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

IN THE MATTER OF THE PROTEST OF
JOHNSON & JOHNSON AND AFFILIATED SUBSIDIARIES, I.D. NO. 02-108895-00 0,
PROTEST TO ASSESSMENT NOS. 1884894
AND 1885005

NO. 96-09

PARTIAL DECISION AND ORDER
MATTER ONE

This matter came on for formal hearing on February 6, 1996 before Gerald B. Richardson, Hearing Officer. Johnson & Johnson and affiliated subsidiaries, hereinafter, "Johnson & Johnson", was represented by Curtis W. Schwartz, Esq. of Modrall, Sperling, Roehl, Harris & Sisk, P.A. and by Paul H. Frankel, Esq. of Morrison & Foerster, L.L.P. The Taxation and Revenue Department, hereinafter, "Department", was represented by Bruce J. Fort, Special Assistant Attorney General. The parties have stipulated that Assessment No. 1884894 should be abated and therefore only Assessment No. 1885005 will be addressed. With respect to that assessment, by an Order of the Hearing Officer dated August 18, 1996, the formal hearing of Johnson & Johnson's protest has been bifurcated. The February 6, 1996 formal hearing addressed only the issues arising out of the May 1, 1992 Tax Settlement Agreement entered into between the Taxpayer and the Department.

Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Johnson & Johnson's corporate headquarters and its principal place of business are located in New Brunswick, New Jersey. New Jersey is Johnson & Johnson's commercial domicile.

2. The tax years at issue herein are the tax years ending in 1987, 1988, 1989, 1990 and 1991.

3. Johnson & Johnson conducts business through domestic subsidiaries in the United States and through foreign subsidiaries in foreign countries. As the parent corporation, Johnson &

Johnson never directly conducted business in New Mexico from 1980-1990. It did, however, have subsidiaries which conducted business in New Mexico during those periods of time.

4. Ethicon, Inc., "Ethicon", is a directly or indirectly wholly-owned subsidiary of Johnson & Johnson. Ethicon operates a manufacturing facility in New Mexico. Ethicon timely filed New Mexico corporate income tax returns for 1981 and 1982. Ethicon elected the separate entity reporting method and filed accordingly.

5. Ethicon's reported factors in New Mexico during years 1981 through 1991 inclusive were:

Year	Property	Payroll	Sales
1981	$14,855,236	$ 1,415,679	$ 299,624
1982	$18,130,553	not available	not available
1983	$22,307,514	$ 5,063,380	$ 419,683
1984	$22,969,339	$ 5,741,312	$ 293,010
1985	$24,020,979	$ 7,587,690	$ 441,911
1986	$24,479,732	$10,350,272	$ 891,753
1987	$26,541,398	$11,213,525	$1,175,471
1988 *2-28-88	$25,822,889	$ 2,086,738	$ 189,776
12-31-88	$25,622,389	$10,188,190	$1,058,890
total	N/A	$12,274,928	$1,248,666
1989	$36,288,843	$13,860,277	$1,229,403
1990	$43,600,404	$16,631,091	$1,464,353
1991	$49,579,167	$23,305,153	$1,902,260

* On March 1, 1988, Ethicon merged into Technicare Corporation and the survivor's name was changed to Ethicon. As a result of the merger, Ethicon had two tax years ending in 1988.

6. Xanar, Inc., "Xanar", is a directly or indirectly wholly-owned subsidiary of Johnson & Johnson. Xanar sold medical equipment in New Mexico. Xanar timely filed a New Mexico corporate income tax return for 1982. Xanar elected the separate entity reporting method and filed accordingly. Xanar's factors in New Mexico during years 1982 through 1989 inclusive were:

Year	Property	Payroll	Sales
1981-1986	not available	not available	not available

1987	0	0	$ 55,825
1988	0	0	0
1988	0	0	0
1989	0	0	0
post 1989--the company was sold			

7. The Multistate Tax Commission, "MTC" is a commission formed pursuant to Article VI of the Multistate Tax Compact, §§ 7-5-1 through 7-5-7 NMSA 1978 (1995 Repl. Pamp.). The MTC conducted an audit of Johnson & Johnson and its subsidiaries. The audit was concluded in 1989. The MTC conducted the audit on behalf of New Mexico and ten other states. The focus of the MTC's audit was corporate income tax. The audit related to the 1980, 1981 and 1982 tax years.

8. The MTC auditor concluded that Ethicon and Xanar had accurately filed their respective New Mexico income tax returns.

9. The MTC auditor also concluded that six other directly or indirectly wholly-owned subsidiaries of Johnson & Johnson had nexus with New Mexico. Those subsidiaries were Codman and Shurtleff, Inc.; Johnson & Johnson Products, Inc.; Ortho Diagnostic Systems, Inc.; Ortho Pharmaceutical Corporation; Personal Products Company and McNeilab, Inc.

10. As a result of the MTC audit, in September 1989, the Department issued separate assessments of corporation income tax to the six Johnson & Johnson subsidiaries listed above for the tax years 1980, 1981 and 1982. The aggregate amount of corporate income tax, penalty and interest assessed under these assessments was $40,410.60.

11. On November 29, 1989, Johnson & Johnson, on behalf of its subsidiaries, timely protested all of the Department's assessments. In its protests, Johnson & Johnson asserted that because the activities of its six subsidiaries in New Mexico were limited to the solicitation of sales, they were protected from having to file New Mexico corporate income tax returns by the provisions of P.L. 86-272.

12. The only issue raised by the MTC audit with respect to New Mexico for tax years 1980-1982 pertained to the issue of whether nexus to tax existed with respect to certain Johnson & Johnson subsidiaries. This is because for those tax years, Johnson & Johnson had elected to file with

New Mexico on a separate corporate entity basis. With respect to other states for whom the MTC conducted the audit, the audit concluded that Johnson & Johnson conducted a world-wide unitary business through its domestic and foreign subsidiaries. Depending upon the statutory provisions of the other states, the effect of this conclusion was to combine all or a portion of either the income of the foreign subsidiaries, or all or a portion of the income Johnson & Johnson received from its foreign subsidiaries in the form of dividends with Johnson & Johnson's other income for purposes of calculating corporate income taxes due in those other states. The effect of this conclusion was to increase (and in some cases, increase very substantially) Johnson & Johnson's assessed liability for taxes to the other states.

13. From 1987 through June of 1992, Manuel F. Gallegos was employed by the department as manager of its Protest Office.

14. In his capacity as the manager of the Department's Protest Office Mr. Gallegos had frequent contact with taxpayers who had formally protested various department actions.

