

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

**IN THE MATTER OF THE PROTEST OF
HAL M. DEAN
ASSESSMENT NOS. 2462271 and 2490193**

No. 01-31

DECISION AND ORDER

A formal hearing on the above-referenced protest was held August 29, 2001, before Margaret B. Alcock, Hearing Officer. Hal M. Dean was represented by Wayne G. Chew, Esq. The Taxation and Revenue Department ("Department") was represented by Bruce J. Fort, Special Assistant Attorney General. At the end of the hearing, the parties agreed to submit closing argument in the form of written briefs. The briefing scheduled ended October 22, 2001, at which time the matter was submitted for decision. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. From January 1992 through April 1999, the audit period at issue in this case, Dean/Krueger & Associates, Inc. ("DKA") was engaged in the business of providing architectural services in New Mexico.
2. DKA was registered with the Department under taxpayer identification number 01-775004-00-0 for payment of gross receipts, compensating and withholding taxes, which are required to be paid monthly under the Department's combined reporting system ("CRS").
3. During the audit period, Hal M. Dean and Eugene K. Baker were the sole shareholders and officers of DKA: Mr. Dean, who owned over 50 percent of DKA's stock, served as president; Mr. Baker served as vice-president, treasurer and secretary.
4. Mr. Dean was primarily responsible for the firm's design work and marketing.

5. Mr. Baker was primarily responsible for the day-to-day business operations of DKA and also worked on architectural drawings and specifications.

6. Mr. Dean and Mr. Baker shared the responsibility for hiring and firing employees.

7. As the majority shareholder, Mr. Dean had the final authority to make decisions on behalf of DKA and could have fired Mr. Baker had he chosen to do so.

8. During the audit period, Mr. Dean and Mr. Baker were the only persons who had signature authority on DKA's bank accounts.

9. Mr. Baker was the person who routinely signed DKA's tax returns and checks, although Mr. Dean signed such documents on occasion.

10. During the 1990s, DKA had cash flow problems resulting from the cyclical nature of the firm's business.

11. At times, DKA had to reduce the number of employees working for the firm and both Mr. Dean and Mr. Baker contributed their own funds to keep the business going.

12. Mr. Dean and Mr. Baker had regular status meetings at which they discussed DKA's income and the funds available to pay consultants and other creditors of the firm.

13. Mr. Dean had the authority to decide which bills would be paid first, although Mr. Baker usually made such decisions in consultation with Mr. Dean.

14. Beginning in 1991, Mr. Baker stopped reporting and paying New Mexico CRS taxes, including withholding taxes that had been deducted from the wages of DKA's employees.

15. Mr. Baker used the amounts deducted as withholding taxes from employee paychecks to cover other bills that Mr. Baker considered to be more urgent.

16. When Mr. Dean asked Mr. Baker whether taxes were being paid, Mr. Baker told him that taxes were paid or were "on a schedule" for payment. Mr. Dean did not follow up to determine

what taxes were behind in payment or how much was owed, nor did he ask to see copies of DKA's tax returns.

17. Most of DKA's business records were kept at the office; some records were kept by Charles W. Orr, DKA's certified public accountant. All DKA's financial records, whether kept at the office or by Mr. Orr, would have been available to Mr. Dean if he had asked to see them.

18. Mr. Orr prepared annual financial statements for DKA's shareholders that included a line item showing DKA's unpaid liabilities.

19. Mr. Dean received copies of DKA's annual financial statements, but never asked Mr. Orr or Mr. Baker for a breakdown of the firm's unpaid liabilities, which would have revealed the liability for unpaid CRS taxes.

20. In addition to acting as DKA's accountant, Mr. Orr prepared Mr. Dean's personal income tax returns each year.

21. Although Mr. Orr knew DKA had not paid the state withholding taxes shown on Mr. Dean's W-2 forms, Mr. Orr claimed these taxes as a credit against Mr. Dean's New Mexico income tax liability when preparing Mr. Dean's 1992-1998 tax returns.

22. At some point, Mr. Orr advised Mr. Dean that the withholding taxes shown on his W-2 forms had not actually been paid to the state by DKA.

23. In July 1999, the Department began a field audit of DKA.

24. Because DKA had not filed CRS returns since 1991, the Department extended the audit period back to January 1992 pursuant to the seven-year limitation period set out in Subsection C of Section 7-1-18 NMSA 1978.

