires new obligations, imposes new duties, or affixes new disabilities to past transactions.” Howell v. Heim, 118 N.M. 500, 506, 882 P.2d 541, 547 (1994) (citing City of Albuquerque v. State ex rel. Village of Los Ranchos de Albuquerque, 111 N.M. 608, 616, 808 P.2d 58, 66 (Ct. App. 1991)). The Hearing Officer acknowledged that the amendment to section 7-1-69 cannot be given retroactive effect, given the absence of any indication of legislative intent of such retroactive effect. See State v. Padilla, 78 N.M. 702, 437 P.2d 163 (Ct. App. 1968). But the Hearing Officer then found that the application of the amendment to tax deficiencies that arose before the effective date of the amendment is not a retroactive application.

The Hearing Officer set out his reasoning on page 6 of the Decision, where he says:

Unless there has been an assessment of tax by the Department or a self assessment by a taxpayer, there is no way of knowing what the amount of unpaid tax is for purposes of calculating how much penalty

is to be imposed, Thus, it is clear that penalty is not imposed at the time the taxes were due but unpaid. It is only imposed at the time that the amount of unpaid taxes has been determined. In this case . . . , that time occurred *after* the effective date of the statutory amendment.

(Decision at page 6.) From this statement, it is apparent that the Hearing Officer confused the creation of the State's legally enforceable right to collect a penalty with the exercise of that right and on the basis of that confusion has misconstrued the retroactive nature of his application of the amendment.

The State's right to exact a penalty from a delinquent taxpayer under section 7-1-69 comes into existence when the due date for filing the return or paying the tax passes without the required filing or payment. This is patently clear from the language of the statute itself, which determines the amount of the penalty based on the length of time that has elapsed "from the date the return was required to be filed." NMSA 1978 § 7-1-69(A)(2) (2007). It is at that moment that the State's rights are determined, and they must be determined by the law in effect at that time.

The fact that the specific amount of the tax liability or penalty may not be known at the moment that right comes into existence is not determinative of the question of retroactive application. In every case where a return is not timely filed or where the tax liability is underreported, the amount of the tax liability and penalty is not known until later – often years later – when the taxpayer files the late return or the Department issues a notice of assessment. But the State's right to the

penalty and the taxpayer's liability for it are created immediately upon the taxpayer's failure to report or pay the tax.

In support of his conclusion that he was not applying the amendment to section 7-1-69 retroactively, the Hearing Officer cited Bradbury & Stamm Construction Co. v. Bureau of Revenue, 70 N.M. 226, 372 P.2d 808 (1962). Although the Court in Bradbury & Stamm did, indeed, find no retroactive application of a statute, its conclusion supports Appellant's position, not the Hearing Officer's.

In Bradbury & Stamm, the relevant issue did not concern a penalty statute, but rather an interest statute, specifically, what rate of interest the taxpayer was entitled to receive on an overpayment of taxes. During the period of time between the taxpayer's overpayment of the tax and the state Supreme Court's opinion, the statute which controlled on the issue was amended, reducing the interest rate on overpaid taxes from six percent to two percent. The taxpayer argued, and the Court agreed, that the amendment should apply prospectively only, reducing the rate on interest accruing after the effective date of the amendment but not before. 70 N.M. at 240, 372 P.2d at 818.

The right of a taxpayer to receive interest on an overpayment, as well as the right of the state to receive interest on a deficiency, accrues on a daily basis. See NMSA 1978, § 7-1-68(B) (2007). Under the court's ruling in Bradbury & Stamm,

the taxpayer's right to interest payments that accrued before the effective date of the amendment was not affected. Likewise, in the instant case, the state's right to collect a penalty of 10%, which arose prior to the amendment of section 7-1-69, is not affected by the amendment.

The Hearing Officer also cited Howell v. Heim, 118 N.M. 500, 882 P.2d 541 (1994), in support of his conclusion that he was not applying the amendment to section 7-1-69 retroactively. In Howell, the New Mexico Human Services Department ("HSD") had promulgated a new regulation which imposed, for the first time, a duration limit of twelve months on certain disability benefits. In applying this limitation, HSD included the months of benefits prior to the enactment of the regulation. The court held that "the regulation does not apply retroactively simply because past events were considered when determining durational limits for individuals receiving benefits payments." Id. at 506, 882 P.2d at 547.

But unlike HSD in Howell, the Department here is not merely "consider[ing] the facts and circumstances surrounding the Taxpayer's nonpayment of taxes in determining whether the imposition of penalty is proper," as the Hearing Officer suggested at page 8 of his Decision. Rather, the Department is requiring new obligations, imposing new duties, and affixing new disabilities to past transactions,

the Howell court's very definition of retroactive application. Howell, 118 N.M. at 506, 882 P.2d at 547.

The facts of the instant case demonstrate one very good reason why retroactive application of punitive statutes is not favored. An important purpose of any penalty is to deter the proscribed behavior. Amrep Sw., Inc. v. Schollenbarger Wood Treating, Inc., (In re Consolidated Vista Hills Retaining Wall Litig.), 119 N.M. 542, 893 P.2d 438 (1995). But deterrence cannot be effected retroactively. Deterrence requires knowledge of the potential punishment, here, the increased penalty. But knowledge of the higher penalty is impossible if, as occurred in the present case, the taxpayer failed to report or pay the tax long before the proposed amendment to section 7-1-69 was even introduced in the legislature.

