

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

**IN THE MATTER OF THE PROTEST OF  
WALT ARNOLD COMMERCIAL BROKERAGE  
TO THE MANAGED AUDIT DISQUALIFY NOTICE  
ISSUED UNDER LETTER ID NO. L0266468304**

**No. 15-13**

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held on February 10, 2015 and continued to March 26, 2015, before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Peter Breen, attorney for the Department. Tom Dillon, protest auditor supervisor, appeared as a witness for the Department. Walt Arnold Commercial Brokerage (“Taxpayer”) was represented by Karen Mendenhall, Esq., of the Mendenhall Firm, P.C. Appearing as witnesses for Taxpayer were Walt H. Arnold and Barbara M. Buell. The exhibits introduced into the record were Exhibits 1-9<sup>1</sup> and G.

In addition to the pleadings and filings referred to in the Findings, the record contains the following: New Mexico Taxation and Revenue Department’s Notice of Filing First Set of Discovery from the Department to the Taxpayer filed on February 10, 2015; Letter and a copy of the authenticated Police Report from Ms. Mendenhall dated March 3, 2015; Amended Notice of Administrative Hearing and Order of Continuance filed on March 5, 2015; Notice of Filing Taxpayer’s Responses to the Department’s First Set of Discovery filed on March 10, 2015; Motion in Limine and to Strike Testimony Concerning Allegedly Embezzling Bookkeeper filed on

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<sup>1</sup>The Department objected to the introduction of the police report arguing that it was hearsay. Rule 11-803(8)(A)(iii) NMRA provides that a public record is an exception to hearsay if the police report is made by a law enforcement officer and offered in a **civil case**.

March 27, 2015; Taxpayer's Response in Opposition to Department's Motion in Limine to Strike Testimony filed on April 6, 2015; and Order Denying Motion in Limine and to Strike Testimony issued on April 20, 2015. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

### FINDINGS OF FACT

1. On November 20, 2014, the Department denied Taxpayer's application for a managed audit using a form letter. **[Letter Id. No. L0266468304; Exhibit 8].**
2. The Department stated that Taxpayer did not qualify for a managed audit but it failed to provide a reason for the disqualification. None of the boxes were checked on the form. **[Letter Id. No. L0266468304; Exhibit 8].**
3. The form letter provided four possible options for the disqualification; 1) You are currently in bankruptcy proceedings; 2) The Department has issued more than 2 non-filer notices for the tax program requested; you have a managed audit and/or an audit engagement letter has been issued for the period and tax program requested; 3) You are currently the subject of a tax related criminal investigation; and 4) You have an outstanding liability in the tax program requested. **[Letter Id. No. L0266468304; Exhibit 8].**
4. On December 8, 2014, Taxpayer protested the disqualification into the managed audit program.
5. On December 18, 2014, the Department acknowledged the protest. **[Letter Id. No. L1676735440].**
6. The Department requested a hearing in this matter on January 21, 2015.
7. On January 21, 2015, the Hearings Bureau mailed a Notice of Administrative Hearing setting the hearing for February 10, 2015. The hearing was continued to March 26, 2015.

8. The Department provided a reason for the disqualification from the managed audit program, after Taxpayer filed a protest, in a letter from Mr. Dillon dated December 22, 2014.

**[Exhibit 9].**

9. Mr. Dillon stated that Taxpayer's managed audit application was denied "based upon the fact that your client had received two or more non filer notices." **[Exhibit 9].**

10. Mr. Dillon attached six non-filer notices to his letter. **[03-26-15 CD 2:18-2:19].**

11. The non-filer notices were sent to the Hearings Bureau along with the Request for Hearing by Mr. Dillon. **[03-26-15 CD 2:18-2:19].** The non-filer notices were copies and not the originals received by Taxpayer. **[03-26-15 CD 2:18-2:19].**

12. The letter from Mr. Dillon was the only written or oral communication by the Department, prior to the hearing, as to why Taxpayer was disqualified from the managed audit program.