25. The only withholding tax records DKA provided to the auditors were for the 1997 and 1998 tax years. For the 1992-1996 and 1999 tax years, the Department estimated the

withholding taxes due to be \$8,688.69 per year, based on the average of the taxes due for 1997 and 1998.

26. At the hearing on his protest, Mr. Dean introduced additional records that were in the possession of Charles W. Orr, DKA's accountant. These records, along with the records provided during the audit, established that the withholding taxes deducted from employee paychecks during each of the years 1994 through 1998 were as follows:

1994:	\$4,647.79
1995:	\$7,287.25
1996:	\$9,719.10
1997:	\$9,836.41
1998:	\$7,765.94

Mr. Dean did not provide any evidence concerning the withholding taxes due for tax years 1992, 1993 or 1999.

27. On December 16, 1999, the Department mailed Assessment No. 2462271 to DKA in the total amount of \$144,990.51, representing gross receipts tax, withholding tax, penalty and interest for tax periods January through December 1992.

28. On February 18, 2000, the Department mailed Assessment No. 2490193 to DKA in the total amount of \$414,934.39, representing gross receipts tax, withholding tax, penalty and interest for tax periods January 1993 through April 1999.

29. In February 2000, the Department mailed an assessment to Hal M. Dean in the total amount of \$112,043.62, representing the withholding tax portion (including related penalty and interest) of Assessment Nos. 2462271 and 2490193.

30. The assessment issued to Mr. Dean was not assigned a new number, but reflected the same numbers previously used in the assessments issued to DKA. The assessment issued to Mr. Dean referenced both his social security number and DKA's taxpayer identification number and

included the following explanation: “Personal Audit Assessment: Withholding Tax Portion of Assessment Numbers 2462271 and 2490193 for Dean\Kruger and Associates.”

31. The Department’s computer system is programmed in such a way that assessment numbers can be assigned to only one taxpayer. In order to issue an assessment to a taxpayer using a number already assigned to another taxpayer, the Department must generate the assessment manually and that assessment will not be reflected in the Department’s computer system.

32. On February 28, 2000, Mr. Dean filed a written protest to the personal audit assessment issued against him.

33. In its written closing argument, filed October 12, 2001, the Department conceded that its assessment of withholding tax against Mr. Dean for the 1992 tax year, as reflected in Assessment No. 2462271, was untimely and agreed to abate that portion of the assessment.

34. The amount remaining in dispute is the \$55,028.36 of withholding tax (plus penalty and accrued interest) assessed against Mr. Dean for tax periods January 1993 through April 1999.

DISCUSSION

The issue to be decided is whether Hal M. Dean is personally liable for withholding taxes that were deducted from the wages of DKA’s employees during the period January 1993 through April 1999 but were never reported or paid to the Department. Mr. Dean raises the following arguments in support of his protest: (1) he had reasonable cause for failing to pay the withholding taxes due to the state and should be excused from liability pursuant to Section 7-3-5(B) NMSA 1978; (2) the manual assessment issued to him in February 2000 was not a valid assessment because it did not have a unique assessment number that could be identified by the Department’s computer; (3) Section 7-1-18 NMSA 1978 limits the period for which he can be assessed to three years because he did not have the initial duty to file withholding tax returns and became a “taxpayer” only after he

was assessed by the Department; and (4) the Department's estimate of withholding taxes due should be adjusted to reflect the actual withholding taxes shown on business records introduced at the hearing.

Liability for Withholding Tax. Payment of withholding taxes is governed by the Withholding Tax Act, Sections 7-3-1, *et seq.*, NMSA 1978. Section 7-3-5 is the specific statute relied upon by the Department to hold Mr. Dean liable for DKA's unpaid withholding taxes. During the period at issue, that section read as follows:

Every withholder shall be liable for amounts required to be deducted and withheld by the Withholding Tax Act regardless of whether or not the amounts were in fact deducted and withheld, except that:

A. if the withholder fails to deduct and withhold the required amounts and if the tax against which the required amounts would have been credited is paid, the withholder shall not be liable for those amounts not deducted and withheld; or

B. if the withholder's failure to deduct and withhold the required amounts was due to reasonable cause, the withholder shall not be liable for amounts not deducted and withheld.