15. Often, Mr. Gallegos was the only department employee with whom taxpayers had contact regarding protested matters.

16. Mr. Gallegos' responsibilities included negotiating protested matters with taxpayers.

17. In his capacity as manager of the Department's Protest Office Mr. Gallegos communicated both by telephone and in writing with Mr. Joseph F. Robinson, Assistant Director of Domestic Taxation for Johnson & Johnson concerning Johnson & Johnson's protests. Sometime in December of 1991, the Department had written Johnson & Johnson proposing an informal conference concerning Johnson & Johnson's protests in January of 1992. Mr. Robinson called Mr. Gallegos in response to the letter and said that it would be difficult to attend a hearing in January, but perhaps the matter could be compromised on some basis. An agreement to compromise the assessed liabilities for $25,000 was proposed and Mr. Robinson also suggested carrying the settlement forward through the 1990 tax year.

18. As a result of the settlement discussions between Mr. Gallegos and Mr. Robinson,

Johnson & Johnson proposed a settlement which was put into the form of a Tax Settlement Agreement. This first draft of the Tax Settlement Agreement was written by Mr. Robinson and was mailed to Mr. Gallegos on February 27, 1992.

19. Following receipt of Johnson & Johnson's draft Tax Settlement Agreement, Mr. Gallegos sent a memo dated March 30, 1992 to both Frank Katz, the Department's Chief Counsel, and Steve Keene, the Director of the Department's Audit & Compliance Division. Mr. Gallegos' memo asked whether the Tax Settlement Agreement was sufficient or whether a standard closing agreement needed to be prepared. By "sufficient", Mr. Gallegos intended to ask whether the form of the agreement was sufficient to effectuate a binding settlement of the matter between the Department and Johnson & Johnson. The memo indicated that the only issue involved was the issue of nexus with respect to certain Johnson & Johnson subsidiaries.

20. In the course of his duties as chief counsel Mr. Katz is familiar with closing agreements, including the drafting and review of such.

21. Mr. Katz had no familiarity with the Johnson & Johnson protests other than to see the draft Tax Settlement Agreement and Mr. Gallegos' March 30, 1992 memo when he responded to the memo in writing. Mr. Katz agreed that the matter could be settled by the Tax Settlement Agreement and he agreed with settling the matter for the dollar amount proposed, but he found some portions of the agreement ambiguous and confusing. He questioned why the nexus of Johnson & Johnson subsidiaries would be an issue after Johnson & Johnson began filing on a federal consolidated basis with the Department and he questioned the provisions of paragraph 9 concerning the finality of the agreement for certain tax periods. Mr. Katz found the reference to the time periods ambiguous and he did not believe that periods through 1990 should be closed out.

22. Mr. Gallegos did not fully understand what Mr. Katz intended to convey by his written comments concerning paragraph 9.

23. Mr. Keene never responded to Mr. Gallegos' memo of March 30, 1992.

24. Subsequent to Mr. Gallegos receiving Mr. Katz' comments, Mr. Gallegos and Mr.

Robinson discussed changes to the proposed settlement agreement.

25. The specific changes that Mr. Gallegos requested were to paragraphs 3, 8 and 9.

26. Mr. Robinson prepared a revised Tax Settlement Agreement which reflected the changes which he and Mr. Gallegos discussed. Mr. Stanley Stern, Director of Domestic Taxation for Johnson & Johnson executed the revised Tax Settlement Agreement on behalf of Johnson & Johnson. Mr. Robinson then forwarded the Tax Settlement Agreement to Mr. Gallegos by letter, dated April 24, 1992, for execution by the Department. Accompanying the Tax Settlement Agreement and Mr. Robinson's transmittal letter was a check for $25,000 in payment of the settlement amount with respect to the 1980 through 1982 tax years.

27. Between the first draft Tax Settlement Agreement and the revised Tax Settlement Agreement, paragraph 9 was changed to delete the phrase "as to the previously identified periods" and in lieu thereof, the phrase "for all tax periods prior to 1991" was inserted.

28. The correspondence and settlement discussions between Mr. Gallegos and Mr. Robinson related to all open tax years prior to 1991, not just 1980 -1982, the years related to the protested assessments.

29. The revised Tax Settlement Agreement, transmitted by Mr. Robinson's letter of April 24, 1992 was executed on behalf of the Department on May 15, 1992 by Steve Keene and by Dick Minzner, then Secretary of the Department, the highest ranking official of the Department.

30. It was the intention of both Mr. Gallegos and Mr. Robinson that the Tax Settlement Agreement be binding and enforceable on all parties thereto.

31. Under the terms of the executed Tax Settlement Agreement, Johnson & Johnson agreed to pay the Department $25,000 in settlement of the issue of the nexus of the six subsidiary corporations for the 1980-1982 audit period. The parties also agreed to a four-two split of the nexus issue for tax years 1983 through 1990, with Johnson & Johnson conceding nexus for four of the subsidiaries and the Department agreeing not to argue or assert nexus for the other two subsidiaries. The agreement provides that the agreement shall be final and conclusive for all periods prior to 1991

and prohibits the Department from reopening these periods for purposes of determining, assessing or collecting any tax not provided for in the agreement absent any adjustments to Johnson & Johnson's federal returns.

32. Mr. Gallegos understood that the Tax Settlement Agreement would close all tax years prior to 1991 to the Department for purposes of auditing or assessing corporate income tax, unless there were future adjustments made by the Internal Revenue Service affecting Johnson & Johnson's federal taxable income.

33. It was Mr. Robinson's intention in negotiating the Tax Settlement Agreement to close all tax years prior to 1991 to future audit or assessment of corporate income tax by the Department, unless there were future adjustments made by the Internal Revenue Service affecting Johnson & Johnson's federal taxable income.

34. The Tax Settlement Agreement is not limited in scope to just the assessments issued to six Johnson & Johnson subsidiaries, but relates to corporate income tax of Johnson & Johnson and its subsidiaries for all tax years prior to 1991.

35. At the time the Tax Settlement Agreement was negotiated, the parties knew that the issue of nexus for all subsidiaries was worth only a few thousand dollars per year.

36. A reasonable estimate of the total tax effect of excluding the factors for the four subsidiaries for whom Johnson & Johnson conceded nexus under the terms of the Tax Settlement Agreement for the 1987-1990 tax years was $3,646. Johnson & Johnson gave this up when it entered into the Tax Settlement Agreement.

37. A reasonable estimate of the total tax effect of considering the factors of the two subsidiaries for whom the Department conceded it lacked nexus under the terms of the Tax Settlement Agreement for the 1987-1990 tax years was $2,087. The Department gave this up when it entered into the Tax Settlement Agreement.

38. Mr. Katz never saw or reviewed the terms of the revised Tax Settlement Agreement prior to its execution by the Department. If he had, he would not have approved it. Because Mr.

Katz had no further involvement with the Tax Settlement Agreement and did not receive or review the revised Tax Settlement Agreement, he took no action to submit the Tax Settlement Agreement to the Attorney General.

39. Johnson & Johnson relied on the Department to obtain all necessary approvals and signatures to be obtained to render the Tax Settlement Agreement binding and enforceable.

40. As a matter of administrative practice, the Department does not impose upon any taxpayer the obligation to see to it that the Department has obtained all necessary approvals with respect to closing agreements compromising assessed taxes.