13. Walt H. Arnold is the owner and managing director of Taxpayer. Taxpayer is organized as a "S" Corporation and is a Sperry Van Ness franchise. **[03-26-15 CD 0:25-0:26].** Taxpayer is in the business of commercial real estate sales, leasing and management. **[03-26-15 CD 0:25-0:26].**

14. Taxpayer has been in business since 1990. **[03-26-15 CD 0:26].**

15. Taxpayer used the software program, Quick Books, for its bookkeeping system. **[03-26-15 CD 1:32].**

16. Quick Books is a good accounting software package. **[03-26-15 CD 2:12].**

17. Taxpayer employed Dana VanDoren for 20 years as its bookkeeper. She was an employee. **[03-26-15 CD 0:56].**

18. Sometime between August and September 2011, Ms. VanDoren left the company.

**[03-26-15 CD 0:26-0:27].**

19. From October 2011 through July 2014, Taxpayer contracted with Maria Romero-McCue to provide bookkeeping services for Taxpayer. **[03-26-15 CD 0:26 and 1:29; Exhibit 1.1, page 4]**. She was assigned most of Ms. VanDoren's job duties.

20. Ms. Romero-McCue asked, that for tax purposes, Taxpayer treat her like an independent contractor (1099) and not like an employee. **[03-26-15 CD 0:28]**.

21. Ms. Romero-McCue's duties included writing checks, paying bills, payroll, paying both federal and state taxes, paying insurance premiums, running reports and opening all the mail for the brokerage side of the office. **[03-26-15 CD 0:28-0:29 and 1:14-1:15]**.

22. Ms. Romero-McCue had access to Taxpayer's bank accounts and she had signing authority on Taxpayer's checking accounts. **[03-26-15 CD 1:16]**.

23. Mr. Arnold provided Ms. Romero-McCue with keys to Taxpayer's building and the code to alarm for the building. **[03-26-15 CD 1:26]**. Ms. Romero-McCue worked around 20-25 hours per week and she would often work on Saturdays. **[03-26-15 CD 0:28]**.

24. Because of certain performance issues, reports were not prepared on time and Mr. Arnold had a general sense that Ms. Romero-McCue was not performing her job duties adequately, Mr. Arnold terminated Ms. Romero-McCue on or about July 2014. **[03-26-15 CD 0:30-31]**.

25. Soon after Ms. Romero-McCue was terminated, Mr. Arnold asked Ms. Barbara M. Buell to review the bank account statements. **[03-26-15 CD 1:31-1:32]**.

26. Ms. Buell has been employed by Taxpayer for 10 years. **[03-26-15 CD 1:28]**.

27. Prior to Ms. Romero-McCue's termination, Ms. Buell was the bookkeeper for the management side of Taxpayer's business. **[03-26-15 CD 1:28-1:29]**.

28. After Ms. Romero-McCue was terminated and after reviewing the bank account statements and Quick Books, Ms. Buell noticed certain financial discrepancies. The discrepancies consisted of either moving money from either Taxpayer's Capital One or Bank of America accounts to Ms. Romero-McCue's own personal bank account or to her husband's credit card account. **[03-26-15 CD 0:31-0:32, 0:42-0:47 and 1:33-1:35; Exhibit 3].**

29. After reviewing the Quick Books accounts, Ms. Buell determined that the Sperry Van Ness royalty payments had not been made. **[03-26-15 CD 0:26].**

30. Ms. Buell also determined that Ms. Romero-McCue failed to file Ms. Romero-McCue's 1099 forms with the Internal Revenue Service. Taxpayer filed an Information Referral Form, IRS form 3949-A, with the Internal Revenue Service. **[03-26-15 CD 0:40 and 1:37-1:38; Exhibit 5].**

31. Ms. Romero-McCue failed to pay taxes and file returns to both the State of New Mexico and the Internal Revenue Service. **[03-26-15 CD 0:39-0:40].**

32. Mr. Arnold decided to hire the forensic accounting firm of McHard Accounting Consulting, LLC, to determine how to proceed once the discrepancies were uncovered. **[03-26-15 CD 0:31-32; 1:31-1:32].**

33. Janet McHard and Beth Mohr, from McHard Accounting Consulting, LLC, advised Taxpayer to file a police report, contact its insurance company, review all of the checks that were written and review all of the vendor files. **[Exhibit 2; 03-26-15 CD 0:32-33].**

34. Taxpayer hired the law firm of Mendenhall Firm, P.C. to assist it with any legal issues. **[Exhibit 7].**

35. On August 15, 2015, the law firm attempted to contact Ms. and Mr. McCue and the McCues were informed of Taxpayer's audit findings, which included the non-filing of the gross

receipts tax returns **[Exhibit 7]**.