## **II. The Hearing Officer's Decision Contravenes the Manifest Legislative Intent That the Amendment Affect Late Filing and Late Payment Equally.**

Section 7-1-69 provides one penalty for either or both of two offenses: (a) the failure to timely pay a tax when due and (b) the failure to timely file a return. The amount of the penalty, regardless of whether the specific offense was an unpaid tax or an unfiled return or both, is the higher of (i) 2% of the unpaid tax for each month it remained unpaid or (ii) 2% of the tax established on the late return for each month it remained unfiled. The pre-amendment cap for either measure of

the penalty was 10%. The only change effected by the 2007 amendment was to change the cap from 10% to 20%.

The legislature did not identify the purpose of either the penalty provided in the pre-amendment section 7-1-69 or the 2007 increase in the maximum penalty under that statute. But the New Mexico Supreme Court in Amrep Sw., Inc., 119 N.M. at 553, 893 P.2d at 449, noted two purposes of any penalty: punishment and deterrence.

The penalty under section 7-1-69, then, is intended to punish and deter the two types of taxpayer delinquency, which the statute treats as equally undesirable. In raising the cap on that penalty, the legislature can reasonably be assumed to have intended to increase its punitive and deterrence effect. When it did so, the legislature did not distinguish between the failure to pay and the failure to file. And absent language to the contrary, it must be assumed that the legislature intended that its amendment to section 7-1-69 be applied in such a way that the enhanced penalty applies equally to punish and deter each offense. The Hearing Officer's application of the amendment frustrates this intent.

Under the Hearing Officer's ruling, the sole determinant of whether the increased penalty applies is whether the assessment was made before or after the effective date of the amendment. Because the filing of a return is the self-assessment of the tax, NMSA 1978, § 7-1-17(B) (2007), the Hearing Officer's

determinant includes the date on which the taxpayer filed its return. Thus, under the Hearing Officer's ruling, the enhanced penalty of the amended section 7-1-69 encourages the prompt filing of the return, but not the prompt payment of the tax due.

Suppose, for example, that a taxpayer incurred a gross receipts tax liability in 2006, but did not report or pay that tax. Suppose further that the taxpayer interpreted the new law to apply only to taxes assessed after January 1, 2008. Wanting to avoid the additional 10% penalty, the taxpayer filed its late return sometime before January 1, 2008, without making a payment. Because the taxpayer reported its tax liability before January 1, 2008, its penalty is capped at 10%, even though the taxes remain unpaid. Thus, the increased penalty would have encouraged the taxpayer to file its delinquent return, but not pay its delinquent tax.

Nothing in the amended statute or the enacting legislation indicates any intent that the increased penalty have a disproportionately greater punitive and deterrent effect on the delinquent filing of returns than on the delinquent payment of taxes. But any rule that pegs the application of the increased penalty to the date of assessment, as the Hearing Officer ruled below, accomplishes precisely that unintended consequence.

**III. Prospective Application of the Increased Penalty Only  
to Returns and Taxes Due after the Effective Date  
Will Accomplish the Legislative Purposes.**

As discussed above, the Hearing Officer's ruling that the applicability of the amendments to section 7-1-69 is to be determined solely on the date of assessment is the unauthorized retroactive application of the increased penalty. The ruling also fails to accomplish the legislative purpose of deterrence when applied, as in the instant case, to taxes that accrued before the effective date of the amendment. And the ruling disproportionately penalizes late filing of returns over late payment of taxes, contrary to the language of section 7-1-69.

All of these infirmities are avoided by restricting the application of the amendments to section 7-1-69 to taxes that accrued after the effective date of the amendments, January 1, 2008.

**Conclusion**

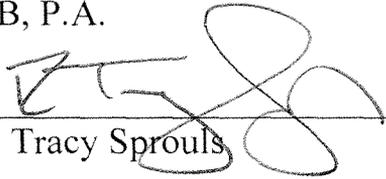
The Hearing Officer improperly applied the amendments to section 7-1-69 retroactively to Appellant's failure to report and pay taxes that accrued prior to the effective date of the amendments. The Hearing Officer's Decision should be reversed, and the Taxation and Revenue Department ordered to reduce to 10% the penalty assessed for failure to report or pay regarding periods before January 1, 2008.

## Statement Regarding Oral Argument

Appellant requests oral argument. Appellant believes that oral argument may assist the Court in understanding the facts, analyzing the authorities, evaluating the arguments of the parties, and reaching a decision on the matters presented by this appeal.

Respectfully submitted,

RODEY, DICKASON, SLOAN, AKIN &  
ROBB, P.A.

by: 

R. Tracy Sprouls

Post Office Box 1888  
Albuquerque, NM 887103  
Telephone: (505) 768-7355  
Fax: (505) 768-7395

-and-

HUTCHINSON BLACK & COOK, LLC  
Adam W. Chase  
921 Walnut Street, Suite 200  
Boulder, CO 80302  
Telephone: (303) 441-7456  
Fax: (303) 442-6593

ATTORNEYS FOR APPELLANT