41. By letter dated June 16, 1992, Mr. Gallegos transmitted a copy of the executed Tax Settlement Agreement to Mr. Robinson.

42. Mr. Gallegos was the only Department employee with whom Johnson & Johnson had substantive contact during the time period of 1992 through November of 1994 regarding the protested assessments and the Tax Settlement Agreement by which those protested assessments were settled between the parties.

43. By letter dated August 13, 1992, to Mr. Gallegos, Mr. Robinson transmitted the schedule required by paragraph 5 of the Tax Settlement Agreement and a check in the amount of $8,621 in payment of the additional income tax liability shown thereon plus applicable interest.

44. Mr. Robinson's August 13, 1992 transmittal letter noted that the adjustment to the numerators of the apportionment factors required by paragraph 6 of the Tax Settlement Agreement was not necessary because Johnson & Johnson had already included the apportionment factors of the four companies treated as having nexus with New Mexico in Johnson & Johnson's apportionment factors.

45. In 1987, Johnson & Johnson elected to change its filing method for reporting and filing corporation income taxes with New Mexico pursuant to Regulation CIT 9:2 and in accordance with Section 7-2A-8.4 NMSA 1978. Johnson & Johnson had elected to no longer file separate corporate income tax returns for each of its subsidiaries doing business in New Mexico on a separate

corporate entity basis, but, instead, to file on a federal consolidated basis. Under the federal consolidated reporting methodology the income, losses and the factors of all of the corporations included in Johnson & Johnson's federal consolidated return are considered in calculating Johnson & Johnson's New Mexico income tax liability.

46. Mr. Robinson made the decision to change Johnson & Johnson's filing method from separate corporate entity filing to the federal consolidated basis in the summer or fall of 1988. This decision was made because Mr. Robinson believed that it would reduce the amount of corporate income tax due to New Mexico from Johnson & Johnson's subsidiaries filing in New Mexico because it would allow losses of other Johnson & Johnson subsidiaries to be taken into account as well as the income of Johnson & Johnson's subsidiaries operating in New Mexico in calculating New Mexico corporate income taxes for Johnson & Johnson.

47. At the time that Mr. Robinson made the decision to change Johnson & Johnson's filing methodology, and consequently, at the time that Mr. Robinson was negotiating the Tax Settlement Agreement with Mr. Gallegos, Mr. Robinson knew that New Mexico included foreign-source dividends from corporations with a unitary relationship to the taxpayer in the taxpayer's apportionable tax base in calculating New Mexico corporate income taxes.

48. Neither Mr. Robinson or Johnson & Johnson believe that Johnson & Johnson is engaged in a unitary world-wide business which includes its foreign subsidiaries.

49. At the time that Mr. Robinson was negotiating the Tax Settlement Agreement with the Department, Mr. Robinson was aware of the MTC audit conclusion that Johnson & Johnson was engaged in a world-wide unitary business.

50. Within the year prior to the finalization of the Tax Settlement Agreement with the Department, and in some instances, during the same time in which the Tax Settlement Agreement was being negotiated with the Department, Mr. Robinson was involved in negotiating settlements with several of the other states involved in the MTC audit who were claiming additional income taxes from Johnson & Johnson based upon the MTC audit conclusion that Johnson & Johnson operated a

unitary world-wide business. In negotiating these settlements, Mr. Robinson negotiated to have the settlements extend beyond the MTC audit period to cover all open tax years, usually through 1989 or 1990. Those settlements resulted in Johnson & Johnson agreeing to terms which included all or part of the income or dividends from Johnson & Johnson's foreign subsidiaries in Johnson & Johnson's apportionable tax base for purposes of calculating income taxes owed to those states for the audit years. These settlements resulted in Johnson & Johnson paying the various states more than five million dollars.

51. Johnson & Johnson timely filed New Mexico income tax returns using the federal consolidated group reporting method for the 1987 through 1990 tax years and those returns were available for Mr. Gallegos to review at the time he was negotiating the Tax Settlement Agreement with Mr. Robinson. Johnson & Johnson's 1991 New Mexico income tax return was not available because it was not yet due.

52. Mr. Gallegos did not review Johnson & Johnson's 1987 through 1990 corporate income tax returns during the period of time he was negotiating the Tax Settlement Agreement with Mr. Robinson. Had he done so, his review would have revealed that Johnson & Johnson was consistently deducting as allocated income dividend income representing more than half of its federal taxable income in arriving at New Mexico taxable income. If Mr. Gallegos had reviewed those returns, he would not have agreed to the terms proposed by Mr. Robinson in the Tax Settlement Agreement without making further inquiry into the deductions being taken by Johnson & Johnson.

53. Had the dividends received by Johnson & Johnson's consolidated groups from Johnson & Johnson's foreign subsidiaries during the 1987 through 1990 tax years been considered business income subject to apportionment by New Mexico, Johnson & Johnson would have owed approximately two million dollars in additional corporate income tax, penalty and interest to the state of New Mexico.

54. During their settlement discussions, the only issue discussed between Mr. Gallegos and Mr. Robinson was the question of nexus for the six disputed corporations and how the terms of

the settlement of that issue would be handled for years subsequent to the audit years. Mr. Gallegos and Mr. Robinson never discussed the fact that Johnson & Johnson allocated all of its foreign source dividend income, excluding it from consideration by New Mexico in calculating Johnson & Johnson's corporation income taxes payable to the Department.

55. Prior to executing the Tax Settlement Agreement no employee of the Department requested or reviewed copies of Johnson & Johnson's New Mexico corporate income tax returns for tax years 1987 through 1990.

56. The Tax Settlement Agreement as prepared by Johnson & Johnson and executed by them and the Department contains no signature line or any other notation to indicate that the agreement would be reviewed or approved by the Attorney General.

57. The Tax Settlement Agreement entered into between the Department and Johnson & Johnson represented a compromise of assessed taxes assessed against six subsidiaries of Johnson & Johnson.

58. The Department has never had a policy or practice of compromising assessed taxes without a closing agreement, signed by the Attorney General.

59. Normally, the Department's attorney handling the protest of assessed taxes would be involved in drafting any closing agreement compromising those assessed taxes. It would be the responsibility of that attorney to forward the closing agreement to the Attorney General to obtain the necessary approval of the closing agreement. In this case, because no Department attorney was handling the protests by Johnson & Johnson's subsidiary corporations and because no attorney was involved in determining the final terms of the Tax Settlement Agreement, the Tax Settlement Agreement was not forwarded to the Attorney General's Office for signature at the time the agreement was executed by the Department.

60. The Attorney General's Office reviews proposed closing agreements for form, propriety and content.

61. The Attorney General's Office review of proposed closing agreements may involve a

discussion between the Department's attorney and the Attorney General's Office representative about the agreement. On occasion, the Attorney General's Office has rejected closing agreements proposed by the Department and/or sent them back to the Department for rewriting.

62. The Attorney General has not delegated authority to anyone in the Department to execute or approve closing agreements on behalf of the Attorney General.

63. The Attorney General's Office and the Taxation and Revenue Department are entirely separate agencies of state government.