36. Mr. Arnold and Ms. Buell filed a police report on August 28, 2014 stating that Ms. Romero-McCue had transferred funds from Taxpayer's bank accounts to her own personal checking account and to her husband's, Jim McCue, credit card account. **[Exhibit 4]**.

37. The Department's gross receipts tax history shows that Taxpayer filed its gross receipts returns in a timely manner from 1999-May 2011. **[03-26-15 CD 1:48-1:49]**.

38. Taxpayer failed to file gross receipt returns and pay gross receipts taxes for June 2011 and July 2011. **[Exhibit 6; 03-26-15 CD 1:48-1:49]**.

39. The Department's system indicates that Taxpayer had two non-filed periods for June 2011 and July 2011. **[Exhibit 6; 03-26-15 CD 1:48-1:49]**.

40. Taxpayer filed gross receipts returns and paid gross receipts taxes for periods from August 2011 through December 2011. **[Exhibit 6; 03-26-15 CD 1:49]**.

41. From January 2012 through May 2014 ("non-filed periods"), Taxpayer failed to file gross receipt returns and pay gross receipts taxes for 29 months. **[Exhibit 6; 03-26-15 CD 1:49]**.

42. The Department's system indicates that Taxpayer had 29 non-filed periods. **[Exhibit 6; 03-26-15 CD 1:49]**.

43. Since June 2014, Taxpayer has timely filed and paid its gross receipts taxes. **[03-26-15 CD 1:49]**.

44. No evidence was presented what the ordinary and customary practice of the Department was when it generated and mailed non-filer notices.

45. Taxpayer's address was correct on the copies of the previously printed copies of the non-filer notices. **[Exhibit 9]**.

46. Mr. Arnold never received or saw any of the non-filer notices from the Department

for the 29 non-filed tax periods (“non-filed periods”) or for the June and July 2011 periods. **[03-26-15 CD 0:43-0:47].**

47. Mr. Arnold never went onto the Department’s online service or TAP system to review his filing history. **[03-26-15 CD 1:25-1:26].**

48. Mr. Arnold was never told by Ms. Romero-McCue that she had received non-filer notices from the Department. **[03-26-15 CD 1:25-1:26].**

49. Ms. Buell did not receive or see any non-filer notices from the Department.

50. Many of Taxpayer’s records are missing from October 2011 through July 2014 and Mr. Arnold believes they may have been shredded. **[03-26-15 CD 0:52].**

51. Taxpayer hired the accounting firm of Schlenker & Cantwell, P.A. (“Schlenker”) to determine its tax liability for the tax periods from October 2011 through June 2014. **[03-26-15 CD 0:51-0:52].**

52. Schlenker has estimated that Taxpayer owes in gross receipts taxes: 2011-\$17,000.29; 2012-\$34,596.29; 2013-\$44,844.17; and 2014-\$20,530.78. **[Exhibit 1.1, page 7.]**

53. Taxpayer hired an employee of Schlenker who was very adept at Quick Books to assist it in reconstructing Taxpayer’s business and bank records. **[03-26-15 CD 1:32].**

54. Taxpayer hired Ronnie Hurst to go through its records and make entries and corrections in Quick Books to more accurately reflect Taxpayer’s financial situation. **[03-26-15 CD 2:22].**

55. Taxpayer, through, Schlenker and the other employees that it hired, was able to reconstruct its business records sufficiently to determine its tax liability.

