

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

**IN THE MATTER OF THE PROTEST OF
EUGENE K. BAKER
ASSESSMENT NOS. 2462271 and 2490193**

No. 01-30

DECISION AND ORDER

A formal hearing on the above-referenced protest was held August 28, 2001, before Margaret B. Alcock, Hearing Officer. Eugene K. Baker 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 19, 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 and Mr. Baker were the only persons who had signature authority on DKA's bank accounts.

5. Mr. Baker was primarily responsible for the day-to-day business operations of DKA and routinely signed DKA's tax returns and checks, although Mr. Dean signed such documents on occasion.

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

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

8. Mr. Baker was the person who decided which of DKA's bills would be paid first, although he usually made these decisions in consultation with Mr. Dean.

9. 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.

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

11. Although Mr. Baker planned to pay the delinquent CRS taxes once DKA's business improved, the business never generated enough cash to cover all of DKA's liabilities, and the CRS taxes due for the period 1991 forward were never paid.

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

13. 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.

14. 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 at \$8,688.69 per year, based on the average of the taxes due for 1997 and 1998.

15. At the hearing on his protest, Mr. Baker introduced additional records that were in the possession of Charles W. Orr, DKA's certified public 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. Baker did not provide any evidence concerning withholding taxes due for tax years 1992, 1993 or 1999.

16. Following the audit, the Department's computer system generated Assessment No. 2462271 to DKA in the total amount of \$144,990.51, representing CRS taxes, penalty and interest due for the period January through December 1992. At the hearing, the Department was unable to present evidence to establish whether—or when—Assessment No. 2462271 was mailed to DKA.

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

18. On February 18, 2000, the Department mailed an assessment to Eugene K. Baker in the total amount of \$112,043.62, representing the withholding tax portion (including related penalty and interest) of Assessment Nos. 2462271 and 2490193.

19. The assessment issued to Mr. Baker was not assigned a new number, but reflected the same numbers previously used in the assessments issued to DKA. The assessment issued to Mr. Baker 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."

20. 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.

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

22. During the August 28, 2001 hearing, the Department acknowledged that it could not determine whether Assessment No. 2462271 had been issued to DKA or Mr. Baker within the seven-year statute of limitations for assessing nonfiled periods. Based on the absence of such evidence, the Department stated that it would abate the 1992 portion of withholding tax, penalty and interest assessed against Mr. Baker.

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

DISCUSSION

The issue to be decided is whether Eugene K. Baker 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. Baker raises the following arguments in support of his protest: (1) the manual assessment issued to him on February

18, 2000 was not a valid assessment because it did not have a unique assessment number that could be identified by the Department's computer; (2) Section 7-1-18 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 only became a "taxpayer" after he was assessed by the Department; and (3) the Department's estimate of withholding tax due should be adjusted to reflect the actual withholding tax shown on business records introduced at the hearing.

Liability for Withholding Tax. Before addressing the specific issues raised by Mr. Baker, a brief overview of New Mexico's withholding tax statutes will be useful. 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. Baker 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, Mr. Baker admitted that he was the corporate officer primarily responsible for DKA's business operations, that he had authority to sign tax returns and checks on behalf of DKA, and that he made a conscious decision not to pay the amounts withheld from employee paychecks over to the state but to use the money to pay other creditors of the corporation. Based on these facts, there is no question that Mr. Baker is personally liable for the withholding taxes DKA failed to pay to the state. The only issue is whether the Department's assessment against Mr. Baker met the statutory requirements set out in the Tax Administration Act.

Use of the Same Assessment Number to Assess Different Taxpayers. The assessment the Department issued to Mr. Baker 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. Baker 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. Baker 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. Baker 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 completely 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. Baker met all the requirements of Section 7-1-17 NMSA 1978 and was a valid assessment.

Limitation Periods for Issuing Assessments. Mr. Baker 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 NMSA 1978 is applicable to Mr. Baker 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. Baker 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. Baker'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. Baker 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. Baker 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. Baker 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 NMSA 1978, Mr. Baker 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. Baker under the seven–year limitation period set out in Section 7-1-18(C) NMSA 1978.

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 28, 2001 hearing on his protest, Mr. Baker introduced general ledger pages, payroll earnings statements and W-2s that

had been in the possession of Charles W. Orr, DKA's certified public accountant. Mr. Baker testified that he had seen the documents before and that they were the type of documents Mr. Orr maintained on behalf of DKA. The Department's auditor testified that they were the type of business records the auditors would have relied upon during the audit. These records, together with the records produced during the audit, established that the following taxes were deducted from employee paychecks during 1994 through 1998:

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

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

In its written closing, the Department objected to the admission of the additional records, arguing that the "hearing officer should not adjust the amount found to be due by the Department where the taxpayer was afforded every opportunity to submit its documents to verification prior to the hearing. To rule otherwise would be to send a signal to the tax bar that last-minute surprises are welcome and effective." The Department's claim of prejudicial surprise is unconvincing. Mr. Baker'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. Baker'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 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. Eugene K. Baker 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. The February 2000 assessment issued to Mr. Baker met all the requirements of Section 7-1-17 NMSA 1978 and was a valid assessment.

3. Mr. Baker 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. Baker for these taxes under the seven-year limitations period set out in Section 7-1-18(C) NMSA 1978.

4. The additional withholding tax records Mr. Baker 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. Baker's protest IS GRANTED IN PART AND DENIED IN PART. Mr. Baker'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 A. With regard to all other issues, Mr. Baker's protest is denied.

DATED November 1, 2001.