Section 7-3-5 imposes liability for withholding taxes on "every withholder". A "withholder" is defined in Section 7-3-2(N) to include an "employer", which is defined in Section 7-3-2(C) as follows:

C. "employer" means a person, or an officer, agent or employee of that person having control of the payment of wages, doing business in or deriving income from sources within the state for whom an individual performs or performed any service as the employee of that person except that if the person for whom the individual performs or performed the services does not have control over the payment of the wages for such services, "employer" means the person having control of the payment of wages.

Based on this statutory language, a corporate officer who has control of the payment of wages is personally liable for payment of the corporation's withholding taxes. In this case, the evidence

shows that Hal Dean was the majority shareholder and president of DKA, participated in hiring and firing employees, participated in deciding which creditors of the corporation should be paid, had the authority to sign tax returns and checks on behalf of DKA, and had access to DKA's books and tax records. Based on these facts, there is no question that Hal Dean had control of the payment of wages on behalf of DKA. *See, e.g., Winter v. United States*, 196 F.3d 339 (2d Cir. 1999); *Benoit v. Commissioner of Revenue*, 453 N.W.2d 336 (Minn. 1990).

Mr. Dean maintains he did not know withholding taxes were not being paid to the state and claims the protection provided in Subsection B of Section 7-3-5, which states: "if the withholder's failure to deduct and withhold the required amounts was due to reasonable cause he shall not be liable *for amounts not deducted and withheld.*" (emphasis added). The problem with Mr. Dean's argument is that taxes *were* deducted and withheld from the paychecks of DKA's employees. Because there was no failure to deduct and withhold, but simply a failure to pay the withheld taxes over to the Department, the exception in Section 7-3-5(B) does not apply.

There is a logical reason for not extending the exception in Section 7-3-5(B) to an employer's failure to pay over taxes withheld from employee paychecks. An employee whose employer has failed to withhold tax from the employee's paycheck remains personally liable for any tax due on his income. In contrast, an employee whose employer has withheld tax receives a credit of this amount against any tax the employee owes to the state. Section 7-3-9. By statute, the withheld amount is treated as a collected tax. Section 7-3-4. The Department cannot collect the tax from the employee a second time, even when the employer has failed to pay over the amount of tax withheld. Applying the "reasonable cause" provision in Section 7-3-5(B) to excuse Mr. Dean, one of the corporate officers in control of the payment of wages, from liability for the taxes withheld by DKA would foreclose the Department's ability to collect tax revenues legitimately due to the state. There is nothing to indicate the legislature

intended this result or intended to extend the very specific exception provided for an employer's "failure to deduct and withhold" to an employer's failure to pay over collected taxes that were withheld from employees' paychecks.

Even if the exception in Section 7-3-5(B) did apply, the evidence does not support Mr. Dean's contention that he had "reasonable cause" not to know that DKA was delinquent in the payment of state withholding taxes. At the hearing, Mr. Dean testified that whenever he asked Eugene Baker whether taxes were being paid, Mr. Baker told him that taxes were either paid or were "on a schedule" for payment. This answer clearly signaled that DKA was not in full compliance with its tax obligations. Nonetheless, Mr. Dean made no effort to determine exactly which taxes were delinquent and being paid "on a schedule" or how much was owed. Nor did he ask to review DKA's tax returns or seek information from Charles Orr, DKA's accountant, concerning the corporation's tax situation. At some point, Mr. Orr approached Mr. Dean with the information that the withholding taxes shown on Mr. Dean's W-2 forms had not been paid to the state. Based on this evidence, and Mr. Dean's position as majority shareholder and president of DKA, there could be no "reasonable cause" for him to be unaware of DKA's continued failure over a period of eight years to pay withholding taxes due to the state.

Use of the Same Assessment Numbers to Assess Different Taxpayers. The assessment the Department issued to Mr. Dean in his individual capacity was not assigned a new number, but reflected the same numbers previously used in the assessments issued to DKA. The assessment issued to Mr. Dean referenced both his social security number and DKA's taxpayer identification number and included the following explanation: "Personal Audit Assessment: Withholding Tax Portion of Assessment Numbers 2462271 and 2490193 for Dean\Kruger and Associates." The Department's computer system is programmed in such a way that assessment numbers can be

assigned to only one taxpayer. In order to issue an assessment using a number already assigned to another taxpayer, the Department must generate the assessment manually. Accordingly, the assessment will not show up in the Department's computer system. Based on these facts, Mr. Dean argues that the manual assessment issued to him in February 2000 was not a valid assessment because it did not have a unique assessment number that could be identified by the Department's computer.

