STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
SANTA FE BAKING COMPANY & CAFÉ INC. No. 15-36
TO ASSESSMENTS ISSUED UNDER LETTER
ID NOs. L1350039504, L1910280144, L0813168592, L0165449680, L1886910416, L1239191504, L0142079952, L0702320592, L1776062416, L0433885136, L1215821776 and L0678950864

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on September 22, 2015 before Brian VanDenzen, Esq., Interim Chief Hearing Officer, in Santa Fe. At the hearing, Erik Struck, owner of Santa Fe Baking Company & Café, Inc. ("Taxpayer") appeared, along with his representative Andrew Perkins, CPA. Staff Attorney Gabrielle Dorian appeared representing the State of New Mexico Taxation and Revenue Department ("Department"). Protest Auditor Nicholas Pacheco appeared as a witness for the Department. Taxpayer Exhibits #1-2 were admitted into the record. Department Exhibits A-C were admitted into the record. All exhibits are more thoroughly described in the Administrative Exhibit Coversheet. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On March 11, 2015, under letter id. no. L1350039504, the Department assessed Taxpayer for $990.75 in withholding tax, $198.15 in penalty, and $77.57 in interest for the CRS reporting period ending on June 30, 2012.

2. On March 11, 2015, under letter id. no. L0813168592, the Department assessed Taxpayer for $766.37 in withholding tax, $153.27 in penalty, and $48.44 in interest for the CRS reporting period ending on December 31, 2012.

3. On March 11, 2015, under letter id. no. L1886910416, the Department assessed Taxpayer for $696.48 in withholding tax, $139.30 in penalty, and $33.66 in interest for the CRS reporting period ending on June 30, 2013.

4. On March 11, 2015, under letter id. no. L0142079952, the Department assessed Taxpayer for $651.60 in withholding tax, $130.30 in penalty, and $21.53 in interest for the CRS reporting period ending on December 31, 2013.

5. On March 11, 2015, under letter id. no. L1215821776, the Department assessed Taxpayer for $797.40 in withholding tax, $63.80 in penalty, and $6.55 in interest for the CRS reporting period ending on October 31, 2014.

6. On March 11, 2015, under letter id. no. L0678950864, the Department assessed Taxpayer for $172.01 in withholding tax, $13.76 in penalty, and $1.41 in interest for the CRS reporting period ending on October 31, 2014.

7. On March 18, 2015, under letter id. no. L1910280144, the Department assessed Taxpayer for $29,699.69 in gross receipts tax, $7,009.58 in penalty, and $2,455.39 in interest for the CRS reporting period ending on June 30, 2012.

8. On March 18, 2015, under letter id. no. L0165449680, the Department assessed Taxpayer for $45,145.53 in gross receipts tax, $9,182.38 in penalty, and $2,879.41 in interest for the CRS reporting period ending on December 31, 2012.

9. On March 18, 2015, under letter id. no. L1239191504, the Department assessed Taxpayer for $52,437.94 in gross receipts tax, $10,626.88 in penalty, and $2,564.43 in interest for the CRS reporting period ending on June 30, 2013.

10. On March 18, 2015, under letter id. no. L0702320592, the Department assessed Taxpayer for $52,482.82 in gross receipts tax, $10,626.88 in penalty, and $1,764.29 in interest for the CRS reporting period ending on December 31, 2013.

11. On March 18, 2015, under letter id. no. L1776062416, the Department assessed Taxpayer for $47,430.79 in gross receipts tax, $6,640.34 in penalty, and $869.35 in interest for the CRS reporting period ending on June 30, 2014.

12. On March 18, 2015, under letter id. no. L0433885136, the Department assessed Taxpayer for $47,673.71 in gross receipts tax, $3,891.44 in penalty, and $419.27 in interest for the CRS reporting period ending on October 31, 2014.

13. On June 17, 2015, Taxpayer protested the Department's assessment[1].

14. On July 1, 2015, the Department's protest office acknowledged receipt of a valid protest.

15. On August 5, 2015, the Department filed a request for hearing in this matter with the Administrative Hearings Office.

16. On August 7, 2015, the Administrative Hearings Office sent Notice of Administrative Hearing, scheduling this matter for a merits hearing on September 22, 2015, within 90-days of the Department's acknowledgment of receipt of a valid protest.

17. The only issue at protest is whether the Department's assessments of penalty should be abated in light of Taxpayer's arguments at protest.

18. Taxpayer is a restaurant in Santa Fe, owned and operated by Mr. Erik Struck since 1998.

[1] Taxpayer had attempted to protest on May 8, 2015, but the protest package was apparently destroyed in the mail. This June 8, 2015 protest date comes from the postage date on the protest packet that the Department received in this matter.

