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

IN THE MATTER OF THE PROTEST OF
ORION TECHNICAL RESOURCES, L.L.C. **No. 12 -02**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L1674580608

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on September 16, 2011, before Sally Galanter, Hearing Officer, in Santa Fe, New Mexico. The Taxation and Revenue Department ("Department") was represented by Department Staff Attorney, Mr. Lewis Terr. Orion Technical Resources LLC ("Taxpayer") was represented by Ms. Patricia Tucker, Esq. In addition to the documents contained in the administrative file articulated at the beginning of the hearing, the following documents are admitted into the record: Joint Stipulated Documents #1 through #28, Department Exhibit #1, Taxpayer Exhibit A, Closing Arguments and Replies to Closing Argument. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Taxpayer is a Limited Liability Company created in 2006 and based in Albuquerque, New Mexico. Taxpayer was created as a small northern New Mexico female owned business to facilitate the bidding on a prospective contract ("VMS Contract") with Los Alamos National Security ("LANS").

2. Before Stanford University was awarded the defense contract for Los Alamos operating the labs as LANS, the Regents of the University of California had the contract for Los Alamos National Labs ("LANL"). When LANS took over the contract all contracts entered into by LANL were affirmed by LANS and continued in full force and effect through the date of the award of the VMS Contract in June 2009. Joint Stipulated Exhibits 21 and 22.

3. Mrs. Maria Estela de Rios (Mrs. Rios) is Taxpayer's President and CEO. Her husband, Dr. Miguel Rios is Taxpayer's managing member.

4. Prior to the VMS Contract being tendered for bid, in 1995, LANL awarded four individual service contracts for temporary technical employees for work at the labs to different contractors.

5. The contracts were slated to be re-bid in 1999 with new contracts awarded in 2000. The four contracts were to be consolidated into one contract, the VMS Contract. The VMS Contract was in fact not bid until 2007 and was awarded in 2009.

6. LANL, rather than solicit bids in 1999, extended the contracts numerous times allowing the four contractors to continue their work with the labs through June 30, 2009.

7. The VMS Contract was to provide a price preference to a small New Mexico owned company. To fit within LANS' restrictions for a "small" company, the VMS Contract restricted the successful bidder's annual income for the prior three years to $12,000,000.00 per year. Additionally, the VMS contract required that the successful bidder supply a complex computer software Vendor Management System.

8. The prospective VMS Contract was attractive to Dr. and Mrs. Rios, Taxpayer's principals, because the contract was worth at least $400,000,000.00 with an anticipated five-year additional option and with potential extensions the contract could be worth approximately $1,000,000,000.00.

9. Years before the anticipated bid, Dr. and Mrs. Rios, aware of this preference, began

investigating the possibility of creating a small New Mexico-owned company that could successfully compete for the VMS Contract.

10. In their investigation Taxpayer's principals determined that it would be a significant advantage to team with one of the current four contractors, prior to the bidding of the VMS Contract, in order to have the inside track for the upcoming bid as none of the four current contractors could qualify to be awarded the contract due to LANS' expected new requirement for a highly technical computer-based management system ("VMS") and the prior three-year gross monetary income limitation.

11. Taxpayer's principals determined that teaming with a current contractor, and thereby becoming an incumbent, would ensure the optimal position for bidding the VMS contract.

12. Taxpayer's principals, through their trusted consultant, Mr. John Emery, investigated the four contractors and determined that W. A. Technical Services Inc., ("WATS"), an Illinois corporation, was the most suitable company to team with to become an incumbent. The sole motivation for partnering with WATS was to acquire incumbency status.

13. On June 15, 2004, the Department issued Assessment Letter ID No. L0854109184 to WATS for unpaid gross receipts tax in the principal amount of $434,727.65, plus interest, for tax periods 01/31/2001 through 06/30/2003. No penalty was assessed. Department Exhibit 1.

14. Mr. Emery, in his investigation of WATS, discovered that WATS was having difficulty meeting its financial obligations including its payroll obligations and its loan to an Illinois bank. Taxpayer loaned $310,000.00 to WATS to meet its payroll obligations in exchange for a second secured position. Joint Stipulated Exhibit 19.

15. Taxpayer, concerned with the possibility of LANL/LANS cancelling the WATS contract, determined to purchase WATS stock in June, 2006.

16. In the June 30, 2006, the Stock Purchase Agreement was signed on Taxpayer's behalf by its member John Emery. Taxpayer purchased all of the outstanding shares and capital stock of WATS for $100,000.00. The agreement acknowledged the outstanding debt to the Department. The agreement provided a payment plan for payment of the debt with funds recovered from disputed unpaid fees owed by LANL/LANS, to WATS for services completed prior to the purchase of the stock. Joint Stipulated Exhibit 16 and 17.

17. Before Taxpayer's purchase of the WATS stock, none of the shareholders, or individuals involved with WATS, were associated with any of Taxpayer's principals, members or officers. Joint Stipulated Exhibits 1 – 11.