64. On October 4, 1994 the Department sent the Tax Settlement Agreement to the Attorney General with a cover letter requesting that the Attorney General review and approve the agreement. The Attorney General declined to sign or approve the agreement on the basis that more than two years had elapsed since the Department had executed the agreement before it was transmitted to the Attorney General for approval. Thereafter, the Department took no further action to obtain the Attorney General's approval of the agreement.

65. Between 1990 and 1994, the Tax Settlement Agreement was the only agreement between the Department and a taxpayer compromising assessed taxes which was not signed or approved by the Attorney General. All tax settlement agreements in the standard form of a closing agreement which settle taxes between the Department and a taxpayer during that time frame were ultimately approved by the Attorney General although they may have been altered from their original form as a result of the review process in the Attorney General's Office.

66. In late 1994, Rex Foutz, a corporate income tax auditor with the Department contacted Johnson & Johnson and informed them that he intended to conduct an audit of New Mexico corporate income tax for 1987 and subsequent tax years.

67. Mr. Foutz was informed by Johnson & Johnson that it would allow Mr. Foutz access to records for an audit of 1991 and subsequent tax years but that tax years prior to 1991 were closed pursuant to the terms of the Tax Settlement Agreement.

68. In late December, 1994 Johnson & Johnson was advised over the telephone by Mr.

Foutz that the Department did not consider itself bound by the Tax Settlement Agreement because it was not signed by the Attorney General of the State of New Mexico. Therefore, Mr. Foutz informed Johnson & Johnson that the Department would assert a corporate income tax deficiency for 1987 and subsequent tax years.

69. The first time any Department employee communicated to Johnson & Johnson that the Department did not consider itself bound by the Tax Settlement Agreement was Mr. Foutz' telephone call in late 1994. At no time prior thereto did any Department employee communicate in any way to any employee or agent of Johnson & Johnson (i) any issue of enforceability of the Tax Settlement Agreement, (ii) the necessity to obtain either the Attorney General's signature on or approval of the Tax Settlement Agreement or (iii) any effort by the Department to obtain the signature or approval of the Attorney General for the Tax Settlement Agreement.

70. The Department issued two provisional assessments to Johnson & Johnson, Assessment Nos. 1885005 and 1884894.

71. Assessment No. 1885005 bears an assessment date of December 29, 1994 and a stamped mailing date for purposes of application of Section 7-1-24(B) NMSA 1978 of December 28, 1994. It assessed $1,228,647 of corporate income tax, $122,864.70 of penalty and $836,033.18 interest through January 15, 1995 for the 1987 through 1991 tax years.

72. Assessment No. 1884894 bears an assessment date of December 25, 1994 and a stamped mailing date for purposes of application of Section 7-1-24(B) NMSA 1978 of December 29, 1994. It assessed $64,790.12 of penalty and $65,340.10 in interest computed through January 15, 1995 for the 1988 through 1991 tax years.

73. The Department has agreed to abate Assessment No. 1884894.

74. The "nexus filing agreements" comprising Exhibit S-21 do not compromise or settle assessed taxes nor do they reflect approval by the Attorney General.

75. Johnson & Johnson was not aware of the nexus filing agreements at the time it negotiated the terms of and prepared the Tax Settlement Agreement with the Department.

DISCUSSION

The only issues to be determined at this juncture relate to the enforceability of the Tax Settlement Agreement entered into between Johnson & Johnson and the Department and whether equitable estoppel would operate to estop the Department from disregarding the terms of the Tax Settlement Agreement in the event it is concluded that the agreement is not binding upon the Department. The remaining issues concerning the taxes, penalty and interest assessed by Assessment No. 1885005 have been bifurcated and will be determined in a subsequent hearing.

Johnson & Johnson was audited by the Multistate Tax Commission ("MTC") on behalf of a number of states, including New Mexico, for tax years 1980-1982. Johnson & Johnson (the parent corporation[1]) did not directly engage in business in New Mexico. Its subsidiaries, Ethicon, Inc. and Xanar, Inc. did engage in business in New Mexico and they elected to report to the Department for corporate income tax purposes using the separate corporate entity filing methodology.[2] The MTC audit concluded that six other Johnson & Johnson subsidiaries were engaged in activities in New Mexico sufficient to establish nexus and in 1989 the Department issued assessments totalling approximately $40,000 against those subsidiaries for corporation income tax for the audit years. Johnson & Johnson protested those assessments on the basis that the six subsidiaries did nothing more than to solicit sales in New Mexico and as such, they were protected by the provisions of P.L. 86-272 from filing corporate income taxes in New Mexico. The MTC audit also concluded, with respect to other states for whom the MTC conducted the audit, that Johnson & Johnson conducted a world-wide unitary business through its domestic and foreign subsidiaries. This audit finding was irrelevant for

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[1] Throughout this decision "Johnson & Johnson" is used to mean Johnson & Johnson, the parent corporation, as well as its subsidiaries and affiliates. When only the parent corporation is intended to be referenced, it will be specifically noted as the parent corporation.

[2] Regulation CIT 9:2 allows a taxpayer to elect any one of four reporting methods when filing its initial corporate income tax return. There are provisions, not pertinent herein, which impose conditions for changing the filing methodology once one is elected, for subsequent years. The four filing methodologies are:

separate accounting
separate corporate entity
combination of unitary corporations
federal consolidated group

purposes of New Mexico taxes because of Johnson & Johnson's election to file on a separate corporate entity basis for its subsidiaries engaging in business in New Mexico. For the other states, however, if they require unitary businesses to file on a water's edge or world-wide unitary basis, the effect of this finding was to include either the income of Johnson & Johnson's foreign subsidiaries or the dividends those foreign subsidiaries paid to Johnson & Johnson to be included in Johnson & Johnson's income subject to apportionment among the states. As a consequence of this MTC audit finding, the other states issued substantial assessments of additional corporate income taxes to Johnson & Johnson. Johnson & Johnson acted to dispute the conclusion that it conducted a world-wide unitary business in those other states, and negotiated settlements to resolve those disputes. In negotiating those settlements, Johnson & Johnson negotiated settlements to settle those matters for all open years, not just the years covered by the MTC audit. Johnson & Johnson ultimately paid over five million dollars to settle those cases.

Sometime in December of 1991, Mr. Manuel Gallegos, the manager of the Department's protest office, wrote to Johnson & Johnson proposing a meeting in January of 1992 to discuss the issues raised by Johnson & Johnson in its protests of the six assessments issued to Johnson & Johnson's subsidiaries. In response to Mr. Gallegos' letter, Mr. Joseph Robinson, Assistant Director of Domestic Taxation for Johnson & Johnson telephoned Mr. Gallegos. Mr. Robinson explained that it would be difficult for Johnson & Johnson to meet with the Department in January and asked if it would be possible to discuss settling the disputed assessments in some manner. There ensued settlement discussions between Mr. Gallegos and Mr. Robinson in which the general terms of a settlement were worked out. Essentially, the parties agreed to a four/two split on the nexus issue, with Johnson & Johnson conceding nexus on four of the subsidiaries and the Department conceding no nexus on the other two and they agreed on a payment of $25,000 to settle the issue for the 1980-1982 audit years. Mr. Robinson also proposed that the settlement be carried forward through the 1990 tax year and that he would draw up a draft of the settlement agreement and send it to Mr. Gallegos for review by the appropriate parties at the Department.