19. When Mr. Struck purchased the businesses, he discovered the previous owner had racked up a tax debt that Mr. Struck had to pay off, which he did with the assistance of office manager Ms. Cassandra Jeffers.

20. During the relevant period, Ms. Cassandra Jeffers continued to serve as office manager for Taxpayer.

21. Ms. Jeffers was responsible for maintaining financial records for Taxpayer.

22. Ms. Jeffers was responsible for reporting and paying New Mexico combined reporting system ("CRS") taxes.

23. During the relevant period, Taxpayer had also engaged the services of a CPA, Richard Aragon, to prepare federal tax filings based on the books that Ms. Jeffers maintained.

24. Ms. Jeffers was not a CPA or otherwise trained in tax accounting methods.

25. Ms. Jeffers changed accounting programs three times from 2013 to 2014, including making changes in the middle of the month.

26. As a result of the changes in accounting system, Taxpayer's financial records were extremely difficult to reconcile.

27. Mr. Struck focused primarily on the kitchen area of the restaurant during the relevant period and trusted that Ms. Jeffers and Mr. Aragon, CPA, were taking care of the financial aspects of the business.

28. Mr. Struck realized there were problems with the accounting when he learned of unpaid bills to vendors in the fall of 2014.

29. Around October 1, 2014, Taxpayer hired Andrew Perkins, CPA, to audit its financial records and reconstruct Taxpayer's records.

30. Mr. Perkins, CPA, discovered that beginning with the reporting period starting on February 1, 2012, and continuing through October 31, 2014, Taxpayer had gone 33-months without reporting and paying the gross receipts tax portion of the CRS returns, even though Taxpayer timely filed CRS related to withholding taxes and paid the withholding taxes.

31. Mr. Perkins, CPA, notified the Department of Taxpayer's omission.

32. Mr. Perkins, CPA, prepared the CRS returns from the reporting periods from February 1, 2012, and continuing through October 31, 2014.

33. Mr. Perkins, CPA, discovered that Taxpayer had two bank accounts in Santa Fe.

34. Mr. Perkins floated checks between local banks to cover account shortages in the short term.

35. The two banks apparently discovered this problem and informed Ms. Jeffers they would only accept cash deposits.

36. Ms. Jeffers continued this practice by writing out checks to herself and then depositing the cash into the account.

37. Mr. Perkins, CPA, found this practice highly questionable and potentially suggestive of potential fraud or misappropriation of business funds.

38. Mr. Perkins, CPA, recommended Mr. Struck relieve Ms. Jeffers of her duties in May of 2015 in light of numerous errors and omissions related to accounting.

39. Ms. Jeffers was in fact relieved of her duties on September 15, 2015.

DISCUSSION

Taxpayer agrees that it owes assessed tax principal and interest. Taxpayer has worked diligently to establish a payment plan to catch up on the outstanding tax principal. The only issue in this protest is whether civil negligence penalty under NMSA 1978, Section 7-1-69 (2007)

must be abated because of Taxpayer's claimed economic hardship and other alleged grounds establishing nonnegligence under Regulation 3.1.11.11 (A) NMAC.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessments issued in this case are presumed correct. Consequently, Taxpayer has the burden to overcome the assessments. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428. Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, §7-1-3 (X) (2013). Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department's assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight).

When a taxpayer fails to pay taxes due to the State because of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, NMSA 1978 Section 7-1-69 (2007) requires that

> there *shall* be added to the amount assessed a penalty in an amount equal to the greater of: (1) two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed twenty percent of the tax due but not paid.

(*italics* added for emphasis).

The statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meets the legal definition of "negligence." *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24, 32 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary).

Regulation 3.1.11.10 NMAC defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required"; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." In this case, Taxpayer was negligent under Regulation 3.1.11.10 (B) & (C) NMAC because Taxpayer failed to take action to report and pay gross receipts on its filed CRS system returns when required through carelessness or inattention of Taxpayer's bookkeeper and accountant.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception: "[n]o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." Here, there is no evidence that Taxpayer made an informed judgment or determination based on reasonable grounds that gross receipts tax did not apply to it when Taxpayer failed to report and pay gross receipts tax on its CRS returns. *See C & D Trailer Sales v. Taxation and Revenue Dep't*, 1979-NMCA-151, ¶8-9, 93 N.M. 697 (penalty upheld where there was no evidence that the taxpayer "relied on any informed consultation" in deciding not to pay tax). Consequently, this mistake of law provision of Section 7-1-69 (B) does not mandate abatement of penalty in this case.