18. The Stock Purchase Agreement required that all communications to buyer, Taxpayer, be addressed as follows: Orion International Technologies, Inc. 2201 Buena Vista Dr. S.E. Suite 211, Albuquerque, New Mexico 87106, Attention: Dr. Miguel Rios Jr., PhD. The agreement provided for the resignation of prior personnel including any position as an officer, director, and/or employee of the Company. After the stock sale, Taxpayer, through its managing member, selected and changed the officers, directors and registered agent of WATS. Joint Stipulated Exhibits 12 – 16.

19. From June 30, 2006, through March 30, 2007, Dr. Rios and Robert Richmond, an employee of another of the Rios' businesses, Orion International Inc, conducted WATS' business with Taxpayer, taking over the WATS contract operations and fulfilling the requirements of the LANL/LANS contract.

20. Thereafter, both the 2006 Illinois Annual Corporate Report for WATS and its NM Public Regulation Commission Foreign Corporate report recognized Dr. Miguel Rios as President and Director and Mr. Robert Richmond as Vice-President, Secretary and Director of WATS and provided as WATS' address the same address as was provided for Taxpayer in all documentation. Joint Stipulated Exhibits 12 - 15.

21. The only valuable and primary asset owned by WATS, other than a few minor purchase agreements, was the LANL/LANS contract. The only value of the contract to Taxpayer was the ability for Taxpayer to become an incumbent prior to the VMS Contract bid.

22. WATS was not terminated by LANL/LANS. Taxpayer purchased the stock and took over operation of WATS until it purchased the assets of WATS. Joint Stipulated Exhibits 16 – 21.

23. Taxpayer was in a position to be a successor to WATS and become an incumbent due to teaming with WATS.

24. LANS acknowledged Taxpayer's purchase of the WATS stock and worked with Taxpayer to affect its fulfilling the WATS contract with LANS until the award of the VMS Contract. Joint Stipulated Exhibit 18.

25. On January 7, 2007, a Novation Agreement was signed between WATS, Taxpayer and the Board of Trustees of Stanford University, LANS' contractor, in which Taxpayer was recognized as the successor party to the WATS contract with LANS as of June 2, 2006. Taxpayer acknowledged its assumption of all obligations and liabilities and all claims against WATS under the contract as if Taxpayer was the original party to the contract. This Novation Agreement was not the agreement which Taxpayer's principals indicated was non-negotiable when signed. Joint Stipulated

Exhibit 22.

26. While Taxpayer's principals intended to complete the teaming process with WATS in a single transaction, due to WATS' financial issues, the stock was purchased in June, 2006, and the assets were purchased nine months later on March 30, 2007. Joint Stipulated Exhibits 16, 19 and 20.

27. If Taxpayer kept the WATS stock, WATS' income for the prior three years would be included in Taxpayer's overall income pushing Taxpayer above the "small" Northern New Mexico company threshold, making it ineligible to bid on the VMS Contract. This restriction prevented the four incumbent contractors from bidding on the VMS contract.

28. Taxpayer determined to sell the WATS stock to enable it to bid the VMS Contract but to hold on to the LANL/LANS contract to retain its incumbency status.

29. On March 30, 2007 Taxpayer purchased all of the assets of WATS, including the essential LANL/LANS contract, for a total purchase price of $1,443,754.00. In the purchase, Taxpayer assumed the loan to the Illinois bank, certain trade accounts payable and payroll taxes and Taxpayer acknowledged its payroll loan to WATS of $310,934.00. Taxpayer listed WATS' obligation to the Department as a liability not assumed along with two other minor liabilities. There was no value assigned to goodwill. Joint Stipulated Exhibit 19.

30. Conflicting with the listing in the Asset Purchase Agreement that Taxpayer was not assuming the obligation to the Department as a liability (Schedule F), Taxpayer acknowledged in the same agreement that it would pay $5,000 of its monthly proceeds from its note to pay down "its obligation to New Mexico Taxation and Revenue." (Paragraph 3.3). Joint Stipulated Exhibit 19.

31. Taxpayer's address is the listed address in the agreement for both the seller and the

purchaser. Mrs. Rios signed the agreement as Taxpayer's President and CEO and Robert Richmond signed as WATS' Director. Joint Stipulated Exhibit 19.

32. On March 30, 2007, another Novation Agreement was signed. This agreement was signed by Taxpayer, WATS and LANS allowing Taxpayer to obtain the subcontract with LANS and continue fulfilling the WATS contract through the award of the VMS Contract. The agreement is on Taxpayer's letterhead and acknowledged WATS' contract with LANL/LANS, the Asset Purchase Agreement, Taxpayer's purchase of WATS' assets and Taxpayer's assumption of all of WATS' obligations and liabilities pursuant to the contract. LANS indicated its recognition of Taxpayer as the successor to the WATS contract. This agreement was signed by Dr. Rios as the President and sole shareholder of WATS and as Taxpayer's managing member. It was also signed by Mrs. Rios as Taxpayer's President and CEO. Robert Richmond signed as Vice-President and Secretary of WATS who certified Dr. Rios' position as President of WATS. John Emery signed as a member and Secretary of Taxpayer and certified Ms. Rios' position as President of Taxpayer. Joint Stipulated Exhibit 21.

