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

IN THE MATTER OF THE PROTEST OF
FLUORESCENT TECHNOLOGY INTERNATIONAL, INC. No. 98-40
ID NO. 02-277192-00 1
ASSESSMENT NOs. 2078950, 2078951 and 2078952

## DECISION AND ORDER

A formal hearing on the Taxpayer's protest was held on July 16, 1998, before Margaret B. Alcock, Hearing Officer. Fluorescent Technology International, Inc. ("Taxpayer") was represented by Jeffrey A. Dixon and Daryl Masters, its corporate officers. The Taxation and Revenue Department ("Department"), was represented by Frank D. Katz, Chief Counsel. Based on the evidence in the record and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

## FINDINGS OF FACT

1. The Taxpayer is a small closely-held corporation doing business in New Mexico and is registered with the Department for quarterly payment of gross receipts, compensating and withholding taxes, which are reported under New Mexico's Combined Reporting System (CRS).

2. The Taxpayer was incorporated in March 1995 and began doing business in July 1995. Until July 1996, Daryl Masters, Jeffrey A. Dixon and John McEown were the shareholders, directors, officers and employees of the corporation: The three had previously been in business together in Vancouver, Canada.

3. Mr. McEown was a chartered accountant in Canada, which is the equivalent of a certified public accountant in the United States. Mr. McEown was also a licensed trustee, which is the equivalent of a bankruptcy trustee in this country.

4. Mr. McEown was treasurer of the corporation and was responsible for the Taxpayer's accounting and financial affairs, including the preparation, filing and payment of federal and state taxes.

5. Mr. McEown prepared returns reporting the Taxpayer's unemployment taxes, federal income taxes and New Mexico CRS taxes. Mr. McEown reported to Mr. Masters and Mr. Dixon that all taxes were current and submitted financial statements showing that taxes had been paid.

6. In July 1996, the financial statements prepared by Mr. McEown showed a surplus in the Taxpayer's bank account, and Mr. McEown withdrew approximately $25,000 to repay his share of various expenses before he left on a vacation to Canada.

7. On July 25, 1996, a few days after leaving on his vacation, Mr. McEown called from Canada to say he was not coming back to New Mexico and was resigning from his positions with the corporation.

8. About a month later, the Taxpayer received a nonfiler notice from the Department stating that no CRS-1 returns had been filed for the quarters ending March and June 1996.

9. After hiring an outside accountant and examining the Taxpayer's books and records, Mr. Dixon and Mr. Masters determined that Mr. McEown had not actually filed the tax returns he prepared, nor had he paid any of the Taxpayer's federal and state taxes.

10. On October 3, 1996, Mr. Dixon filed the Taxpayer's CRS-1 returns for the first, second and third quarters of 1996, showing taxes due in the following amounts:

| | |
|---|---|
| Quarter ending March 1996: | $ 3,726.50 |
| Quarter ending June 1996: | $ 3,779.35 |
| Quarter ending September 1996: | $ 3,009.95 |

Mr. Dixon included a letter explaining that the Taxpayer was currently unable to pay the taxes shown on the reports and asking that a payment plan be established.

11. On October 17, 1996, the Department issued Assessment Nos. 2078950, 2078951 and 2078952 assessing penalty and interest on the unpaid balance shown on the Taxpayer's returns.

12. On November 26, 1998, Mr. Dixon requested a retroactive extension of time to file a protest to the Department's assessments. An extension was granted, and on January 8, 1997, the Taxpayer filed a formal protest to the penalty and interest assessed on its unpaid taxes.

13. On December 20, 1996, the Taxpayer paid $2,630.00 of back taxes under a four-month payment plan entered into with the Department. The Taxpayer has been unable to make subsequent payments due under the plan, but is continuing to work with the Department to pay off its outstanding liability.

**DISCUSSION**

The Taxpayer's protest requested abatement of the penalty and interest assessed on its late payment of CRS taxes for the first, second and third quarters of 1996. At the July 16, 1998 hearing, Mr. Dixon acknowledged the Taxpayer's liability for payment of interest. The only issue remaining in dispute is whether the Taxpayer is liable for the negligence penalty assessed under Section 7-1-69(A) NMSA 1978 (1995 Repl. Pamp.), which imposes a penalty of two percent per month, up to a maximum of 10 percent:

> in the case of failure, due to negligence or disregard of rules and regulations, but without intent to defraud, to pay when due any amount of tax required to be paid... [1]

Taxpayer "negligence" for purposes of assessing penalty is defined in Regulation 3 NMAC 1.11.10 (formerly GR 69:3) as:

> (1) failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
>
> (2) inaction by taxpayers where action is required;
>
> (3) inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

In this case, the Taxpayer's late payment of CRS taxes was due to Mr. McEown's failure to report and pay taxes when due and his misrepresentations concerning the Taxpayer's financial condition, which ultimately left the Taxpayer without sufficient funds to pay current taxes. Under the facts presented, Mr. McEown's conduct may well have amounted to fraud. Without question, his actions come within the definition of negligence set out in the Department's regulations.

