STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
JTC INC.
TO ASSESSMENT
ISSUED UNDER LETTER
ID NO. L1659639360

v. **D&O No. #18-17**

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

A formal hearing on the merits in the above-captioned protest was held on January 18, 2018 before Hearing Officer Chris Romero, Esq., in Santa Fe, New Mexico. The Taxation and Revenue Department (Department) was represented by Mr. Peter Breen, Staff Attorney. Mr. Tom Dillon, Auditor, also appeared on behalf of the Department. Mr. Louis J. Terr, Esq. (Ahr Law Offices) appeared with Mr. Dean Ford, President of JTC Inc. ("Taxpayer") and Ms. Tami Montoya, Taxpayer's chief operating officer. Taxpayer Exhibits 1 – 7 and Department Exhibits A – D were admitted into the evidentiary record of the hearing. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet. Upon approval of the Hearing Officer, with concurrence of the Department, Taxpayer filed Taxpayer's Specification of Abatement Requested on March 8, 2018. The parties were thereafter permitted through April 30, 2018 to file their written closing arguments. On May 29, 2018, Taxpayer filed Taxpayer's Motion for Directed Order which will be addressed below.

The Hearing Officer took notice of all documents in the administrative file. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On February 3, 2011, the Department assessed Taxpayer for gross receipts tax, penalty, and interest for the tax periods from January 31, 2004 through December 31, 2009. The assessment was for $96,261.50 in gross receipts tax, $19,257.07 in penalty, and $21,634.05 in interest. [*See* Administrative File].

2. On February 24, 2011, Taxpayer filed a formal protest letter by and through its representative, Mr. Robert E. Bivins, J.D. (Palmer & Co., P.A.). [*See* Administrative File].

3. On March 1, 2011, the Department acknowledged receipt of Taxpayer's protest under Letter ID No. L1092950592. [*See* Administrative File].

4. On May 16, 2017, the Department submitted a Hearing Request to the Administrative Hearings Office which brought the above-captioned protest to its attention for the first time. The Department requested that the Administrative Hearings Office set the matter for a hearing on the merits. [*See* Administrative File].[1]

5. On May 16, 2017, the Administrative Hearings Office filed and served a Notice of Administrative Hearing setting a hearing on the merits of Taxpayer's protest for August 15, 2017. [*See* Administrative File].

6. On August 15, 2017, neither Taxpayer nor its representative appeared for the hearing on the merits of its protest. [*See* Administrative File].

7. On August 18, 2017, the Administrative Hearings Office entered a Decision and Order denying Taxpayer's protest as a result of its failure to appear at the hearing previously noticed to occur on August 15, 2017. [*See* Administrative File].

[1] The record does not demonstrate the source of the 6-year delay between Taxpayer's protest being acknowledged and the Department requesting a hearing. Prior to enactment of the Administrative Hearings Office Act in 2015, there was no statutory deadline for requesting or conducting a hearing. In this protest, the Administrative Hearings Office set a hearing as soon at the protest was brought to its attention by the Department's Hearing Request.

8. On December 1, 2017, Taxpayer, by and through Mr. Lewis J. Terr, Esq., submitted correspondence to the Administrative Hearings Office requesting that the Decision and Order entered on August 18, 2017 be set aside. [*See* Administrative File].

9. Having considered the correspondence, the undersigned Hearing Officer granted the request to set aside the Decision and Order entered on August 18, 2017. Findings in support of setting aside the Decision and Order were fully explained in the Order Setting Aside Decision and Order and Notice of Administrative Hearing, entered on December 27, 2017. A second hearing on the merits of Taxpayer's protest was noticed to occur on January 18, 2018. [*See* Administrative File].

10. On January 25, 2018, the Administrative Hearings Office entered a Post-Hearing Scheduling Order which formalized the agreement of the parties with respect for post-hearing submissions and closing arguments. [*See* Administrative File].

11. Mr. Dean Ford is the President of Taxpayer and has been employed with Taxpayer for approximately 24 years. [Testimony of Mr. Ford].