The other grounds for abatement of civil negligence penalty are found under Regulation 3.1.11.11 NMAC. That regulation establishes eight indicators of nonnegligence where penalty may be abated. Based on the argument of Taxpayer and the evidence presented, only three

factors under Regulation 3.1.11.11 NMAC are potentially pertinent in this proceeding:

> A. the taxpayer proves the taxpayer was affirmatively misled by a department employee;
> …
> C. the taxpayer shows that physical damage to the taxpayer's records or place of business caused a delay in filing a return or making payment of tax;
> D. the taxpayer proves that the failure to pay tax or to file a return was caused by reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts; failure to make a timely filing of a tax return, however, is not excused by the taxpayer's reliance on an agent;

In Taxpayer's closing argument, Mr. Perkins argued that under 3.1.11.11 (A) NMAC, Taxpayer was misled by the Department's technological or systematic failure to detect the absence of gross receipts tax filings and payments when Taxpayer filed and paid withholding taxes on its CRS returns. This alleged systematic failure does not equate to being "*affirmatively* misled by a department employee" required under subsection A. Under New Mexico's self-reporting tax system, "every person is charged with the reasonable duty to ascertain the possible tax consequences" of his or her actions. *Tiffany Construction Co. v. Bureau of Revenue*, 1976-NMCA-127, ¶5, 90 N.M. 16. It is the duty of Taxpayer to determine what CRS taxes need to be reported and paid. Unless a specific Department employee affirmatively told Taxpayer that the gross receipts taxes were not due with the withholding taxes on the CRS returns, which there is no evidence of in this protest, the alleged systematic failure does not abrogate Taxpayer of its responsibility to file and pay the tax.

Taxpayer also argued that because Ms. Jeffers did such a poor job maintaining the books and developing a coherent and consistent accounting system, Taxpayer's records were effectively physically damaged under Regulation 3.1.11.11 (C) NMAC. As part of this argument, Mr. Perkins argued that no one from the Department bothered to check the state of the records.

However, as discussed above, under the presumption of correctness attached to the assessment of penalty, it is Taxpayer's burden to establish the grounds for abatement. Physical damage to records, such as a fire or a flood at the place of business, is not equivalent to the inadequate accounting systems and disorganization established on this record—which are the exact things civil negligence penalty is designed to discourage. This factor gives no relief to Taxpayer.

The factor most potentially relevant in this case is found under Regulation 3.1.11.11 (D) NMAC, where civil negligence penalty may be abated if Taxpayer reasonably relied on the advice of competent tax counsel or accountant after full disclosure of all relevant facts. Here, Taxpayer did employ a C.P.A., Mr. Aragon, to assist with its tax filings. Employing a licensed C.P.A. meets the baseline competency requirement necessary to find reasonable reliance on that accountant's advice. The problem in this case is that the evidence established that Mr. Aragon, C.P.A. was focused on filing of federal taxes while Ms. Jeffers was responsible for filing and paying the CRS taxes, including the unreported and paid gross receipts tax liabilities. There is no evidence that Ms. Jeffers was a C.P.A. or otherwise a competent tax accountant. In fact, there is very little evidence at all about her credentials. While credentials are not necessarily dispositive, they certainly play a part in determining the reasonableness of Taxpayer's reliance on Ms. Jeffers in tax matters. In this case, Mr. Struck indicated that he essentially handed over the accounting, bookkeeping, and CRS tax reporting functions to Ms. Jeffers and trusted her to get the job done so he could focus on the food side of the business. Given a taxpayer's duty under *Tiffany Construction Co.*, 1976-NMCA-127, ¶5, to ascertain the tax consequences of its actions, a taxpayer cannot "abdicate this responsibility [to learn of tax obligations] merely by appointing an accountant as its agent in tax matters." *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶14, 108 N.M. 795. Consequently, since Taxpayer essentially asks

for abatement of penalty because it delegated its own responsibilities to a person whom was ultimately not up to the tax reporting and accounting requirements, *El Centro Villa Nursing* established that the civil negligence penalty is appropriate for such delegated, inadvertent error and Regulation 3.1.11.11 (D) NMAC does not provide grounds for abatement of that penalty.

Taxpayer also argued that the Department in fact has forgiven penalty in the past without specific statutory or regulatory cause under the Tax Amnesty programs, giving the Department the precedence necessary to do so in this circumstance despite the absence of a specific authorizing statute or regulation. The Tax Amnesty programs came from specific Legislative action, authorized for a defined, limited period of time that has now expired. There is currently no statutory provision that allows for Tax Amnesty. The closest current equivalent to the Tax Amnesty programs is a managed audit under NMSA 1978, Section 7-1-11.1 (2003), which is a program that Taxpayer did not seek to enter in this case before filing its amended returns and before receiving the assessments.