Section 7-1-17(B)(2) NMSA 1978 provides that assessments of tax are effective:

when a document denominated "notice of assessment of taxes", issued in the name of the secretary, is mailed or delivered in person to the taxpayer against whom the liability for tax is asserted, stating the nature and amount of the taxes assertedly owed by the taxpayer to the state, demanding of the taxpayer the immediate payment of the taxes and briefly informing the taxpayer of the remedies available to the taxpayer;

The assessment mailed to Mr. Dean in February 2000 meets these statutory requirements. There is nothing in Section 7-1-17—or any other section of the Tax Administration Act—that requires the Department to assign numbers to the assessments it issues. The numbering of assessments is done purely for the Department's convenience. While an assessment number is usually identified to a specific taxpayer, nothing prohibits the Department from identifying an assessment number to a specific tax liability instead.

Mike Giles, an auditor in the Department's protest office, explained that the same assessment number is used to assess different taxpayers in situations where more than one taxpayer is liable for the same tax. Assigning one assessment number to taxpayers who are jointly and severally liable for the same tax liability insures that all payments received are credited to that liability and prevents the possibility of collecting the tax more than once. The fact that the Department's computer system is programmed in such a way that assessments to additional taxpayers must be manually created off-

line is irrelevant. The validity of an assessment is determined by statute, not by the constraints of the Department's computer system. In this case, the February 2000 assessment issued to Mr. Dean met all the requirements of Section 7-1-17 and was a valid assessment.

Limitation Periods for Issuing Assessments. Mr. Dean argues that Subsection A of Section 7-1-18 NMSA 1978 limits the period within which the Department could issue an assessment to him in his individual capacity to three years from the end of the calendar year in which DKA's withholding taxes were due. The Department contends that the seven-year period provided in Subsection C of Section 7-1-18 is applicable to Mr. Dean and to all persons who qualify as "withholders" under the Withholding Tax Act. The pertinent portions of Section 7-1-18 read as follows:

- A. Except as otherwise provided in this section, no assessment of tax may be made by the department after three years from the end of the calendar year in which payment of the tax was due,....
- B. ...
- C. In case of failure by a taxpayer to complete and file any required return, the tax relating to the period for which the return was required may be assessed at any time within seven years from the end of the calendar year in which the tax was due,....

There is no dispute that DKA failed to file CRS returns from 1991 through 1999 and that the Department had seven years from the end of the calendar year in which taxes for that period were due to issue an assessment to DKA. Mr. Dean maintains that the seven-year limitation period in Subsection C does not apply to him in his individual capacity because he was not a "taxpayer" required to file CRS returns and did not become a taxpayer until after he was assessed by the Department.

Mr. Dean's reading of the statute is too narrow. Section 7-1-18(C) gives the Department seven years to assess "the tax" relating to any period for which required returns were not filed. The

seven-year limitation period applies to the assessment of tax, not to the assessment of a particular taxpayer. Any taxpayer liable for tax relating to a nonfiled period may be assessed within seven years from the end of the calendar year in which the tax was originally due. Section 7-1-3(W) NMSA 1978 defines a “taxpayer” as:

a person liable for payment of any tax, a person responsible for withholding and payment or for collection and payment of any tax or a person to whom an assessment has been made, if the assessment remains unabated or the amount thereof has not been paid.

Mr. Dean focuses on the last part of Subsection W, which defines a taxpayer to mean a person to whom an assessment of tax has been made. He ignores the preceding language which defines a taxpayer to include “a person responsible for withholding and payment or for collection and payment of any tax.” Mr. Dean also confuses the meaning of “delinquent taxpayer” in Section 7-1-16 NMSA 1978 with the meaning of “taxpayer” in Section 7-1-3(W) NMSA 1978. Whether a taxpayer is “delinquent” is relevant only in the context of collection actions. At the present time, Mr. Dean is not a delinquent taxpayer and cannot become one until after this protest is finally resolved. This has no bearing, however, on whether he qualified as a “taxpayer” liable for payment of DKA’s withholding taxes during the nonfiled periods at issue. Pursuant to Sections 7-1-3(W) and 7-3-5, Dean was a taxpayer personally liable for payment of withholding tax deducted from the paychecks of DKA’s employees but never reported or paid to the Department. Accordingly, the Department correctly assessed Mr. Dean under the seven-year limitation period set out in Section 7-1-18(C).

