

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

**IN THE MATTER OF THE PROTEST OF  
MZA ASSOCIATES CORPORATION  
ID NO. 02-202518-00 9  
ASSESSMENT NOS. 2594885 through 2594897**

**No. 01-16**

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held July 30, 2001, before Margaret B. Alcock, Hearing Officer. MZA Associates Corporation ("MZA") was represented by its attorney, Gary D. Eisenberg, Esq., Betzer, Roybal & Hill, P.C. The Taxation and Revenue Department ("Department") was represented by Donald F. Harris, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

**FINDINGS OF FACT**

1. MZA, which began business in 1991, is a federal contractor involved in developing software for the government.
2. In 1995, MZA hired a woman named Michelle as its office manager.
3. Michelle's duties were extensive and included responsibility for MZA's financial records and accounting system. She was in charge of reviewing MZA's monthly bank statements and balancing its accounts and was also authorized to sign checks and tax returns on behalf MZA.
4. Beginning in July 1997, Michelle's filing of monthly CRS returns used to report the corporation's gross receipts, compensating and withholding taxes to New Mexico, became erratic and she eventually stopped filing returns altogether.

5. In November 1997, MZA was broken into and all its computers and software, including its accounting system, were stolen. MZA's backup accounting system had some problems and was not completely accurate after the robbery.

6. From July 1997 through September 1999, Michelle continued to be sporadic in filing MZA's CRS returns. For several months, she prepared the returns and wrote checks to cover the taxes due, but never mailed the returns or payments to the Department. Many of the returns she did file were prepared incorrectly.

7. During this period, Michelle used the corporation's credit card for personal expenses and also wrote several checks to "cash" with no accounting entries to show how the money was spent. The combined value of unauthorized charges and checks was about \$30,000.

8. MZA's corporate officers did not review the corporation's financial or tax records on any regular basis, but left MZA's financial operations completely up to Michelle. For this reason, they were not aware that Michelle was not filing the corporation's tax returns.

9. At some point, the corporate officers realized Michelle had not prepared the annual "incurred cost submissions" MZA was required to submit under the terms of MZA's government contracts.

10. In March 1999, MZA hired Edward J. Cunion, III, in the newly created position of Controller.

11. Mr. Cunion's primary task was to prepare 1997 and 1998 "incurred cost submissions" to bring MZA into compliance with its government contracts. Mr. Cunion reviewed all of the corporation's invoices and traced each invoice to MZA's bank statements to insure the company had actually incurred the costs charged to the government.

12. In the process of reconciling MZA's checkbook to its bank statements for the 1997 calendar year, Mr. Cunion noticed that starting in July 1997, there were no checks in payment of New Mexico CRS taxes or, in some cases, that the checks written to pay taxes had never been cashed.

13. Mr. Cunion discovered the problem with MZA's 1997 taxes in November 1999. He asked Michelle whether there were any other nonfiled tax periods, and she said no, indicating that all other returns had been filed.

14. Mr. Cunion notified MZA's corporate officers of the problem and began work on preparing MZA's CRS returns for the period July through December 1997.

15. November 1999 was the last month of the Department's three-month "Amnesty Program", under which the state waived the imposition of interest and penalty on payments of outstanding tax liabilities made during the amnesty period.

16. Mr. Cunion was able to file MZA's delinquent 1997 CRS returns, together with a payment of \$65,000 in tax principal, before the end of the amnesty period. As a result, interest and penalty were waived for these months.

17. Mr. Cunion continued his investigation into the 1998 and 1999 calendar years. He realized there were additional problems with MZA's tax accounts, but his work was hampered by the fact that Michelle refused to give him access to certain bank statements and other financial records.

18. Mr. Cunion discussed the situation with MZA's president. The president spoke to Michelle, but she continued to delay the production of documents.

19. In September 2000, Michelle was fired and Mr. Cunion took over her duties.

20. Shortly after Michelle left the company, Mr. Cunion discovered CRS returns for July 1998 and October 1998 through September 1999 in her desk. It did not appear the returns had been

filed. When Mr. Cunion reviewed MZA's bank statements, he found that checks had been written to cover the tax liabilities but had never cleared the bank.

21. In October 2000, Mr. Cunion filed MZA's delinquent CRS returns without payment.

22. On November 8, 2000, the Department issued Assessment Nos. 2594885 through 2594897 to MZA, assessing \$84,341.52 gross receipts tax, \$36,474.99 withholding tax, \$27,880.70 interest, and \$12,081.67 penalty for tax periods July 1998 and October 1998 through September 1999.

23. On December 6, 2000, MZA filed a written protest to the penalty portion of the assessments.

24. In January 2001, MZA made a \$21,000 payment toward its outstanding tax liability and has continued to make regular monthly payments to the Department.

### **DISCUSSION**

The sole issue to be determined is whether penalty was properly assessed against MZA for tax periods July 1998 and October 1998 through September 1999. Section 7-1-17(C) NMSA 1978 provides that any assessment of taxes made by the Department is presumed to be correct. Section 7-1-3(X) NMSA 1978 defines tax to include not only the amount of tax principal imposed but also, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." Accordingly, the presumption of correctness of an assessment of taxes applies to the assessment of penalty. *See also, El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989).