Taxpayer claimed undue financial hardship as a basis to abate penalty, as Taxpayer believed it would be extremely difficult to keep the restaurant open, pay its employees, pay the undisputed tax principal and interest, as well as pay for the assessed penalty. By abating penalty, Taxpayer believed it would be in a much better position to satisfy its outstanding tax obligation and meet its continuing business obligation. Related to this argument is Taxpayer's claim that policy should dictate abatement of penalty in this case, as Taxpayer employees some 20 employees and abatement of penalty might be the difference in allowing this long-standing business to remain in New Mexico rather than close like so many other businesses have had to do over the past five years. This is a particularly difficult decision to render in light of these financials circumstances and this policy consideration. However, despite sympathy with Mr. Perkins' rather persuasive

closing argument about maintaining business in this state, a hearing officer of the Administrative Hearings Office is not allowed to engage in questions of tax policy. *See* NMSA 1978, § 7-1-24.1 (2013) and NMSA 1978, § 7-1B-8 (2015). Nor does New Mexico law provide a statutory or regulatory provision for abatement of penalty for undue financial hardship. While federal law does allow for abatement of penalty for undue financial hardship in limited circumstances, New Mexico's treatment of civil negligence penalty differs from federal law. *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶8, 108 N.M. 795. The Department is required to assess a taxpayer for any tax liability exceeding $25.00. *See* § 7-1-17 (A). NMSA 1978, Section 7-1-20 (1995) only allows the Department to compromise on a tax assessment when it has a "good faith doubt" to the liability. That section does not contain any financial hardship exception. Regulation 3.1.6.14 NMAC (01/15/01) does not allow the Department to abate otherwise legally required assessments based on Taxpayer's ability to pay.

Taxpayer's current accountant Mr. Perkins, CPA, expressed concerns about some of Ms. Jeffers questionable accounting practices (including using two banks to float checks), the general disorganized state of the accounts, and the possibility that some of these accounting practices may have hidden some broader fraudulent conduct. This raises some potential similarities in this protest with another Decision and Order issued by this hearing officer, *In the Matter of the Protest of Sipapu Recreation Dev. II, LLC*, No. 10-21 (non-precedential), where penalty was abated in light of the fraudulent conduct of that taxpayer's bookkeeper. However, in that case there was much more evidence that the taxpayer's accountant repeatedly assured her supervisors that the taxes were being actively reported and paid while simultaneously engaging in active deception making the accountant's failings difficult to detect in the ordinary course of prudent business. In that case, the taxpayer was more actively involved in the accounting side of the

business and consequently more quickly discovered the problem, relieved the employee immediately, and had a forensic audit done to detect the issues. Unfortunately in this case, and distinct from *Sipapu*, Mr. Struck's approach appeared to be much more hands off and it took nearly two years for Taxpayer to discover the financial problem. And aside from Mr. Perkins, CPA.'s informed speculation, it is still not clear on the record whether the problem in this case was related to the accountant's basic incompetence and lack of supervision (which is subject to penalty) or some sort of active deception or fraud undetectable through reasonably prudent business practices that may not constitute negligence subject to penalty. For the foregoing reasons, Taxpayer's protest **IS DENIED**.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Department's denial of the claim for refund, and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing was timely set within 90-days of protest under NMSA 1978, Section 7-1-24.1 (2013).

C. Taxpayer did not overcome the presumption of correctness, including the assessed penalty, that attached to the assessments under NMSA 1978, Section 7-1-17 (C) (2007) and *Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428.

D. Under NMSA 1978, Section 7-1-69 (2007), Taxpayer is liable for civil negligence penalty because Taxpayer's inaction in failing to include gross receipts tax and payment of tax on its CRS returns during the relevant period met the definition of civil negligence under Regulation 3.1.11.10 NMAC. Taxpayer did not establish a good faith, mistake of law made on reasonable grounds that would allow for abatement of penalty under Section 7-1-69 (2007).

E. None of the indicators of nonnegligence found under Regulation 3.1.11.11 NMAC allow for abatement of penalty in this protest.

F. Inability to pay is not grounds for abatement of an assessed tax liability under Regulation 3.1.6.14 NMAC (01/15/01).

For the foregoing reasons, the Taxpayers' protest **IS DENIED**. **IT IS ORDERED** that the Taxpayer is liable for the assessed penalty. The Department is further ordered to provide Taxpayer a clear summary of outstanding penalty, as Department Ex. C did not include a clear total of the remaining assessed penalty.

DATED: December 7, 2015.

Brian VanDenzen
Interim Chief Hearing Officer
Administrative Hearings Office
P.O. Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (1989), the parties 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* Rule 12-601 NMRA. If an appeal is not filed within 30 days, this Decision and Order will become final. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may being preparing the record proper.