33. On March 30, 2007, Taxpayer sold all of the WATS stock to Midwest Land to maintain its "small" Northern New Mexico company status. Dr. Rios signed as President of WATS and in the document he was recognized as Taxpayer's managing member. Joint Stipulated Exhibit 23.

34. MLC members are unrelated to any of Taxpayer's members, officers or directors. Joint Stipulated Exhibits 23 - 25.

35. Between March 30, 2007, and July 2, 2007, Taxpayer fulfilled the WATS

LANL/LANS contract pursuant to the Asset Purchase Agreement. Joint Stipulated Exhibits 19 – 22.

36. From July 3, 2007, through June 30, 2009, Taxpayer's principals, through Taxpayer's ownership of the WATS stock, and subsequently as purchaser and successor to the WATS contract, fulfilled the terms of the contract by supplying technical temporary employees to LANS for work at the labs. On average between 63% and 84% of WATS employees worked for Taxpayer in fulfilling the requirements of contract. Taxpayer Exhibit A, Joint Stipulated Exhibit 28.

37. On June 15, 2007, a post-closing Asset Purchase Agreement was finalized showing a revised purchase price for the assets of WATS of $1,114,273.00, including the transfer of all assets and establishing a value of $729,674.00 for goodwill. The revised list of assumed liabilities does not include Taxpayer's payroll loan to WATS but does include the other assumed liabilities listed in the original Asset Purchase Agreement. The Department's debt is again listed as a liability not assumed by Taxpayer, along with several additional smaller debts.

38. On June 29, 2007, Mrs. Rios, as Taxpayer's President, signed a subcontract with LANS. This subcontract indicated the original contract period as starting as of May 1, 1995, through June 30, 2007, with Taxpayer's performance period starting July 1, 2007, and concluding April 2, 2008. Taxpayer's potential payment pursuant to the contract through April 2, 2008, is listed as $5,500,000.00.

39. LANS extended the contract through June 30, 2009, the time when the VMS contract was awarded.

40. Taxpayer was not awarded the VMS contract.

41. The Department issued Assessment Letter ID #L1674580608 to Taxpayer on

April 2, 2009, (the "Assessment") as a Successor in Business to WATS in the principal amount of $132,628.82, plus interest through the date of the assessment. No penalty was assessed against Taxpayer.

42. On May 13, 2009, the Department received Taxpayer's request for a retroactive extension of time to file a protest to the assessment.

43. On June 26, 2009, Taxpayer filed a formal written protest to the assessment. The Department acknowledged receipt of the protest on August 3, 2009.

44. On May 6, 2011, the Department requested a formal hearing. The Hearing Bureau set the formal hearing for September 13, 2011, at 10:00 a.m. The hearing was re-scheduled for September 16, 2011, at 10:00 a.m.

DISCUSSION

There are two main issues to be decided in this protest. First, whether Taxpayer is liable as a successor in business for gross receipts tax originally assessed to WATS. Second, if Taxpayer is liable as a successor in business, whether Taxpayer's liability is limited to the amount paid to WATS' shareholders pursuant to the Stock Purchase Agreement of June 30, 2006 or whether Taxpayer is liable for the full amount of the assessed tax liability.

Burden of Proof

There is a statutory presumption that any assessment of tax made by the Department is correct. NMSA 1978, § 7-1-17(C); *Holt v. New Mexico Department of Taxation & Revenue*, 2002 NMSC 34, ¶ 4, 133 N.M. 11, 59 P.3d 491. Once the presumption of correctness is rebutted, however, the burden shifts to the Department to show the correctness of the assessed tax. *MPC Ltd.*

V. New Mexico Taxation and Revenue Department, 2003 NMCA 21, P. 13, 133 NM 217, 62 P.3d 308.

Successor Liability under the Tax Administration Act

To determine whether Taxpayer is liable for WATS' gross receipts tax debt, an examination of NMSA 1978 Sec. 7-1-61 (1997) and 7-1-63 (1997) of New Mexico's Tax Administration Act is necessary. NMSA 1978 Sec.7-1-61(C), (1997) provides,

> If any person liable for any amount of tax from operating a business transfers that business to a successor the successor shall place in a trust account sufficient money from the purchase price or other source to cover such amount of tax until the secretary or secretary's delegate issues a certificate stating that no amount is due, or the successor shall pay over the amount due to the department upon proper demand for, or assessment of, that amount due by the secretary.

Although the statute does not define what it means to be a "successor", the statute obligates a successor to place in a trust "sufficient money from the purchase price" to provide for payment of outstanding taxes and imposes liability on the purchaser who fails to do so. The question in this case is whether Taxpayer was a "successor" for the purposes of the statute.

Regulation 3.1.10.16 (F) (2) NMAC, defines "successor" to mean "any transferee of a business or property of a business." A "transfer" is defined as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with the property of a business." Regulation 3.1.10.16 (F) (3) NMAC. Regulation 3.1.10.16 (A) NMAC (2001) provides numerous factors to consider whether a business is a successor.

> (1) Has a sale and purchase of a major part of the materials, supplies, equipment, merchandise or other inventory of a business enterprise occurred between a transferor and a transferee in a single or limited number of transactions?
> (2) Was a transfer not in the ordinary course of the transferor's business?