When Mr. Gallegos received the draft Tax Settlement Agreement from Mr. Robinson, he sent it, along with the cover memo, to Mr. Frank Katz, the Department's chief counsel, for review. Mr. Katz was not familiar with the Johnson & Johnson assessments or protests. Mr. Gallegos' memo asked whether the draft Tax Settlement Agreement was sufficient to effectuate a binding settlement of the Johnson & Johnson protests or whether a standard closing agreement was needed. His memo also explained that the Johnson & Johnson protests involved only the question of nexus with respect to Johnson & Johnson subsidiaries. Mr. Katz reviewed the matter briefly and responded that he agreed with settling the matter for the dollars indicated and by the form of agreement proposed, but he raised several questions concerning the agreement. With respect to paragraph 9 which accorded finality to the agreement as to "all previously identified periods", Mr. Katz commented that he found the agreement confusing and raised the concern that the agreement talks about every period up to 1990. Mr. Katz testified that he did not agree with closing the tax years through 1990. His written comments, however, do not clearly convey that opposition. Mr. Gallegos did not understand from Mr. Katz' comments that he disagreed with closing all tax years through 1990, but only understood that the ambiguity in the draft agreement needed to be clarified as to which years would be closed. When Mr. Gallegos next spoke with Mr. Robinson, he proposed language which explicitly provided that the agreement be final and conclusive for "all periods prior to 1991" to clarify the ambiguity as to which years would be closed. That language was incorporated into the final Tax Settlement Agreement which was executed by both the Department and Johnson & Johnson.

The Tax Settlement Agreement was not sent to the Attorney General for approval at the time the agreement was executed by the Department. Closing agreements, which are provided for at Section 7-1-20 NMSA 1978 as the means by which assessed taxes may be compromised by the Department, are required to be approved by the Attorney General. The Department's legal division handles the coordination of the process of sending closing agreements to the Attorney General and tracking those closing agreements once they are sent there. In this case, Mr. Katz never saw the final version of the Tax Settlement Agreement, nor would he have approved it because of the finality

provision to which he objected. Since nobody in the Department's legal division was involved in finalizing the Tax Settlement Agreement, nobody at the Department took any action to have it approved by the Attorney General at the time it was executed. Only in 1994, apparently after the Department determined that it wanted to audit some of the years which it was prohibited from auditing under the terms of the Tax Settlement Agreement, was the agreement sent to the Attorney General's Office. The Attorney General's Office refused to approve the Tax Settlement Agreement, noting the two year delay between the execution of the agreement by the parties and its submission for approval by the Attorney General.

The discussions between Mr. Gallegos and Mr. Robinson addressed only the nexus issue concerning the six Johnson & Johnson subsidiaries and how the settlement of that issue for the audit years would be carried forward to the open years beyond the audit years. Although Johnson & Johnson had filed its 1987-1990 tax returns with the Department and they would have been available for Mr. Gallegos to review in the context of his settlement negotiations with Mr. Robinson, Mr. Gallegos did not review those returns. In retrospect, that was a mistake, for that review would have revealed under its new filing methodology, Johnson & Johnson was consistently deducting more than half of its federal taxable income as non-business income not taxable in New Mexico. If Mr. Gallegos had discovered this, he would have made further inquiry into what type of income was being treated as non-business income and whether the Department agreed with that characterization before agreeing to the terms of the proposed Tax Settlement Agreement.

The deductions Johnson & Johnson claimed as non-business income only become an issue because in 1987, Johnson & Johnson had changed its filing with the Department, electing to report on the federal consolidated basis. This means that Johnson & Johnson would no longer file separate returns under the separate corporate entity filing method in New Mexico for each of its subsidiaries doing business here. Rather, one return would be filed using the same consolidated filing group of corporations which Johnson & Johnson used when filing with the Internal Revenue Service. Johnson & Johnson believed this to be advantageous in New Mexico because the losses of some of its other

subsidiaries would be combined to offset the income of its subsidiaries operating in New Mexico, reducing its New Mexico corporate income tax liability. This election of filing methods also brought Johnson & Johnson (the parent corporation) into the group of corporations filing in New Mexico. Johnson & Johnson received more than half of its federal taxable income in the form of dividends from its foreign subsidiaries, and the Department considers that this foreign dividend income would also be included in the pot of income New Mexico looks to in determining its proportionate share of taxable income. Johnson & Johnson was aware of the Department's view but it deducted all of its foreign dividend income on the basis that it qualifies to be classified non-business income because Johnson & Johnson contends that no unitary relationship exists between it and its foreign subsidiaries.[3] Within the year prior to, and in some cases, at the same time, that Mr. Robinson was negotiating the terms of the Tax Settlement Agreement with Mr. Gallegos, Johnson & Johnson had negotiated and settled its protests with some of the other states involved in the MTC audit in which the taxability of Johnson & Johnson's foreign source income was an issue.

It is in this context that the enforceability of paragraph 9 of the Tax Settlement Agreement is to be decided. It provides as follows:

> This agreement shall be final and conclusive for all periods prior to 1991, and these periods shall not be reopened by the Department, nor shall any suit, action or proceeding for determination, assessment, collection, refund or credit be brought by either party; provided, however, that adjustments to J&J's federal return by the Internal Revenue Service shall be subject to adjustment for New Mexico tax purposes. For the limited purpose of reflecting such limited adjustments only, J&J may file an amended return or the Department may issue an adjustment.

The language of paragraph 9 is unambiguous and clearly prohibits the Department from auditing or assessing additional tax for 1990 and prior years. Since the assessment at issue herein, assesses tax for the 1987-1991 tax years, the terms of paragraph 9 would prohibit the Department from assessing for all but the 1991 tax year.

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[3] Whether a unitary relationship exists between Johnson & Johnson and its foreign subsidiaries who paid the foreign dividend income and the business or non-business nature of that foreign dividend income will be addressed, for at least the 1991 tax year, when a formal hearing is held to address the remaining issues raised by Johnson & Johnson's protest.