56. Taxpayer will seek financing to pay its tax liability for the tax periods from January 2012 through May 2014. **[03-26-15 CD 0:53-0:54].**

57. Taxpayer has never been selected for an audit by the Department. **[03-26-15 CD 2:11-2:12]**.

58. The Department is not pursuing collection actions against Taxpayer. **[03-26-15 CD 2:11-2:12]**.

59. Mr. Arnold testified in a truthful and forthright manner. His answers were clear and consistent. When faced with the discrepancies in his bank accounts, he took immediate and appropriate action by hiring a forensic accountant to advise him on the steps he should take, hiring an accountant to review his tax liability, and hiring an attorney to assist him with the legal issues.

60. By reviewing its bank accounts, hiring a forensic accounting firm, an accounting firm, an attorney, and determining what its tax liability is, Taxpayer has demonstrated a willingness and ability to comply with New Mexico's tax laws.

61. The Department believes that Taxpayer has demonstrated a willingness and ability to comply with New Mexico's tax laws. **[03-26-15 CD 2:12]**.

62. The Department did not know if Taxpayer had acceptable internal controls and business records. **[03-26-15 CD 1:53]**.

63. Taxpayer has not been the subject of a criminal investigation. **[03-26-15 CD 2:13]**.

64. Taxpayer's resources are available to conduct the managed audit. **[03-26-15 CD 2:13]**.

65. Taxpayer is not already in a legal dispute with the Department over the taxability of the transactions that are the subject of the managed audit. **[03-26-15 CD 2:13-2:14]**.

66. The unpaid gross receipts taxes and unfiled returns are not existing liabilities because the Department has not assessed Taxpayer for those tax periods. **[03-26-15 CD 2:11]**.

67. Taxpayer has not paid any existing or outstanding tax liabilities. **[03-26-15 CD**

2:15].

68. Taxpayer has not previously entered into and completed a managed audit for the same tax issue. [03-26-15 CD 2:14-2:15].

69. Because Taxpayer hired a contractor who embezzled its business funds, this does not necessarily mean that Taxpayer did not have an acceptable system of internal controls. [03-26-15 CD 2:32].

### DISCUSSION

The sole issue to be determined is whether the Department properly disqualified Taxpayer from the managed audit program because Taxpayer received two or more non-filer notices.<sup>2</sup> The Department first argued that Taxpayer had more than two non-filer notices and then later in the hearing, the Department argued that Taxpayer had no internal controls.

#### ***Burden of Proof.***

Pursuant to Regulation 3.1.8.10(A) NMAC, Taxpayer has the burden of proof in this matter.

#### ***Managed Audit.***

In 2001, the Legislature enacted the managed audit program found in NMSA 1978, Section 7-1-11.1. 2001 N.M. Laws, ch. 16, §1. A managed audit is a variation on the traditional field audit. New Mexico Department of Taxation and Revenue, FYI-404, *Managed Audits for Taxpayers* (5/2014), page 2. Under this program, a taxpayer may conduct a self-audit and report and pay taxes due and owing for those tax programs listed under Section 7-1-11.1(A) (1) through

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<sup>2</sup> This is the first managed audit case before the Hearings Bureau in which the Department has not issued an assessment. In the prior cases involving managed audits, the Department had already assessed the taxpayer. See *NM Orthopedic*, No. 13-37; *Grandin Testing Lab Inc.*, No. 13-22; *Vincent and Tesslin Vigil*, No. 13-11; *Christopher Martin*, No. 10-08; and *Juan Ortega*, No. 06-01.

(4). There is an application process, which includes a form that must be filled out and if a taxpayer meets certain requirements, the Department enters into a written agreement under which the taxpayer will conduct the self-audit to determine the amount due and owing to the State of New Mexico. FYI-404, pages 2-3. For the self-audit portion of the program, the Department allows the taxpayer to choose between two options: Option A-a taxpayer prepares the audit work papers with minimum guidance or Option B-the taxpayer works with an assigned auditor throughout the audit process. FYI-404, page 2. The taxpayer, then, presents the results of the managed audit to the Department on or before any due date set out in the agreement. NMSA 1978, Section 7-1-11.1(F) (2001). The Department, finally then, issues an assessment to the taxpayer for any unpaid taxes found to be due. Pursuant to NMSA 1978, § 7-1-67(A)(1),(4) (2013) and NMSA 1978, §7-1-69(G)(2) (2007), no interest or penalty is imposed on taxes found to be due as the result of a managed audit. A taxpayer is required to pay the assessment within the time period set out in the agreement but in any event no later than 180 days from the date of the assessment. FYI-404, page 2.