(3) Was a substantial part of both equipment and inventory transferred?
(4) Was a substantial portion of the business enterprise that had been conducted by the transferor continued by the transferee?
(5) By express or implied agreement did the transferor's goodwill follow the transfer of the business properties?
(6) Were uncompleted sales, service or lease contracts of the transferor honored by the transferee?
(7) Was unpaid indebtedness to suppliers, utility companies, service contractors, landlords or employees of the transferor paid by the transferee?
(8) Was there an agreement precluding the transferor from engaging in a completing business to that which was transferred?

Further, under Regulation 3.1.10.16 (F) (2) (B) NMAC (2001), the Department may presume that the business is a successor under the statute if it finds any of the above-referenced factors applicable.

Traditionally, a successor corporation, giving adequate consideration without notice of prior claims, will not be liable for the predecessor's debts in absence of a contractual provision assuming the obligations. *Southwest Distributing Co. V. Olympia Brewing Co.*, 90 NM 502, P.505, 565 P.2d 1019, P. 1022 (1977). In this case, Taxpayer was fully aware of WATS' gross receipts tax liability owed to the Department.

Under some circumstances an acquiring corporation will be liable for certain state tax obligations of a seller corporation. When successor liability is imposed, a creditor having a claim against the seller may assert that claim against and collect payment from the purchaser. Successor liability is imposed against a purchaser when a substantial portion of the assets are acquired, regardless of the good faith intentions of either party. It is the responsibility of the acquiring business to determine whether the selling corporation has met its state tax liabilities. State statutes make the acquiring business secondarily liable for the selling corporation's tax obligations to the state. *See Knudson Dairy Products Co. V. State Board of Equalization,* 12 Cal. App. 3d 47, 90 Cal. Rptr. 533

(1970), and *Tri-Financial Corp. v. Dep't of Revenue,* 6 Wash. App. 637, 495 P.2d 690 (1972).

In this matter, all eight of the 3.1.10.16 (A) NMAC (2001) regulation criteria which determine whether a business is a successor are met. The assets of WATS, including the LANL/LANS contract were purchased by Taxpayer. Acknowledging that Taxpayer's principals may not have initially wanted to take the actions that ultimately they did in order to be designated an "incumbent", the evidence established that on June 30, 2006, Taxpayer did purchase WATS' stock and, from that date until the date the WATS assets were purchased by Taxpayer, March 30, 2007, the stockholders were the same in both Taxpayer and WATS, and Dr. Rios was both the President and sole stockholder of WATS and Taxpayer's managing member. Dr. Rios was pivotal in both companies making decisions. Maria Estela de Rios is the wife of Dr. Rios and Taxpayer's President and CEO. When the asset purchase agreement was signed, the address for both companies was the address provided in all documents as Taxpayer's address. The individual signing on behalf of WATS was Robert Richmond, a trusted employee of Taxpayer's principals, Dr. and Mrs. Rios. Therefore from June 30, 2006, and thereafter, there was common identify of officers and stockholders. The evidence clearly established that Taxpayer was the successor to WATS. Therefore, even though Taxpayer's intent was not to purchase the stock and assets, Taxpayer did in fact purchase the stock, followed by a purchase of all of the assets of WATS. Taxpayer's intent does not alter the fact that Taxpayer determined to assume the risk of purchasing the stock and assets in order to obtain "incumbency" status when bidding on the VMS contract and therefore was the successor in business to WATS.

Taxpayer claims that it is not a successor in business to WATS as Taxpayer's goal was to

obtain an independent contract with LANS so that Taxpayer would be an incumbent for the upcoming VMS Contract bid. Originally, Taxpayer's intent was to purchase WATS and make it a subsidiary with WATS' own personnel continuing its work with LANS until such time as Taxpayer could obtain its own contract with LANS. While Taxpayer's intent may have been limited from the outset of the transaction with WATS, in determining whether Taxpayer was a successor in business to WATS, the actual circumstances and transactions that developed between the two entities must be considered. Despite Taxpayer's intent as to limited involvement with WATS, because of WATS' day-to-day financial problems, it became necessary for Taxpayer to purchase WATS' stock and assets. Once Taxpayer obtained WATS' stock and assets, it further became necessary for Taxpayer to divest itself of WATS through the sale to MLC so that it would remain eligible to bid on the VMS Contract.

Taxpayer asserts that the execution of the Asset Purchase Agreement was in the ordinary course of business of WATS. However, under that Asset Purchase Agreement WATS sold and Taxpayer purchased all of the materials, supplies, and equipment of WATS in a single transaction. Such a sale was obviously not in the ordinary course of WATS' business because WATS was in the business of supplying technical temporary employees to LANL. All of WATS' assets were transferred to Taxpayer. While Taxpayer claimed that not all of its assets were transferred, the agreement indicates that "none" of the assets were retained by the seller.