12. Taxpayer is primarily engaged in the business of painting large architectural structures, and applying coatings for a variety of customers, including industrial consumers. Taxpayer also operates a blasting and coating facility in which it provides coating and blasting services for clients requiring engineered coating systems for various types of applications. [Testimony of Mr. Ford].

Transactions with Mid Columbia Engineering, Inc. for National Enrichment Facility

13. One such customer was Mid Columbia Engineering, Inc. (hereinafter "MCE") which in 2009, had been retained by Louisiana Energy Services to engineer equipment to be utilized in the National Enrichment Facility in Eunice, New Mexico. [Testimony of Mr. Ford].

14. The project was funded by an Industrial Revenue Bond in which the Lea County Board of Commissioners executed a Type 9 non-taxable transaction certificate (hereinafter "NTTC", or its plural form, "NTTCs") to MCE. [*See* Taxpayer Ex. 2].

15. Construction of that facility required compliance with the highest standards of quality assurance for nuclear facilities, known as Nuclear Quality Assurance-1, or NQA-1, because the structure was being constructed to contain centrifuges utilized to enrich uranium. [Testimony of Mr. Ford].

16. Taxpayer had been aware of the project at the time it was contacted by MCE which expressed interest in procuring Taxpayer's services for work on the project. MCE provided Taxpayer with detailed plans. Taxpayer responded with a cost estimate and was selected to provide services to MCE. [Testimony of Mr. Ford].

17. With respect to transactions with MCE, Taxpayer performed services on components engineered by MCE that MCE, not Taxpayer, would then supply to Louisiana Energy Services for installation or incorporation in to the National Enrichment Facility. [Testimony of Mr. Ford].

18. The product of the services performed for MCE was initially delivered or used in New Mexico. [*See* Department Ex. A; Department Ex. C-B4.5].

19. Because MCE represented that the project was tax exempt, and funded under an Industrial Revenue Bond, Taxpayer did not include gross receipts tax as part of its cost estimate

or ever pass on to MCE any charges for gross receipts tax for its services. [Testimony of Mr. Ford].

20. MCE provided Taxpayer with a Resale Certificate issued by the Department of Revenue of the State of Washington. [Testimony of Mr. Ford; *See* Taxpayer Ex. 3].

21. Significant and vital portions of the Resale Certificate were incomplete and blank. It did not identify any seller, including Taxpayer, and relevant and mandatory date information was omitted. For example, it did not indicate when it was executed, when it would become effective, or when it would expire. [*See* Taxpayer Ex. 3].

22. The Department declined to accept the MCE Resale Certificate as an NTTC or as a document equivalent thereto. [Testimony of Ms. Montoya].

23. Taxpayer provided various documents in support of its claim that receipts from MCE should not be taxable as gross receipts, including correspondence and the Type 9 NTTC executed by the Lea County Board of Commissioners to MCE. [*See* Taxpayer Ex. 1, 2, 3, 4]

24. Ms. Tami Montoya is Taxpayer's chief operating officer and has been employed with Taxpayer for approximately 18 years. [Testimony of Ms. Montoya].

25. Ms. Montoya's duties include bookkeeping and payment of Taxpayer's gross receipts tax. [Testimony of Ms. Montoya].

26. Ms. Montoya has been responsible for payment of Taxpayer's gross receipts taxes since 2011. She was trained by Taxpayer's past owner and president who retired in 2011. [Testimony of Ms. Montoya].

27. Ms. Montoya was the primary contact for Taxpayer during the audit giving rise to the assessment subject of the protest. [Testimony of Ms. Montoya].

28. Ms. Montoya perceived various errors with the Department's audit, including the refusal to accept the Resale Certificate provided by MCE. [Testimony of Ms. Montoya].

Transactions with ABQ Manufacturing and Associated Entities

29. Ms. Montoya asserted error by the Department for its assessment of gross receipts taxes on receipts deriving from services provided to other entities, particularly ABQ Manufacturing and other entities affiliated with it. [Testimony of Ms. Montoya].