Section 7-1-11.1 further provides other requirements a taxpayer must meet before entering the managed audit program. Paragraph (D) states that the Department will review certain information from the taxpayer; namely:

- (1) the taxpayer's history of tax compliance;
- (2) the amount of time and resources the taxpayer has available to dedicate to the audit;
- (3) the extent and availability of the taxpayer's records; and
- (4) the taxpayer's ability to pay any expected liability.

Section 7-1-11.1(E) goes further and provides that "(t)he decision whether to enter into an agreement for a managed audit rests solely with the secretary or the secretary's delegate."

To assist the secretary's delegate and taxpayers in making the determination whether a taxpayer is eligible for a managed audit, the Department publishes an informational guide called "Managed Audits for Taxpayers." In the section entitled "Who is Eligible?" the Department sets out numerous criteria for eligibility. The criteria are described as follows:

- The Department has not already selected the taxpayer for audit;
- The Department is not currently pursuing collections on the taxpayer;
- The taxpayer demonstrates a willingness and ability to comply with New Mexico's tax laws;
- The taxpayer demonstrates an acceptable system of internal controls and business records;
- The taxpayer has not been the subject of a criminal investigation;
- The taxpayer's resources are available to conduct the managed audit;
- The taxpayer is not already in a legal dispute with the Department over the taxability of the transactions that are the subject of the managed audit;
- The managed audit does not apply to existing liabilities;
- The taxpayer has *received* no more than 2 non-filer notices;
- The taxpayer's existing outstanding liability was paid in full prior to requesting a managed audit agreement;
- The managed audit does not include transactions that are subject to a tribal gross receipts tax that the Department administers on behalf of any tribe pursuant to a Gross Receipts Tax Tribal Cooperative Agreement;
- The taxpayer has not entered into and completed a managed audit for the same tax issue previously.

FYI-404, pages 2-3. (Emphasis added). Publications, which are “written statements or directives of the secretary or secretary’s delegate not dealing with the merits of any law but otherwise in aid of the accomplishment of the duties of the secretary,” are “presumed to be a proper implementation of the provisions of the laws.” NMSA 1978, Sections 9-11-6.2(B)(4), (G) (1995). It is this criteria that Taxpayer must meet if it is to qualify for the managed audit program.

***Non-filer Notices.***

When the Department initially disqualified Taxpayer from the managed audit program on November 20, 2014, the Department provided Taxpayer with a form letter with certain boxes that could be checked off. Unfortunately, none of the boxes on the form were checked off. **[Letter Id. No. L0266468304; Exhibit 8]**. The form letter provided four possible options for the disqualification; 1) You are currently in bankruptcy proceedings; 2) The Department has issued more than 2 non-filer notices for the tax program requested; you have a managed audit and/or an audit engagement letter has been issued for the period and tax program requested; 3) You are currently the subject of a tax related criminal investigation; and 4) You have an outstanding liability in the tax program requested. **[Letter Id. No. L0266468304; Exhibit 8]**. Mr. Dillon rectified the issue of not providing Taxpayer with a reason as to why it was disqualified from the managed audit program by sending a letter dated December 22, 2014 stating the reason for the disqualification. **[Exhibit 9]**. His letter stated that, “based upon the fact that your client had received two or more non filer notices,” Taxpayer is disqualified from the managed audit program. **[Exhibit 9]**. Mr. Dillon attached six copies of previously printed non-filer notices to his letter. **[03-26-15 CD 2:18-2:19; Exhibit 9]**. The letter from Mr. Dillon was the only written or oral communication by the Department, prior to the hearing, as to why Taxpayer was disqualified from the managed audit program.

