

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

**IN THE MATTER OF THE PROTEST OF
MR. HUBCAP, INC.
ID NO. 01-176426-00-0
ASSESSMENT NOS. 3913634 through 3913636,
3917025 through 3917028, and 3917099 through 3917102**

No. 03-10

DECISION AND ORDER

A formal hearing on the above-referenced protest was held June 5, 2003, before Margaret B. Alcock, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Peter Breen, Special Assistant Attorney General. Mr. Hubcap, Inc. ("Taxpayer") was represented by Mark Sivert, its president. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is a family-owned business that is registered with the Department for payment of gross receipts, compensating, and withholding taxes, which are required to be paid monthly under the Department's combined reporting system ("CRS").
2. Mark Sivert is the president of the company, and he and his brother manage the day-to-day operation of the business. From 1977 through 1998, their sister did the bookkeeping for the business. During this period, the Taxpayer had an exemplary tax reporting history with the Department.
3. In 1998, Mr. Sivert's sister retired and his wife took over as bookkeeper.
4. In 2000, Mr. Sivert's wife suffered a stroke. At that time, a family friend named Bonnie was hired to perform the bookkeeping duties for the business.

5. Bonnie was responsible for all of the Taxpayer's accounting procedures. This included depositing the money collected by the business each day, balancing the checkbook each month, making out the checks to pay taxes and other bills, preparing the Taxpayer's monthly CRS returns, and providing information to the Taxpayer's CPA, who prepared the Taxpayer's state and federal income tax returns.

6. Bonnie was not authorized to sign tax returns or checks on behalf of the Taxpayer. Once the returns and checks were prepared, she brought them to Mr. Sivert or his brother for review. After the returns and checks were signed, Bonnie was responsible for making sure they were mailed in a timely manner.

7. For the months of August and September 2000, April through December 2001, and continuing into 2002, Bonnie failed to pay the Taxpayer's CRS taxes.

8. During this same period, Bonnie began embezzling funds from the business. The embezzlement was accomplished in two ways: (1) Bonnie had Mr. Sivert's brother sign blank checks or checks made out to cash and told him they were for office supplies or other items for the business. Bonnie subsequently cashed the checks and diverted the funds to her own use. (2) Bonnie made checks out to herself and forged the signature of Mr. Sivert's brother on those checks.

9. Mr. Sivert and his brother trusted Bonnie completely and never reviewed or questioned how she was handling the Taxpayer's financial operations.

10. Mr. Sivert never checked to see whether Bonnie was making the Taxpayer's monthly CRS tax payments in a timely manner.

11. Mr. Sivert and his brother never looked at the monthly bank statements for the business, nor did they ask their outside accountant to do so.

12. Because the Taxpayer did not have internal controls in place, Mr. Sivert and his brother did not realize that Bonnie had stopped paying taxes and was diverting money from the business to her personal use.

14. On August 13, 2002, the Department assessed the Taxpayer for CRS taxes, plus interest and penalty, due for reporting periods August and September 2000, and April through December 2001.

15. Upon receiving the assessments and notices from other creditors, Mr. Sivert and his brother began an investigation to determine why taxes and other bills were not being paid.

16. Upon review of the Taxpayer's bank statements, Mr. Sivert's brother realized that his signature had been forged on several checks and that the blank checks he signed at Bonnie's request had been made out to Bonnie or to cash, instead of to the various vendors from whom Bonnie claimed to have purchased supplies.

17. On August 19, 2002, the Siverts notified the Albuquerque Police Department and filed an incident report concerning Bonnie's forgery and embezzlement.

18. On September 10, 2002, the Taxpayer filed a written protest to the \$661.10 of penalty assessed by the Department.

DISCUSSION

The issue to be determined is whether the Taxpayer is liable for penalty on the late payment of CRS taxes due for reporting periods August and September 2000 and April through December 2001. 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 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." *See also, El Centro Villa Nursing Center v. Taxation and*

Revenue Department, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989). Accordingly, the presumption of correctness applies to the assessment of penalty at issue in this case, and it is the Taxpayer's burden to present evidence and legal arguments to support an abatement.

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. Taxpayer negligence for purposes of assessing penalty is defined in Regulation 3.1.11.10 NMAC 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.

Here, the Taxpayer's failure to pay CRS taxes is attributable to the illegal activities of its bookkeeper and to its own lack of internal financial controls.

Illegal Activities of the Bookkeeper. During the periods at issue, the Taxpayer's bookkeeper stopped sending required CRS payments to the Department. Under the doctrine of *respondeat superior*, an employer is generally liable for the acts of its employee if the wrongful acts are committed in the course and scope of employment. An employee who steals or embezzles is not acting in the interests of his or her employer, but is acting from some independent, personal motive. *See*, UJI 13-407; *Los Ranchitos v. Tierra Grande, Inc.*, 116 N.M. 222, 227, 861 P.2d 263, 268 (Ct. App. 1993). In this case, the bookkeeper's failure to make required tax payments coincided with her illegal activities and appears to have been part of her overall scheme to divert the Taxpayer's funds

to her own use. Accordingly, these acts cannot be attributed to the Taxpayer under the doctrine of *respondeat superior*.

Lack of Safeguards in Accounting System. While the most direct cause of the Taxpayer's failure to make timely tax payments was the illegal acts of its bookkeeper, the failure was also attributable to the lack of accounting safeguards maintained by the Taxpayer. The evidence establishes that Mr. Sivert and his brother delegated total responsibility for the Taxpayer's accounting operations to their bookkeeper. As a result, the bookkeeper had complete and unsupervised control over the deposit of funds to the Taxpayer's account, the payment of taxes and other bills, the reconciliation of the Taxpayer's monthly bank statements, and the opening of all mail coming to the Taxpayer. The one safeguard that was in place—reserving signature authority over the bank account to the principals of the business—was undermined by the willingness of Mr. Sivert's brother to sign blank checks and checks made out to cash. This allowed the bookkeeper to divert money from the Taxpayer's account to her own use.

It is understandable that a small business may not have the resources to assign more than one employee to perform the company's routine bookkeeping and office duties. In that situation, however, it is incumbent upon the company's principals to regularly review the monthly bank statements and accounting records or to arrange for an outside accountant to do so on their behalf. In this case, the Taxpayer was the victim of an unscrupulous employee and had no intention of cheating the State of New Mexico of taxes due. The fact remains, however, that the employee could not have carried out her scheme (and probably would not have tried) if procedures had been in place to detect her forgery and diversion of funds. The Taxpayer was negligent in giving such complete and unsupervised control over its accounting system to a single employee, and penalty was properly imposed under Section 7-1-69 NMSA 1978.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment Nos. 3913634 through 3913636, 3917025 through 3917028, and 3917099 through 3917102, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer was negligent in failing to have a system of internal financial controls or to properly supervise its bookkeeper's activities, and penalty is due under Section 7-1-69 NMSA 1978.

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

DATED June 12, 2003.