The Department contends, however, that the Tax Settlement Agreement is unenforceable because it was not approved by the Attorney General. The Department's argument is based upon the provisions of Section 7-1-20 NMSA 1978 (1990 Repl. Pamp.)[4], the provision of the Tax Administration Act[5] which authorizes closing agreements as the means by which assessments of tax may be compromised and sets forth the conditions governing closing agreements. The provisions of Section 7-1-20 are as follows:

> A. At any time after the assessment of any tax, if the director in good faith is in doubt of the liability for the payment thereof, he may, *with the written approval of the attorney general*, compromise the asserted liability for taxes by entering, with the taxpayer, into a written agreement that adequately protects the interests of the state.
>
> B. The agreement provided for in this section is to be known as a "closing agreement". If entered into after any court acquires jurisdiction of the matter, the agreement shall be part of a stipulated order or judgment disposing of the case.
>
> C. As a condition for entering into a closing agreement, the director may require the taxpayer to furnish security for payment of any taxes due according to the terms of the agreement.
>
> D. A closing agreement is conclusive as to liability or nonliability for payment of assessed taxes relating to the periods referred to in the agreement and, except upon a showing of fraud or malfeasance, or the misrepresentation or concealment of a material fact:
> (1) the agreement shall not be modified by any officer, employee or agent of the state; and
> (2) in any suit, action or proceeding, the agreement or any determination, assessment collection, payment, abatement, refund or credit made in accordance therewith shall not be annulled, modified, set aside or disregarded.

(Emphasis added)

There is no other provision in the Tax Administration Act, nor elsewhere, such as the Taxation and Revenue Department Act[6] where the secretary's power to compromise assessments of tax is addressed. The Tax Settlement Agreement, by its very terms, purports to compromise the taxes

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[4] The version of Section 7-1-20 contained in the 1990 Replacement Pamphlet is referred to because it is the version in effect when the parties entered into the Tax Settlement Agreement. The only changes between it and the version in the 1995 Replacement Pamphlet is that the references to "director" in subsections A and C have been amended to "secretary".

[5] Chapter 7, Article 1, NMSA 1978

[6] Chapter 9, Article 11, NMSA 1978

which had been assessed by the Department for the 1980-1982 tax years, as well as providing terms to carry the settlement forward to additional years. Section 7-1-20 is the statutory provision which addresses the conditions upon which an assessment of taxes may be compromised. Subsection A unambiguously requires the written approval of the Attorney General to any agreement to compromise the assessment of any tax. Thus, the legislature has stated the public policy in New Mexico that agreements which compromise assessed taxes must, in addition to meeting with the Secretary's approval, receive the scrutiny and written approval of the Attorney General. The reasons for such a provisions should be obvious. Protection of the public fisc is of great importance to the functioning of government. Providing for review and approval by the Attorney General not only protects the state against the potential for corrupt acts by its public officials, it also provides protection against innocent mistakes and careless or complacent enforcement of the state's tax laws by the state's taxing officials. In short, it provides additional assurance that the agreement "adequately protects the interest of the state", as required by Subsection A.

In this case, the Attorney General expressly refused to grant approval to the Tax Settlement Agreement. Since the Tax Settlement Agreement fails to meet the express statutory provisions of Section 7-1-20 because it lacks the written approval of the Attorney General, none of the protections of Subsection D binding the state to the terms of the agreement can be invoked by Johnson & Johnson. In fact, absent the approval of the Attorney General, the Department lacks the legal capacity to enter into an agreement, such as the Tax Settlement Agreement, which compromises assessed taxes. Because the Tax Settlement Agreement lacks the written approval of the Attorney General, it is contrary to the express public policy requiring such approval found in Section 7-1-20. Contracts in violation of public policy are a nullity and unenforceable. ***State ex rel. Udall v. Colonial Penn***, 112 N.M. 123, 130, 812 P.2d 777 (1991). Thus, Johnson & Johnson may not rely upon the Tax Settlement Agreement to bar the Department from auditing or assessing tax for the years at issue herein.

Johnson & Johnson attempts to avoid the fatal consequence of the absence of the Attorney

General's approval by asserting that such approval is not necessary under the doctrine of apparent authority. Under this doctrine, the exercise of authority flowing from one's position which a reasonably prudent person naturally would suppose the other to possess by virtue of the trappings of actual authority acts to bind the party exercising the authority. ***Ellingwood v. N.N. Life Ins.***, 111 N.M. 301, 805 P.2d 70 (1991). Johnson & Johnson argues that it should reasonably be able to rely upon the authority of the Secretary of the Department to contractually bind the Department to the terms of the Tax Settlement Agreement. While it might seem reasonable under most circumstances for Johnson & Johnson to believe that the Secretary can act to bind the Department, under the circumstances of this case, such a belief is not reasonable. In the first place, there is an express statutory provision which unambiguously requires the written approval of the Attorney General to effectuate the compromise of taxes. Although Johnson & Johnson may not have had actual knowledge of the requirement, it had constructive knowledge, since it was codified in the statutes which are available for any taxpayer to consult. In this regard, it is noteworthy that in this instance we are not dealing with a mom and pop taxpayer without the resources or sophistication to consult a statute or a tax service. Johnson & Johnson is a large, multinational company which possesses a staff of competent tax professionals who handle highly complex federal and state tax matters. Additionally, the Secretary of the Department and the Attorney General are obviously separate governmental officials with separate statutory and constitutional duties and obligations. There is no basis for Johnson & Johnson to conclude that the Secretary of the Department had the apparent authority to act for the Attorney General.

Johnson & Johnson also argues that the failure to obtain the approval of the Attorney General was a unilateral mistake of law on the part of the Department which should not relieve the Department from the binding effect of a contract. There was a mistake of law on the Department's behalf in this instance, but it was a mistake shared by Johnson & Johnson. As noted above, Johnson & Johnson is a sophisticated taxpayer with the professional staff and resources necessary to know the legal requirements for compromising taxes. The truth of the matter is that both the Department and

Johnson & Johnson regarded the matter which was the subject of the Tax Settlement Agreement to be a small dollar issue of no significant legal importance. The Department's chief counsel admitted that he gave little thought to the issue of the form of the agreement. He devoted far more attention to the substance of the terms of the agreement. Mr. Robinson, who prepared the draft and final form of the agreement apparently took a similar approach. He gave no attention to the form of the agreement. He made no effort to research New Mexico law on what such agreements require and he had no discussions with Mr. Gallegos about the form of the agreement in their negotiating process. Thus, the mistake about the form of the agreement was a mutual mistake for which Johnson & Johnson also shares some responsibility. Such a mutual mistake is more appropriately grounds for rescission or reformation of the contract, rather than its enforcement. With respect to the particular mutual mistake in this case, reformation is not even a consideration to remedy the mistake where the Attorney General has refused to approve the agreement.

Even though the Tax Settlement Agreement is unenforceable due to its failure to meet the conditions of Section 7-1-20, the issue remains as to whether the Department should be equitably estopped from denying the binding effect of the agreement. As a general rule, courts are reluctant to apply the doctrine of equitable estoppel against the state. This general rule is given even greater weight in cases involving the assessment and collection of taxes. ***Taxation and Revenue Department v. Bien Mur Indian Market***, 108 N.M. 228, 231, 770 P.2d 873, 876 (1989). However, estoppel may be applied against the state when "right and justice demand it". ***United States v. Bureau of Revenue***, 87 N.M. 164, 166, 531 P.2d. 212, 214 (Ct. App. 1975).