The testimony established that WATS had one item of value, the LANL/LANS contract. Both the testimony and the documentary evidence established that Taxpayer's motive in purchasing the stock and subsequently purchasing WATS' assets was to obtain and retain WATS' contract with

LANL/LANS. Other than a few minor purchase orders WATS' entire business consisted of the LANL/LANS contract. Taxpayer took over the LANL/LANS contract as well as the other few minor purchase orders. Therefore, the entire business enterprise that had been conducted by WATS was continued by Taxpayer.

Taxpayer claimed that WATS did not have any goodwill associated with the sale and that the goodwill indicated in the post-closing Asset Purchase Agreement was just a "plug-in" number without any value or meaning. Yet, both Dr. Rios and Mrs. Rios testified that, while WATS essentially had no other assets and its purchase was risky if Taxpayer was not awarded the VMS Contract, WATS' contract with LANL/LANS still had a very high value to Taxpayer because it would enable Taxpayer to achieve a presence as the only small, New Mexico incumbent business contracted with LANS prior to the VMS bid. Certainly, Taxpayers sought the intangible value/goodwill associated with WATS' position as an incumbent at LANS.

According to Schedule D of the Asset Purchase Agreement, Taxpayer assumed liabilities of trade accounts, payroll and related tax obligations, accrued compensated absences payable, the National City Bank Loan and the liability WATS owed Taxpayer for its payroll loan. Additionally, there was a specific non-compete clause preventing WATS from competing with Taxpayer for two years from the date of closing as a prime or subcontractor for performing work not only at LANL/LANS but also at Sandia National Laboratory and/or Stanford Linear Accelerator Center. In light of this evidence, every single criteria enumerated in Regulation 3.1.10.16 (A) NMAC is established by the sale and purchase between WATS and Taxpayer. Additionally, Taxpayer was a transferee of a business pursuant to Regulation 3.1.10.16 (F) (2) NMAC.

Taxpayer claims that the regulation should not be considered because it is too narrow, it has never been reviewed by the court and according to subsection B, it allows the Department to rely on a single listed factor to determine whether an entity is a successor. NMSA 1978, §9-11.6.2 (1995) empowers the secretary of the Department with the authority to issue regulations and rulings necessary to implement the provisions of the law that the Department is charged with enforcing. The statute enumerates the departmental requirements that must be followed in order for a regulation to be effective [Subsection C and D]. *See Grogan v. New Mexico Taxation and Revenue Dept.,* 133 N.M. 354, 62 P.3d 1236 (NM App 2002) *and Hawthorne v. Taxation and Revenue Dept.* 94 N.M. 480, 481, 612 P.2d 710, 711 (Ct. App. 1980) ("The construction given a statute by the administrative agency charged with the enforcement of it is a significant factor to be considered by the courts in ascertaining the meaning of such statute….").

Regulation 3.1.10.16 (A) NMAC lists the factors that the Department can consider in determining whether a business is a successor. In *Sterling Title Co. v. Commissioner of Revenue,* 85 N.M. 279 , 511 P.2d 765 (Ct. App. 1973), the first four criteria enumerated in Regulation 3.1.10.16 NMAC were applicable to Sterling's purchase of Dona Ana Title and therefore supported a presumption that the requirements of Section 7-1-61 were met. See Regulation 3.1.10.16 (E) NMAC. Whether or not the regulation allows the Department to rely on a single listed factor to determine whether an entity is a successor, in this matter, all eight criteria are present. Therefore the evidence supported the presumption that Taxpayer is a successor in business to WATS.

Taxpayer argued that *Garcia v. Coe Manufacturing Company,* 1997-NMSC-013, 123 NM

34, 933 P.2d 243, is controlling. *Garcia* explained that the 'key element of a continuation is a common identity of officers, directors and stockholders in the selling and purchasing corporations. *Leannais v. Cincinnati, Inc.,* 565 F. 2d 437, 440 (7th Cir. 1977). Thus, the mere continuation exception 'has no application without proof of continuity of management and ownership between the predecessor and successor corporations." *Id at 13.*Taxpayer argued that because in *Garcia*, the court determined the criteria for an entity to be determined to be a successor, that it must be established that there was a common identity of officers, directors and stockholders in the selling and purchasing corporation. Garcia, a tort liability case, was concerned with whether a company was a "mere continuation" of another company. Mere continuation is not an issue in this matter.

However, rather than the *Garcia* case cited by Taxpayer, this matter is more similar to the facts in *Bank of Commerce, v. Woods, Commissioner of Revenue,* 585 S.W.2d 577 (1979). In *Bank of Commerce,* the bank had a perfected security interest in inventory, fixtures and equipment in a store. When the debtors in *Bank of Commerce*, the Stepps, became delinquent, they transferred their interest to the bank to avoid foreclosure. The bank was held to be a successor in interest of the business because the court found that it was clear that the bank was the buyer of the debtor's business; that it became the debtor's successor and was therefore liable for the tax. Citing, *Accord, Richards v. Blackmon,* 233 GA. 739, 213 S.E. 2d 638 (1975), the court explained,

> The public interest in the efficient collectability of State revenue cannot be jeopardized on account of private business decisions. When the Bank decided to purchase the store instead of foreclosing on the loan, it took the risk that it would be liable for unpaid sales tax. *Id. at* ¶12.