The criterion at issue is whether Taxpayer “*received* no more than 2 non-filer notices.” The question is did Mr. Arnold “receive” more than two non-filer notices, and if he did not receive the non-filer notices, does it matter if he did not personally receive the non-filer notices. Mr. Arnold credibly testified that he never received or saw any of the non-filed notices from the Department for the non-filed periods because his bookkeeper, Maria Romero-McCue pretended that the tax returns were filed and the taxes were paid, at the same time she was embezzling from Taxpayer. **[03-26-15 CD 0:43-0:47]**. As for the non-filed periods (29 periods), he explained in some detail that Ms. Romero-McCue, his bookkeeper at the time, while she was in charge of writing checks, paying bills, payroll, paying both federal and state tax returns, and opening the mail, she failed to notify him of the non-filed notices, if she indeed received them. **[03-26-15 CD 0:26, 0:28-0:29, 0:30-0:31, and 1:29]**. For the periods of June and July 2011, Mr. Arnold testified that Ms. VanDoren was transitioning from her position as a bookkeeper and that she did not share with him the non-filer notices but that she must have taken care of them. Ms. Buell testified that she did not receive or see any non-filer notices from the Department. Mr. Arnold also testified that he never went onto the Department’s online service or TAP system to review his filing history. **[03-26-15 CD 1:25-1:26]**. Therefore, there is no evidence that Mr. Arnold or any employee of Taxpayer received any of these non-filer notices.

The Department’s counsel made the point of not allowing Taxpayer to benefit from being in a “noncompliant bubble.” In listening to the testimony of Mr. Arnold, it is clear that he placed a great deal of trust in Ms. Romero-McCue, as he had in his previous bookkeeper, Ms. VanDoren. Ms. Romero-McCue had keys to the office and to the alarm code. **[03-26-15 CD 1:26]**. And she had signing authority to Taxpayer’s bank accounts. **[03-26-15 CD 1:16]**. Ms. Romero-McCue had a great deal of responsibility over Taxpayer’s daily operations. Mr. Arnold did not discover

the extent of Ms. Romero-McCue's failure to file returns and pay taxes and her embezzlement until after he terminated her. **[03-26-15 CD 0:31-0:32, 0:42-0:47 and 1:33-1:35; Exhibit 3]**. It is clear from Mr. Arnold testimony that he believed he had been compliant with the taxing authorities and it was not until Ms. Buell starting reviewing the bank accounts that his trust in Ms. Romero-McCue started unraveling. Perhaps this trust prevented Mr. Arnold from looking with a keen eye at the work Ms. Romero-McCue's was doing for him. Perhaps this may be a bubble. Regardless, the test is not whether a taxpayer is in a bubble. The test is whether a taxpayer received more than two non-filer notices.

There was concern by the Department over the testimony related to the shredding of documents. As for what documents were shredded, Mr. Arnold believes that Ms. Romero-McCue shredded many documents. **[03-26-15 CD 0:52]**. This fact is almost not relevant. The inquiry is whether Mr. Arnold "received" the non-filer notices and without knowing what documents were shredded, there is no evidence that the shredded documents included the non-filer notices.

Other evidence which is persuasive in finding Mr. Arnold credible is that he testified that prior to hiring Ms. Romero-McCue, he had a very good filing and history with the Department. In fact, Mr. Dillon confirmed that since 1999, Taxpayer has only had two non-filing periods in 2011 and then the 29 non-filed periods in which Ms. Romero-McCue was in charge of bookkeeping. **[Exhibit 6; 03-26-15 CD 1:48-1:49]**. In support of Mr. Arnold's testimony, it does not seem reasonable that after being in business since 1990 and after having a fairly consistent record of paying and reporting taxes, that Mr. Arnold would suddenly disregard 29 non-filer notices from the Department.

In New Mexico the mailbox rule presumption applies, that is that proof that a letter has been properly addressed and deposited in the mail gives rise to the presumption that it was

received by the recipient in the ordinary course of business. *Schneider National, Inc. v. State*, 2006-NMCA-128, ¶13, 144 P.3d 120. Taxpayer's address was correct on the copies of the previously printed copies of the non-filer notices which were attached to Mr. Dillon's December 2014 letter. **[Exhibit 9]**. However, the party relying on service by mail has the burden of proving that the mailing was done. *Myers v. Kapnison*, 1979-NMCA-085, 93 N.M. 215, ¶216.