Section 7-1-69 NMSA 1978 governs the imposition of penalty. Subsection A imposes a penalty of two percent per month, up to a maximum of ten percent when a taxpayer fails "due to negligence or disregard of rules and regulations" to pay taxes or file required tax reports in a timely

manner.<sup>1</sup> Taxpayer negligence for purposes of assessing penalty is defined in Regulation 3.1.11.10

NMAC as:

- A. failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
- B. inaction by taxpayers where action is required;
- C. inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

In this case, MZA's failure to timely file its monthly gross receipts tax reports was attributable to two factors: (1) the inaction of MZA's office manager and (2) the lack of attention paid to the financial and tax aspects of the business by MZA's corporate officers. Both of these factors support imposition of the negligence penalty.

*Inaction of the Office Manager.* In 1995, MZA hired a woman named Michelle as its office manager. Michelle was given responsibility for almost every aspect of the routine management of the business, including filing and payment of the company's taxes. Beginning in July 1997, Michelle's filing of New Mexico gross receipts tax returns became erratic, and she eventually stopped filing returns altogether. MZA did not introduce any evidence to explain Michelle's actions or suggest a motive for her failure to file returns. There is nothing to indicate she was ill or had suffered an emotional breakdown, nor is there any evidence she was embezzling the tax funds. Although Mr. Cunion discovered some unauthorized credit card charges and unexplained checks made out to cash, these amounts did not correspond to the delinquent tax liabilities: the total of the credit card charges and checks was about \$30,000; MZA's unpaid tax liability exceeded \$120,000.

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<sup>1</sup> Based on a notation on the Department's assessment, MZA contends it was assessed only for late filing, and the issue of late payment is not relevant to this protest. The Department disagrees, arguing that the penalty was assessed for both late payment and late filing. Because there is sufficient evidence to support imposition of penalty based solely on MZA's late filing of its gross receipts tax reports, there is no need to address this issue.

The reason for Michelle's behavior remains a mystery. There is no dispute, however, that she failed to carry out her responsibility to file MZA's gross receipts tax returns in a timely manner. Under the doctrine of *respondeat superior*, her inaction is attributable to her employer and justifies imposition of the penalty against MZA. Although not raised at the formal hearing, MZA's original protest argued that the actions of non-managerial employees should not be imputed to their corporate employer. This argument is based on the distinction New Mexico courts have drawn with respect to liability for punitive damages. *See, e.g., Albuquerque Concrete Coring Company, Inc. v. Pan Am World Services, Inc.*, 118 N.M. 140, 879 P.2d 772 (1994). The Court of Appeals has held, however, that this distinction does not apply to the imposition of the negligence penalty under Section 7-1-69(A) NMSA 1978 because that penalty "bears no resemblance to punitive or exemplary damages, which are limited to punishment of conduct that is intentional." *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 798, 779 P.2d 982, 985 (Ct. App. 1989). As case law confirms, delegating tax responsibilities to an employee or other agent will not relieve the employer of its liability for penalty when the employee is negligent in performing his or her duties.

*Inattention of MZA's Corporate Officers.* The most direct cause of MZA's failure to file tax returns was the inaction of its office manager, but the failure was also attributable to the inattention of MZA's president and vice president. The evidence establishes that the corporate officers delegated their entire responsibility for many key aspects of the business to Michelle, including the authority to sign checks and file tax returns. There is nothing in the record to justify their apparent confidence in her honesty and abilities. The only witness to testify on behalf of MZA was Mr. Cunion, who had no knowledge of Michelle's education or qualifications. Mr. Cunion did note, however, that several tax returns Michelle prepared were incorrect. After reviewing these returns, Mr. Cunion concluded that she did not even understand the reporting period to which monthly CRS returns applied. Until Mr.

Cunion took over Michelle's duties, there was no system of checks and balances and no procedure for corporate officers to review the corporation's outgoing payments, invoices, tax returns or statements of account. Mr. Cunion gave his opinion that it is prudent for corporate officers to review such documents on a regular basis, and he has now instituted such a system within the corporation.

MZA points to the work of Mr. Cunion, both in uncovering MZA's tax problems and in taking prompt steps to correct them, as evidence that the corporation exercised ordinary care and prudence in the conduct of its business. MZA was indeed prudent in hiring Mr. Cunion to audit its books and correct the errors in its accounting system. This does not excuse the years of negligence that preceded this decision. Prior to the time Mr. Cunion became MZA's Controller in March of 1999, the corporation allowed a single employee to have complete control over the company's accounting system. This employee was responsible for, among other things, picking up the mail, sending out invoices, writing checks, balancing the bank statements and filing tax returns. There was no mechanism in place for anyone to review her activities, and more than two years passed before obvious errors and omissions were discovered in MZA's financial records. Based on the corporate officers' inattention, inaction, and apparent indifference to their corporate responsibilities, imposition of the negligence penalty was justified.

### **CONCLUSIONS OF LAW**

1. MZA filed a timely, written protest to Assessment Nos. 2594885 through 2594897, and jurisdiction lies over the parties and the subject matter of this protest.
2. MZA was negligent in failing to file its monthly CRS returns in a timely manner and penalty was properly imposed pursuant to Section 7-1-69(A) NMSA 1978.

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

DATED August 1, 2001.