Further, the Court stated, *id* at ¶14:

> The Bank desired to protect its investment and avoid a foreclosure, by purchasing the food store so that it could be operated without interruption as a going business. The Stepps sold their equity in satisfaction of the debt and quit the business. The Bank as buyer became their successor and liable for the sales tax. The fact that the Bank's objective was to be a short-term owner and in turn to sell the business to a third party did not alter their successor status under the statute. *Id at ¶14.*

Whatever Taxpayer's initial intent was in becoming an incumbent, Taxpayer purchased WATS' stock, purchased WATS' assets and then sold WATS minus the assets. It was Taxpayer's responsibility to determine, prior to purchasing, if WATS had met its state tax obligations. Taxpayer knew WATS owed the Department taxes. In the Asset Purchase Agreement, Taxpayer stipulated that it had an obligation to the Department as the purchaser of the assets. [Paragraph 3.3]. From June 2006 through March 30, 2007 Taxpayer and WATS shared the same principals and both were operated from the same location in Albuquerque. As all factors as explained in Regulation 3.1.10.16 (A) NMAC have been established, Taxpayer is determined to be the successor in business to WATS.

The Amount of Taxpayer's Liability as a Successor.

Having made the determination that Taxpayer is a successor to WATs, it must now be determined what the amount of Taxpayer's liability is as a successor. Taxpayer claims, if it is deemed a successor to WATS, its liability is limited to the $100,000.00 that it paid for the stock. The Department alternately claims that Taxpayer should be liable for the full amount of the WATS tax liability because (1) the value Taxpayer paid when it purchased the assets was more than the total amount of the tax debt, (2) Taxpayer acknowledged it was the transferee of the

assets and liabilities, (3) Taxpayer acknowledged in the signed documents that it assumed all obligations and liabilities of WATS under the subcontracts and (4) in the Novation Agreement Taxpayer represented that it could fully perform all obligations under the contract. Taxpayer's response to the March 30, 2007 Novation Agreement was that LANS dictated the terms and Taxpayer's principals had no choice based on LANS' directives but to sign the agreement even though some of the terms were inaccurate. Additionally, Taxpayer's principals claimed that the value of goodwill stated in the post-closing Asset Purchase Agreement was simply a "plug-in" number and that there was actually no goodwill purchased from WATS.

NMSA 1978, Section 7-1-63 (1997) provides:

> A If, after any business is transferred to a successor, any tax …for which the former owner is liable remains due, the successor shall pay the amount due within 30 days…
> C. A successor may discharge an assessment made pursuant to this section by paying to the department the full value of the transferred tangible and intangible property...

The issue to be determined is the full value of the WATS transferred tangible and intangible property. The Asset Purchase Agreement reveals that the total consideration paid or assumed for WATS' assets was $1,443,754.00. In the agreement, Taxpayer agreed to assume the bank debt and did not require payment of the $310,934.00 loan made to WATS as a payroll advance. Taxpayer acknowledged in the Asset Purchase Agreement that it purchased all assets listed on Schedule E with no assets being excluded from the sale. Taxpayer specifically purchased the one substantial asset that WATS owned, the contract between WATS and LANL. The agreement stated that Taxpayer was not assuming three debts, the major one being the tax

debt to the Department. The post-closing Asset Purchase Agreement indicated additional debts that were not assumed; however the only substantial debt which was not assumed was the tax debt owed the Department.

The original Asset Purchase Agreement indicated that there would be a final accounting completed as a post-closing Asset Purchase Agreement which would reflect changes in the difference between the acquired assets and the assumed liabilities, and that such changes would be reflected as goodwill. The post-closing Asset Purchase Agreement indicated that the revised purchase price was $1,114,273.00. This agreement indicated the value of goodwill to be $729,674.00. Therefore both agreements acknowledge that the purchase price for the assets of WATS was over $1,000,000.00. While there was testimony as to Taxpayer's principals being required to sign the Novation Agreement without ability to negotiate the terms, the evidence established that the Asset Purchase Agreement and the post-closing Asset Purchase Agreement were agreed to and signed for after review by Taxpayer's legal counsel and negotiation between the parties. The purchase price is substantially greater than the amount of the WATS tax liability. Therefore, Taxpayer is liable for the full amount of the tax debt.

Taxpayer argued that the value of the assets was much less as the value stated for goodwill was inaccurate, was simply a plug-in number and accurately should be zero. Additionally, Taxpayer claimed that there were no assets and only liabilities. The documents established that Taxpayer indicated it paid over $1,000,000.00 for the assets assuming different debts owed by WATS. The documents reveal that Taxpayer purchased all of WATS' assets and was assigned WATS' LANL/LANS Contract. The evidence established that Taxpayer teaming

with WATS was a business risk so that Taxpayer could best position itself to be awarded the VMS Contract. Recognizing the risk, Taxpayer's principals determined to proceed with the stock purchase and asset purchase because WATS had the one asset that Taxpayer needed to be considered an incumbent, its contract with LANL. The VMS Contract had a very high value to Taxpayer because it would enable Taxpayer to achieve a presence as an incumbent. Certainly, there was intangible value/goodwill associated with WATS' position as an incumbent. The issue is whether the goodwill amounted to the figure as indicated in the post-closing Asset Purchase Agreement.