In this case, the only proof of mailing is that the copies of the non-filer notices had the same address as Taxpayer's address. However, the evidence stops there. The Department did not present any evidence to show how the non-filer notices were generated or mailed from its system in the ordinary course of business. The only testimony offered on this point is Mr. Dillon's testimony that the system indicated that there were more than two non-filer notices. Where the issue of receipt is at issue, there must be some evidence of the mailing. There have been a number of Decision and Orders addressing this very point that when the issue is whether Department is relying on proof that a document was mailed by the Department, there must be at least a modicum of evidence to show how and when the document was mailed. See, *Club 33*, No. 12-13; *Mico Services, LLC*, No. 12-05; but see *David Montoya*, No. 00-36 (the hearing officer found in favor of the Department when it provided evidence of the procedures for mailing).

The Department's counsel submitted the Memorandum Opinion in *NM Taxation and Revenue Department v. Exerplay, Inc.*, No. 33,935, mem. op. (N.M. Ct. App. November 13, 2014) (non-precedential) to stand for the proposition that an employee's miscommunication over whether taxes were paid meant that no penalty was due. **[03-26-15 CD 2:38-2:39]**. The Department's counsel went on to argue that the only difference between this fact pattern and the facts in *Exerplay* is that in *Exerplay*, the taxpayer did not ask for a managed audit. The facts in *Exerplay, Inc.*, No. 14-27 (the underlying Decision and Order) do not apply to this case, since the

taxpayer in *Exerplay* received six assessments and never applied for a managed audit. In this case, Taxpayer has never been assessed and has applied for a managed audit. If a taxpayer has been assessed for the relevant tax periods, he or she is not eligible for a managed audit.

Therefore, because there was no evidence of the procedures used to generate non-filer notices and how these notices were mailed to Taxpayer and because Mr. Arnold testified that he never received the non-filer notices, Taxpayer is not disqualified from participating in the managed audit program for failure to receive two or more non-filer notices. If the Department had introduced some evidence related to how the non-filer notices were generated and then mailed to Taxpayer, it would not have mattered if Mr. Arnold had personally received the notices.

***Internal Controls and Business Records.***

The Department argued during the hearing that Taxpayer did not have “sufficient” internal controls and business records and therefore it should be denied into the managed audit program. [3-26-15 CD 1:48-1:50]. While an Order Denying the Motion in Limine and to Strike Testimony was issued discussing the Department’s second reason for disqualifying Taxpayer from the managed audit program, a few more words are needed on this subject. It is clear that the Department did not disqualify Taxpayer from the program because it lacked internal controls and business records. There was no one from the Department who testified that the lack of sufficiency of the internal controls and business records was one of the reasons for the disqualification. In fact, no employee from the Department has evaluated whether Taxpayer’s internal controls and business records are acceptable. When Mr. Dillon testified, he said that he did not know if Taxpayer had acceptable internal controls and business records. [03-26-15 CD 1:53]. In fact, Mr. Dillon said that Quick Books was a “good” accounting software package. [03-26-15 CD 2:12]. He did express some concerns but he qualified those concerns with the caveat that he had not

reviewed Taxpayer's business records. This criterion of whether Taxpayer can demonstrate an acceptable system of internal controls and business records still needs to be addressed by the Department employees who will review Taxpayer's application for a managed audit. There is no requirement that the controls and records be sufficient but they only be acceptable.

The hearing officer understands the Department's need to make the point that Taxpayer must have good and reliable business records since Taxpayer will be conducting a self-audit, which is the purpose of the managed audit. It should be noted that Taxpayer has taken a number of positive steps to recreate its business records and determine its tax liability. Taxpayer hired the accounting firm of Schlenker to determine its tax liability for the tax periods from October 2011 through June 2014. **[03-26-15 CD 0:51-0:52]**. Schlenker has estimated that Taxpayer owes in gross receipts taxes: 2011-\$17,000.29; 2012-\$34,596.29; 2013-\$44,844.17; and 2014-\$20,530.78. **[Exhibit 1.1, page 7]**. Taxpayer, through, Schlenker, was able to reconstruct its business records sufficient to determine its tax liability. Taxpayer has hired several employees to go through its records and make entries and corrections in Quick Books to more accurately reflect Taxpayer's financial situation. **[03-26-15 CD 2:22]**. All of these efforts should go a long way in showing the Department, that Taxpayer has an acceptable system of internal controls.