Although I as a decision maker must admit a great deal of discomfort in general with the concept of not holding parties to the agreements they have made, upon analysis of the full context of this matter, I must conclude that this matter is not so aggravated or shocking that right and justice require the Department be estopped.

At the hearing, the Department presented a great deal of evidence which would indicate a strong possibility that Johnson & Johnson had knowingly put one over on the Department. Mr.

Robinson negotiated and drafted the Tax Settlement Agreement on behalf of Johnson & Johnson. It was at his suggestion that tax years through 1990 be included in the terms of the settlement. At the time he was negotiating the terms of the Tax Settlement Agreement, Mr. Robinson knew that New Mexico considered foreign source dividends to be includible in a taxpayer's apportionable tax base where a unitary relationship exists between the dividend payor and a taxpayer. Mr. Robinson was also aware that Johnson & Johnson had deducted its foreign dividend income in determining its apportionable tax base for New Mexico commencing with tax year 1987, when it changed its tax filing methodology in New Mexico. Although Mr. Robinson testified that he did not believe that Johnson & Johnson was engaged in a unitary business with its foreign dividend paying subsidiaries, he was aware that the same Multistate Tax Commission audit which gave rise to the liability he was negotiating to settle with New Mexico had concluded that Johnson & Johnson operated a unitary world-wide business with its foreign dividend paying subsidiaries. With respect to other states involved in the MTC audit, this conclusion resulted in the assessment of millions of dollars of additional income tax. Within the year in which the Tax Settlement Agreement was negotiated with New Mexico, Mr. Robinson was also involved in negotiating settlements over these other states' assessments which required Johnson & Johnson to pay more than five million dollars of additional income taxes.

In spite of this evidence, Mr. Robinson testified passionately that at the time he was negotiating the Tax Settlement Agreement with New Mexico that he was not thinking about Johnson & Johnson's potential exposure on its treatment of its foreign dividend income in New Mexico, but was only trying to settle the assessments at issue in New Mexico and to obtain closure through all open tax years. In response to cross examination by the Department's counsel in which counsel asked Mr. Robinson why he wasn't surprised that in negotiating the agreement Mr. Gallegos did not mention the foreign dividend issue Mr. Robinson testified:

> We don't spend our time worrying about New Mexico and the tax department. We've got 39 other states. We've got the federal tax return. I was changing jobs. I'm not sitting there scheming about how we can do the state of New Mexico. *I'm closing an issue.* I'm closing through 1990. I want closure. And I'm not sitting there thinking, well, what might New Mexico come back and say?

Transcript of Proceedings, pp. 234-235. (Emphasis added.)

Frankly, in spite of the evidence that Mr. Robinson might have been trying to "do" the state of New Mexico, I found Mr. Robinson to be credible. I believe that he wasn't really thinking about Johnson & Johnson's exposure on its treatment of its foreign dividend income when he negotiated the Tax Settlement Agreement with Mr. Gallegos. His testimony is also revealing, however, of what I believe to be the crux of this matter concerning estoppel. It reveals that in Mr. Robinson's view, the only issue that he and Mr. Gallegos were negotiating and settling was the issue of nexus involving the Johnson & Johnson subsidiaries which the MTC audit had concluded were taxable by New Mexico. That this is what was in Mr. Gallegos' mind when negotiating the agreement is confirmed by the language of his memorandum to Mr. Katz transmitting the draft Tax Settlement Agreement to Mr. Katz to review. The memorandum indicated that "it involves only the question of nexus on four subsidiaries of Johnson and Johnson for the audit period of 1980, 1981 and 1982." Exhibit S-10. The language of the Tax Settlement Agreement itself provides further confirmation that the nexus issue is what the parties were negotiating. It details not only how the nexus issue will be settled for the audit years, but it also addresses in some detail how the terms of that settlement will be carried forward to the years beyond the audit. In spite of the more general language of paragraph 9, which closes all tax years through 1990 and does not limit the closure to only the nexus issue, it is clear that Mr. Gallegos and Mr. Robinson were focusing on the nexus issue in all of their discussions. This context also explains why Mr. Gallegos did not take the precautionary measure of examining Johnson & Johnson's tax returns for 1987 through 1990 which would have revealed that Johnson & Johnson was deducting the majority of its income prior to determining its New Mexico taxable income. Because the nexus issue was worth only a few thousand dollars per year in taxes, both Johnson & Johnson and the Department considered the settlement to be a rather small potatoes issue. This context was most likely a significant factor as to why neither Mr. Katz, or Mr. Robinson devoted any time or attention to the issue of legal requirements of the form of the agreement to effectuate a binding compromise of taxes. This is not a practice which should be condoned or approved, but it

does indicate the state of mind of the parties when the agreement was negotiated and entered into.

This context thus demonstrates that, in spite of its protestations to the contrary, Johnson & Johnson has gotten essentially what it was negotiating for when it negotiated the agreement. It got settlement of the nexus issue and it got closure on that issue through the open tax years. The Department has not reneged on any aspect of the nexus issue settlement. If it had, a far more compelling case for equitable estoppel would be presented. But that is not this case. It is for this reason that this case is not one in which "right and justice" demand that the Department be estopped.

The supreme court's decision in the ***Bien Mur*** case is also instructive on the issue of estoppel. In that case, a taxpayer was claiming estoppel against the tax department on the basis of oral representations made by a Department employee. The court found that the element of reasonable reliance by the party seeking to assert estoppel was missing in that case. The basis for the court's conclusion was that there exists a statutory provision of the Tax Administration Act, Section 7-1-60 NMSA 1978, which expressly provides for estoppel against the state in taxation matters in only two circumstances. Those are where the taxpayer relies upon a regulation which was in effect during the time the tax liability arose, or where the taxpayer acts in reliance upon a written ruling addressed to him personally and in writing by the director of the Department. The court concluded that Bien Mur could not have reasonably relied upon the oral advice given by the Department employee because of the existence of Section 7-1-60, a provision of which the taxpayer had constructive notice. ***Id.***, 108 N.M. at 231. In this case it would be equally unreasonable for Johnson & Johnson to rely upon the Tax Settlement Agreement to effectuate a binding compromise of taxes where there was no evidence of compliance with the requirements of Section 7-1-20 with regard to the need for written approval of the compromise by the Attorney General.

In addition to a lack of reasonable reliance, the other elements of equitable estoppel also appear to be lacking. As related to the party claiming estoppel, the elements are: (1) lack of knowledge and of the means of knowledge of the truth as to the facts in question; (2) reliance upon the conduct of the party estopped; and (3) action based thereon of such a character as to change his

position prejudicially. ***Westerman v. City of Carlsbad***, 55 N.M. 550, 555-56, 237 P.2d 356, 359 (1951). With respect to the first element, lack of knowledge as to the fact that the agreement may not be enforceable because of the lack of approval by the Attorney General, Johnson & Johnson fails to meet this requirement due to the fact that it was well within its means to obtain this knowledge since it had only to consult the statutes or a tax service to learn of the requirements of Section 7-1-20. Even the third element appears to be lacking in this case. Johnson & Johnson presented no evidence that it had taken any actions based upon the closure of tax years 1987-1990 which had changed its position prejudicially. It only presented testimony as to its reliance upon the Tax Settlement Agreement. At the hearing, Mr. Stanley Stern, Johnson & Johnson's Director of Domestic Taxation testified that Johnson & Johnson always pays its fair share of taxes. Transcript of Proceedings, p. 253, pp. 258-260. If that is the case, then there should be no prejudice to letting the matter of Johnson & Johnson's income tax liability for tax years 1987-1990 proceed to a determination through the administrative and judicial process to determine whether it, in fact, paid its fair share of taxes.