Taxpayer was able to continue fulfillment of the WATS' contract with LANL/LANS and, due to having purchased the WATS stock, Taxpayer was able to negotiate a contract in its own right. Taxpayer would not have had the opportunity to fulfill the WATS contract or to become an incumbent without teaming with one of the four contractors which had a present contract with LANL/LANS. Therefore, Taxpayer put itself in a position to be considered an incumbent for purposes of bidding on the VMS Contract by teaming with WATS through its purchase of the WATS stock and subsequently the WATS assets. The purchase enabled Taxpayer to sign the Novation Agreement with LANS and fulfill the terms of WATS contract and ultimately become a successor to the contract and thereafter bid on the VMS Contract as a small northern New Mexico incumbent business.

In determining whether there was goodwill purchased from WATS, the reasoning behind the purchase of WATS is important. The testimony revealed that Taxpayer was willing to pay over $310, 000.00 as a loan to WATS when it was known that the only substantial asset WATS had was the LANL/LANS contract. Loaning more to WATS than what Taxpayer's principals claimed was the

full value of the WATS stock, indicates that the value of WATS to Taxpayer was significantly higher than the $100,000.00 which Taxpayer paid for the stock. Additionally, Taxpayer was willing to take the risk that teaming with WATS and taking the steps necessary to obtain "incumbency" provided Taxpayer an enhanced opportunity above other bidders to be awarded the VMS Contract. The VMS Contract had a value, once awarded, of at least $400,000,000.00 with the potential of being worth $1,000,000,000.00. It was critical to Taxpayer's principals to obtain incumbency status to have the best opportunity to be successful bidder on the VMS Contract. Taxpayer could not have been declared a successor to the WATS contract without WATS' cooperation and LANS' agreement. Without acquiring the WATS contract, Taxpayer could not be deemed an incumbent. LANL/LANS could have terminated WATS' contract but would not have awarded the contract to another prior to the VMS Contract being offered for bid. LANL/LANS never terminated WATS.

After purchasing the WATS stock, Dr. Rios assumed control as WATS' President and sole shareholder and fulfilled the WATS contract until such time as Taxpayer was declared successor to the WATS contract. WATS' contract with LANL/LANS was uncompleted at the time of the asset purchase. After the March 30, 2007purchase of the assets, Taxpayer kept WATS' assets and sold WATS to another company providing Taxpayer the best opportunity to be awarded the VMS as an incumbent without WATS' prior three-year revenue stream. Taxpayer continued to fulfill and honor the contract until June, 2007, when it was assigned its own subcontract concluding its subcontract June 30, 2009. The subcontract provided payments to Taxpayer of a maximum of $5,500,000.00 through April 2, 2008. Taxpayer received additional monies due to the extension of the contract, from April 2, 2008, through June 30, 2009, when the VMS contract was awarded.

Having kept the one valuable WATS asset, even considering its debt service and considering the risk involved if Taxpayer was not awarded the contract, and considering the monetary value associated with being a successor to the WATS contract and the potential monetary possibility if awarded the VMS contract, it is determined that the value assessed to goodwill in the post-closing asset purchase agreement is objectively reasonable. There certainly was intangible value to the WATS contract in that it provided Taxpayer the only opportunity to be an incumbent providing the insider opportunity to be successful in bidding the VMS contract.

Moreover, aside from the definite value of the goodwill of WATS, Taxpayer is also fully liable for the tax debt of WATS because the value acknowledged in the post-closing Asset Purchase Agreement minus the value assessed for goodwill is greater than the total amount of the WATS tax liability. Even if it were assumed that there was no value for goodwill, the value acknowledged as the price for the assets per the post-closing Asset Purchase Agreement is $1,114,273.00. After deducting the value of the goodwill, $729,674.00, the remaining value of the assets purchased is $384,599.00. This value is greater than the value of WATS tax liability. Therefore, Taxpayer is liable for the full amount of the WATS tax debt.

While Taxpayer's principals testified that they had no choice but to sign the Novation Agreement as dictated by LANL, Taxpayer provided LANS the Asset Purchase Agreement dated March 29, 2007, as evidence that it would be able to fulfill the terms of the WATS contract. The Novation Agreement is completed on Taxpayer letterhead and it acknowledged that Taxpayer is the "transferee" of the WATS contract and that WATS had transferred all of its assets to Taxpayer. Taxpayer agreed to assume all of WATS' obligations and liabilities and indicated that

it was fully able to perform all obligations existing under the contract, consistent with what LANS required to transfer the contract. While Taxpayer's principals testified that changes could not be made to the Novation Agreement, it was acknowledged in the agreement that the statements were true. Having signed and acknowledged the statements as true to be provided an advantage and being allowed to be a successor to the WATS contract, they are bound by the terms of the contract. Therefore Taxpayers are liable for the full amount of the WATS tax debt.

Fairness.