Therefore, this issue of an acceptable system of internal controls and business records will need to be addressed by Taxpayer and the Department at a later time. Since this issue was not the basis for the denial of entry into the managed audit program, this question is not currently before this Hearing Officer.

***Other Criteria.***

There are a number of other criteria mentioned in FYI-404, namely: the Department has not already selected the taxpayer for audit; the Department is not currently pursuing collections on

the taxpayer; the taxpayer has not been the subject of a criminal investigation; the taxpayer's resources are available to conduct the managed audit; the taxpayer is not already in a legal dispute with the Department over the taxability of the transactions that are the subject of the managed audit; the managed audit does not apply to existing liabilities; the taxpayer's existing outstanding liability was paid in full prior to requesting a managed audit agreement; the managed audit does not include transactions that are subject to a tribal gross receipts tax that the Department administers on behalf of any tribe pursuant to a Gross Receipts Tax Tribal Cooperative Agreement; and the taxpayer has not previously entered into and completed a managed audit for the same tax issue. FYI-404, pages 2-3.

Mr. Dillon testified to the following: that Taxpayer has never been selected for audit by the Department. **[03-26-15 CD 2:11-2:12]**. The Department is not pursuing collection actions against the Taxpayer. **[03-26-15 CD 2:11-2:12]**. Mr. Dillon also testified that he believes that Taxpayer has demonstrated a willingness and ability to comply with New Mexico's tax laws. **[03-26-15 CD 2:12]**. Also by hiring a forensic accounting firm, an accounting firm, an attorney, and determining what its tax liability is, Taxpayer has demonstrated a willingness and ability to comply with New Mexico's tax laws. Mr. Arnold testified that he will seek financing to pay the tax liability for the tax periods from January 2012 through May 2014. **[03-26-15 CD 0:53-0:54]**. Taxpayer has not been the subject of a criminal investigation. **[03-26-15 CD 2:13]**. Mr. Dillon also testified that Taxpayer has resources available to conduct the managed audit. **[03-26-15 CD 2:13]**. Mr. Dillon believes that Taxpayer is not already in a legal dispute with the Department over the taxability of the transactions that are the subject of the managed audit. **[03-26-15 CD 2:13-2:14]**. He also testified that Taxpayer has not paid any existing or outstanding tax liabilities for the tax periods at issue. **[03-26-15 CD 2:15]**. Mr. Dillon went on to testify that the unpaid

gross receipts taxes and unfiled returns are not existing liabilities because the Department has not assessed Taxpayer for those tax periods. **[03-26-15 CD 2:11]**. Finally, Mr. Dillon testified that Taxpayer has not previously entered into and completed a managed audit for the same tax issue. **[03-26-15 CD 2:14-2:15]**.

There is more than sufficient evidence to prove that the remaining criteria has been met by Taxpayer.

### **CONCLUSIONS OF LAW**

A. Taxpayer filed a timely written protest to the managed audit disqualify notice Letter Id. No. L0266468304.

B. Jurisdiction rests over the subject matter of this protest.

C. The hearing was timely set as required by NMSA 1978, Section 7-1-24.1(A) (2013).

D. The Department disqualified Taxpayer from the managed audit program because it believed that Taxpayer had received two or more non-filer notices.

E. Taxpayer was able to prove through credible testimony that it did not receive two or more non-filer notices.

F. The Department did not present any evidence or testimony of its procedures for generating and mailing non-filer notices.

G. Taxpayer is not disqualified from the managed audit program because it received two or more non-filer notices.

H. The issue of whether Taxpayer has an acceptable system of internal controls and business records has not been decided.

I. Other than the issue of an acceptable system of internal controls and business records, Taxpayer is eligible, as of the date of the hearing, for the managed audit program.

For the foregoing reasons, the Taxpayer's protest **IS GRANTED**.

DATED: April 27, 2015

*Monica Ontiveros*

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