A few other matters raised by the parties also deserve comment. It was stipulated by the parties that the Department had entered into numerous "nexus filing agreements". *See,* Exhibit S-21. These agreements were entered into in situations where there were substantial questions as to whether a taxpayer had sufficient nexus with New Mexico to be subject to tax and a taxpayer agrees to come forward and commence reporting and paying tax in return for the Department agreeing not to audit for prior periods. *See* Exhibits S-18 and S-19 for the Department's policy regarding these agreements. These agreements were not reviewed or approved by the Attorney General. Johnson & Johnson points to these agreements as evidence that the Department entered into numerous agreements without the approval of the Attorney General. While the validity of these agreements is not an issue herein and will not be addressed herein, two things are notable with respect to these agreements. First, by their terms, they do not compromise *assessed* taxes. At most, under their terms the Department may only agree not to conduct audits of past periods to determine if taxes should be assessed. Since by its very terms, a closing agreement may be entered only "after the

assessment of any tax" to "compromise *the asserted tax liability*", the nexus filing agreements do not amount to a closing agreement. Section 7-1-20(A). (Emphasis added.) Secondly, Johnson & Johnson presented no evidence that it was even aware of the existence of this type of agreement at the time it was negotiating the Tax Settlement Agreement. Thus, it could not have relied upon them as an indication that the Attorney General's approval was not necessary for the Tax Settlement Agreement.

The Department argued that there was no additional consideration given by Johnson & Johnson for the Department's agreement to close tax years 1987-1990 when the Tax Settlement Agreement was negotiated. Johnson & Johnson argues that the agreement is a single, indivisible agreement for which adequate consideration was given. Thus, there need be no analysis of the consideration given for each element of the agreement. I agree the agreement is a single, indivisible agreement and I have no reason to second guess the Department's judgement that adequate consideration was given at the time the agreement was negotiated and entered into.

In conclusion, this case amply illustrates the wisdom of the public policy of New Mexico, as expressed in Section 7-1-20, which requires the review and approval of the Attorney General to any agreements which compromise assessed taxes to assure that the interests of the state are adequately protected. In this case, Mr. Gallegos, a well meaning employee with the responsibility to oversee and resolve thousands of administrative tax protests thought he was settling a relatively small dollar tax protest involving only the issue of nexus for six of Johnson & Johnson's subsidiaries and carrying the substance of that settlement forward to the open tax years beyond the years covered by the assessments in protest. Mr. Gallegos understood that the terms of paragraph 9 were broader than just the nexus issue, but he mistakenly failed to review Johnson & Johnson's tax returns to determine if there were any other obvious problems with closing out those years as to all issues. Mr. Katz, the Department's Chief Counsel, in reviewing the draft agreement did not focus on the form of the agreement, but on its substance, and he did not approve of the provision, which due to its ambiguous nature, might close out tax years 1987-1990 as issues going beyond the nexus issue being negotiated.

Unfortunately, there was a failure of communication between Mr. Katz and Mr. Gallegos and the agreement was rewritten only to clarify the ambiguity as to the tax years being closed. These were inadvertent mistakes by well intentioned public servants. The effect of these mistakes, however, have the potential to compromise up to several million dollars of public tax monies for less than $40,000. Obviously, this result would not have adequately protected the fiscal interests of the state. The public policy of this state, however, is that agreements which compromise taxes must receive a second and independent review and approval by the Attorney General. This provides an additional assurance that inadvertent mistakes or oversights by public employees do not operate to the prejudice the public fisc. Because the Tax Settlement Agreement was in clear contravention of the public policy of the state, it is unenforceable. Additionally, because the Johnson & Johnson had constructive notice of the requirement of Attorney General approval, and the parties negotiations focused solely on the nexus issue, right and justice do not demand that the Department be estopped from examining issues other than the nexus issue for the 1987-1990 tax years. For these reasons, Johnson & Johnson's protest with respect to the issue of the enforceability of the Tax Settlement Agreement must be denied.

CONCLUSIONS OF LAW

1. Johnson & Johnson filed timely, written protests to Assessment Nos. 1884894 and 1885005, pursuant to Section 7-1-24 NMSA 1978 and jurisdiction lies over both the parties and the subject matter of this protest.

2. The Tax Settlement Agreement compromised assessed taxes of six subsidiary corporations of Johnson & Johnson.

3. Any compromise of assessed taxes requires the written approval of the Attorney General in order to be effective. Section 7-1-20 NMSA 1978.

4. The Tax Settlement Agreement was not approved by the Attorney General and is therefore unenforceable and void *ab initio*.

5. The Attorney General's office and the Department are separate governmental agencies and no agency relationship or delegation of authority exists by which the Department can act on behalf of or with the apparent authority for the Attorney General with respect to the compromise of taxes by closing agreements.

6. The Taxpayer had constructive knowledge of the requirement of Section 7-1-20 NMSA 1978 that any compromise of assessed taxes must have the written approval of the Attorney General.

7. Because Johnson & Johnson had constructive knowledge of the requirements of Section 7-1-20, it could not have reasonably relied upon the binding effect of the terms of the Tax Settlement Agreement.

8. Johnson & Johnson did not take any actions to its prejudice in reliance upon the terms of the Tax Settlement Agreement which closed tax years 1987-1990.

9. The Department has never had a policy of compromising assessed taxes without the Attorney General's approval.

10. The "nexus filing agreements" do not compromise assessed taxes.

11. Johnson & Johnson did not rely upon the "nexus filing agreements" when negotiating the terms or determining the form the Tax Settlement Agreement.

12. The intent of the parties when negotiating the Tax Settlement Agreement was to compromise the taxes assessed for tax years 1980-1982 concerning the nexus issue with respect to six Johnson & Johnson subsidiaries and to carry the effect of the terms of that settlement forward through the 1990 tax year.

13. Right and justice do not require that the Department be estopped from denying the binding effect of the provision of the Tax Settlement Agreement which closed tax years 1987-1990 for issues other than the nexus issue.

14. The Tax Settlement Agreement was negotiated and entered into as a single, indivisible agreement, for which adequate consideration exists.

For the foregoing reasons, Johnson & Johnson's protest with respect to the issue of the enforceability of the Tax Settlement Agreement IS HEREBY DENIED.

DONE, this 26th day of March, 1996.