Taxpayer claims that it is unfair for it to be deemed to be a successor in business to WATS and therefore be assessed more than the $100,000.00 it paid for the WATS stock because Taxpayer's principals were forced to take the actions they took to ensure that LANL/LANS was protected and to enable Taxpayer to be an incumbent to the WATS contract due solely to WATS inability to pay on its monetary obligations. Taxpayer's intent was not to purchase the stock and assets but for WATS to be Taxpayer's subsidiary. Practically, Taxpayer wanted the benefits of the WATS contract without being saddled with the WATS tax debt. Under the circumstances as present in this case, allowing a successor to assume the assets of a company without also assuming the tax liability is contrary to New Mexico law.

Sterling Title Co. of Taos v. Commissioner of Revenue, 85 N.M. 279, 511 P.2d 765 (Ct. App. 1973), addressed the policy behind New Mexico's successor in business statutes. Dona Ana Title Company sold its title plant, furniture, fixtures and equipment to Sterling, which also assumed Dona Ana's lease and a note owed to third parties. Sterling challenged the Department's determination that Sterling was liable for Dona Ana's unpaid gross receipts taxes as a successor in business, arguing

that Dona Ana was not actively engaged in business at the time the assets were transferred. The court rejected this argument, holding that Sterling was a successor in business for purposes of NMSA 1978, Section 7-1-61 (then codified as NMSA 1953, Section 72-13-74), which provided that the "tangible and intangible property used in any business" remains subject to tax in the hands of a successor. In his specially concurring opinion, Judge Sutin noted that:

> *[T]he primary purpose of the statute was to make tangible and intangible property security for payment of the tax.* The legislature intended this to protect the Bureau and the public against successor who did not withhold an amount sufficient to pay the tax owed by delinquent taxpayers. The legislature did not intend a delinquent taxpayer like Dona Ana to declare its normal business operation ended prior to September 13, 1967, then sell all its personalty to Sterling so that Sterling would be free of liability for the tax. It intended each of the parties to be liable. *It intended tangible and intangible property to be security.* (emphasis added).

Id., 85 N.M. at 282, 511 P.2d at 768. The legislature clearly intended to ensure that the state did not lose tax revenues because a business changes hands, no matter how the transaction is handled by the seller and purchaser. The broad construction of the successor statutes received the approval of the Court of Appeals in *Sterling Title* where the court cited with approval two decisions from other jurisdictions with successor in business statutes which found that where a person had simply taken over the assets of an insolvent or defunct business, that the person was a successor liable for the taxes of the business which was taken over. *See Knudsen Dairy Products Co. v. State Board of Equalization,* 12 Cal App. 3d 47, 90 Cal Rptr. 533 (1970), and *Tri-Financial Corp v. Department of Revenue,* 6 Wash. App. 637, 495 P.2d 690 (1972). It is the clear intent of the successor liability statutes to provide that the tax debt follow the business, its assets or any portion of them. *See Gottsch Feeding Corp. v. State of Nebraska,* 261 Neb. 19, 621 N.W.2d 109 (2001).

In this matter, Taxpayer was intent on becoming an incumbent in order to position itself advantageously to prevail on the bid for the VMS Contract. All of its actions were driven by the need to become an incumbent to facilitate it being the only small New Mexican incumbent company bidding on the contract. It bought the WATS stock and purchased the assets in order to become an incumbent. It kept all of WATS' assets including the only valuable asset WATS owned, the LANL/LANS contract. It assumed the bank loan of $774,546.00 and many other of WATS' debts but not the Department debt. It is clear that both the New Mexico legislature and the judiciary did not intend for a successor company to purchase the valuable assets of a company and leave a legitimate tax debt not paid because the predecessor company is left without any assets which can be attached. Taxpayer is liable for the tax liability as a "successor" as Taxpayer purchased the stock of WATS and purchased the assets of WATS. Taxpayer did not conduct itself merely as a stockholder or creditor of WATS. Taxpayer conducted itself as a successor and is liable for the full amount of the tax debt as a successor.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the assessment No. L1674580608 and jurisdiction lies over the parties and the subject matter of this protest.

B. Taxpayer is a successor in business to WATS within the meaning of Sections 7-1-61 and 7-1-63.

C. The value of the assets purchased by Taxpayer exceeded the amount of the tax debt.

D. Taxpayer is liable for the full amount of WATS unpaid gross receipts tax and interest on the unpaid amount.

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

Dated: January 3, 2012.

SALLY GALANTER
Hearing Officer
Taxation & Revenue Department

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, § 7-1-25 (1989), the taxpayers have the right to appeal this decision by filing a notice of appeal with the New Mexico Court of Appeals within 30 days of the date shown above. See, NMRA, 12-601 of the Rules of Appellate Procedure. If an appeal is not filed within 30 days, this Decision and Order will become final.

CERTIFICATE OF SERVICE

On January ____, 2012, a copy of the foregoing Decision and Order was mailed by certified mail #_____to Ms. Patricia Tucker, Law Office of Patricia Tucker, PC, 202 Girard Blvd. S.E. Albuquerque, NM 87106, and delivered by interoffice mail to Lewis Terr, Attorney, Taxation and Revenue Department, Santa Fe, New Mexico.

SALLY GALANTER
Hearing Officer
Taxation & Revenue Department
Post Office Box 630
Santa Fe, NM 87504-0630