Tax Base Used to Assess Withholding Tax. During the audit of DKA, the only withholding tax records provided to the Department’s auditors were for the 1997 and 1998 tax years. For the 1992-1996 and 1999 tax years, the Department estimated the withholding taxes at \$8,688.69 per year, based on the average of the taxes due for 1997 and 1998. At the August 29, 2001 hearing on

his protest, Mr. Dean introduced general ledger pages, payroll earnings statements and W-2s that had been in the possession of Charles W. Orr, the company's certified public accountant. Mr. Orr testified that these were true and accurate copies of business records he maintained on behalf of DKA. These records, together with the records produced during the audit, established that the following taxes were deducted from employee paychecks during the years 1994 through 1998:

1994:	\$4,647.79
1995	\$7,287.25
1996:	\$9,719.10
1997:	\$9,836.41
1998:	\$7,765.94

No evidence was provided concerning withholding tax for the years 1992, 1993 or 1999.

In its written closing argument, the Department objected to the admission of the additional records on two grounds: (1) that Charles Orr was not a credible witness; and (2) that Mr. Dean should not be allowed to introduce "last-minute evidence" at the hearing. With regard to the Department's first argument, I reject the suggestion that Mr. Orr fabricated the documents introduced as Taxpayer's Exhibit D. I accept Mr. Orr's testimony that these were records kept in the regular course of DKA's business and reflect the actual amount of DKA's withholding tax for the years at issue. With regard to the Department's second argument, there is simply no legal authority for excluding the taxpayer's exhibit. Mr. Dean's February 28, 2000 protest letter clearly stated that he was challenging the "erroneous calculation of the taxes due and assessed." If the Department wished to determine the basis for Mr. Dean's challenge, it had eighteen months to conduct discovery and request production of documents the taxpayer intended to introduce to dispute the correctness of the Department's assessment. There is no indication that the Department conducted any formal discovery prior to the date of the hearing. That being the case, the Department is in no position to

claim prejudicial surprise or ask the hearing officer to prohibit the taxpayer from introducing additional evidence to support the issues raised in his protest.

CONCLUSIONS OF LAW

1. Hal M. Dean filed a timely, written protest to Assessment No. 2490193, issued to him in his individual capacity as a corporate officer of DKA on February 18, 2000, and jurisdiction lies over the parties and the subject matter of this protest.

2. Mr. Dean was both a “withholder” and an “employer” as defined in New Mexico’s Withholding Tax Act and was personally liable for DKA’s unpaid withholding taxes for the period January 1993 through April 1999.

3. The “reasonable cause” exception provided in Section 7-3-5(B) NMSA 1978 does not apply to the facts of this case and does not excuse Mr. Dean from liability for DKA’s withholding taxes.

4. The February 2000 assessment issued to Mr. Dean met all the requirements of Section 7-1-17 NMSA 1978 and was a valid assessment.

5. Mr. Dean was a taxpayer personally liable for payment of DKA’s withholding taxes during periods when no returns were filed, and the Department correctly assessed Mr. Dean for these taxes under the seven-year limitation period set out in Section 7-1-18(C) NMSA 1978.

6. The additional withholding tax records Mr. Dean introduced at the administrative hearing were sufficient to overcome the presumption of correctness of the Department’s estimate of taxes due for 1994, 1995 and 1996 and provide a reasonable basis for adjusting the Department’s assessment for those years.

For the foregoing reasons, Mr. Dean’s protest IS GRANTED IN PART AND DENIED IN PART. Mr. Dean’s protest is granted with respect to the Department’s estimate of tax for the 1994,

1995 and 1996 tax years, and the Department is ordered to adjust the assessment for those years to reflect the amount of withholding tax shown on Taxpayer Exhibit D. With regard to all other issues, Mr. Dean's protest is denied.

DATED November 1, 2001.