Mr. Dixon and Mr. Masters argue that they reasonably relied on Mr. McEown to handle the Taxpayer's financial affairs and should not be held liable for his negligence. They point out that Mr. McEown was a licensed accountant and trustee and had fulfilled his financial duties in their Canadian business in a responsible manner. Based on Mr. McEown's representations and the financial statements he prepared, Mr. Dixon and Mr. Masters had no reason to suspect that taxes were not being paid in a timely manner. As soon as they discovered the problem, they acted promptly to bring the Taxpayer's CRS filing current and try to work out a payment plan.

---

[1] Section 7-1-69 was amended effective July 1, 1996. The amendment did not change the quoted language of Subsection A, which was taken from the 1995 Replacement Pamphlet.

In closing argument, the Department acknowledged that it has abated the negligence penalty in some cases involving embezzlement or other illegal acts of a taxpayer's employees. The Department did not abate penalty in this case because the law treats the conduct of corporate officers differently than the conduct of lower level employees when determining whether a corporation is liable for penalties. This distinction goes back to the 1800s. In *Lake Shore & Michigan Southern Railway Company v. Prentice*, 147 U.S. 101 (1893), the United States Supreme Court held that a railroad was not liable for punitive damages for the illegal conduct of one of its conductors. The Court differentiated between the actions of a corporate officer "wielding the whole executive power" of the corporation and the actions of an employee or subordinate agent. The conduct of the corporation's president or vice president

> may well be treated as so far representing the corporation and identified with it that any wanton, malicious, or oppressive intent of his, in doing wrongful acts in behalf of the corporation to the injury of others, may be treated as the intent of the corporation itself; but the conductor of a train, or other subordinate agent or servant of the railroad corporation, occupies a very different position...."

147 U.S. at 114. In *Coulliard v. Bank of New Mexico*, 89 N.M. 179, 548 P.2d 459 (Ct. App. 1976), the New Mexico Court of Appeals applied the *Lake Shore* approach to hold that the Bank of New Mexico was not liable for punitive damages for the fraudulent conduct of a corporate officer who did not represent "the whole executive power" of the bank. In the later case of *Cornell v. Albuquerque Chemical Co., Inc.*, 92 N.M. 121, 126, 584 P.2d 168, 173 (Ct. App. 1978), the court reached the opposite result, finding that the defendant's vice president "wielded the executive power of the corporation" and that his wrongful acts "were the acts of defendant."

In 1994, the New Mexico Supreme Court expressly rejected the rule that a corporation can be held liable for punitive damages only for the conduct of officers or agents who wield the "whole

executive power" of the corporation. In *Albuquerque Concrete Coring Company, Inc. v. Pan Am World Services, Inc*., 118 N.M. 140, 146, 879 P.2d 772, 778 (1994), the court adopted the broader rule set out in Section 217(C) of the Restatement (Second) of Agency, holding that liability for punitive damages can be based on evidence that the wrongdoer was acting in a managerial capacity: "When a corporate agent with managerial capacity acts on behalf of the corporation...his acts are the acts of the corporation; the corporation has participated."

Reviewing the evidence in this case, I find that Mr. Dixon and Mr. Masters acted responsibly in their roles as directors and corporate officers. Given Mr. McEown's financial training, it was reasonable for them to rely on his expertise. The business was in operation barely a year when Mr. McEown resigned. This was not so long a period that the other officers should be considered negligent for failing to discover the Taxpayer's accounting problems. Had the assessments been issued against Mr. Dixon and Mr. Masters individually, I would have no hesitation in abating the penalty. In this case, however, the assessments were issued against the corporation—not against its individual officers and directors.

Until July 1996, the Taxpayer had three corporate officers. There is no question that John McEown, as treasurer, acted for the Taxpayer in a managerial capacity. Mr. McEown's failure to report and pay New Mexico CRS taxes was as much an act of the corporation as Mr. Dixon's and Mr. Masters's later efforts to correct the problem. Although Mr. Dixon argues that the test used to determine corporate liability should not apply to small closely-held corporations, he has not provided legal authority to support this position. Nor is there any apparent policy reason for holding that a large corporation is liable for penalties arising out of the misconduct of its corporate officers while a small corporation is not. The law does not allow the Taxpayer to disavow the actions of one corporate officer

and ask the Department to make its determination of negligence based solely on the actions of the other two. The Taxpayer is liable for penalties attributable to the negligent acts of Mr. McEown.

**CONCLUSIONS OF LAW**

1. The Taxpayer filed a timely, written protest to Assessment Nos. 2078950, 2078951 and 2078952, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer was negligent in failing to pay its CRS taxes for the first, second and third quarters of 1996 in a timely manner, and the negligence penalty was properly imposed under Section 7-1-69(A), NMSA 1978.

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

DONE, this 21st day of July 1998.