30. The asserted error resulted from the fact that various buyers of Taxpayer's services, including ABQ Manufacturing, were no longer in business, or were unable to execute NTTCs for other various reasons. [Testimony of Ms. Montoya].

31. With specific reference to receipts from ABQ Manufacturing and its associated entities, its authority to execute NTTCs had been suspended or revoked, precluding it from executing NTTCs to Taxpayer. However, Ms. Montoya's understanding from the Department's auditor was that the Department could nevertheless obtain NTTCs through the Department's internal systems which would effectively resolve any issues with respect to the deductibility of the receipts from those transactions. [Testimony of Ms. Montoya; *See* Taxpayer Ex. 6].

32. The Department did not obtain NTTCs as suggested and receipts from ABQ Manufacturing were ultimately disallowed. [*See* Department Ex. C, Page B4.15, Entry for 10/5/2010; Testimony of Ms. Montoya].

33. In some circumstances, the Department also declined to accept NTTCs due to variations in the names of executing entities. [Testimony of Ms. Montoya].

Other Receipts

34. Ms. Montoya also initially identified various types of receipts which should not be included as gross receipts, including refunds from overpayments to Taxpayer's suppliers, refunds from Taxpayer's insurance company, reimbursements from employees, a tax refund, deposits from loans, and proceeds from the sale of Taxpayer's equipment, such as a truck. [Testimony of Ms. Montoya].

Post-Hearing Submissions

35. On March 8, 2018, Taxpayer, in accordance with the Post-Hearing Scheduling Order, filed Taxpayer's Specification of Abatements Requested. The Department, having ten days under the Post-Hearing Scheduling Order to file objections to Taxpayer's submission or any part thereof, did not file any objections. [*See* Administrative File].

36. On March 22, 2018, the Department filed a Stipulated Motion for Extension of Time to File Closing Arguments. [*See* Administrative File].

37. On March 27, 2018, the Administrative Hearings Office entered an Order Extending Deadline to File Closing Arguments. The deadline was extended through April 30, 2018. [*See* Administrative File].

38. On April 30, 2018, the Department filed Department's Closing Argument and Taxpayer filed Taxpayer's Closing Argument. [*See* Administrative File].

39. On May 29, 2018, Taxpayer filed Taxpayer's Motion for Directed Order. [*See* Administrative File].

40. As of January 18, 2018, the Taxpayer's purported outstanding liability was $94,233.13 in gross receipts taxes, $21,132.89 in penalty, and $63,852.52 in interest, for a total outstanding liability of $179,218.54 [*See* Department Ex. B], although counsel for the Department acknowledged that amount could be subject to further updates depending on any

information Taxpayer might submit as agreed upon by the parties at the conclusion of the hearing and as permitted in the Post-Hearing Scheduling Order.

DISCUSSION

The issue to be decided is whether Taxpayer should be relieved from gross receipts tax, penalty, and interest under the assessment. According to Taxpayer, relief from the assessment should stem from three (3) categories in which it asserted error with the Department's audit giving rise to the assessment: 1) the alleged failure of the Department's auditor to allow deduction of Taxpayer's receipts from MCE; 2) the alleged failure of the auditor to allow deduction of Taxpayer's receipts from ABQ Manufacturing and associated entities; and 3) alleged error in determining that certain income appearing on Taxpayer's records were gross receipts within NMSA 1978, Section 7-9-3.5.

Taxpayer's Motion for Directed Order

As a preliminary matter, the Hearing Officer addresses Taxpayer's Motion for Directed Order, filed on May 29, 2018. Nearing conclusion of Taxpayer's presentation of evidence, Taxpayer's counsel candidly acknowledged that Taxpayer was not fully prepared to establish the amount of the abatement to which it was asserting entitlement. The Department suggested that it would not object to Taxpayer preparing and submitting, as a late-filed exhibit, a document addressing the amounts and bases of potential abatements. The Taxpayer agreed to provide a recapitulation at which time the Department also stated that it was not waiving its right to object to the contents of the recapitulation, but that Taxpayer should have the opportunity to provide some information to substantiate any claims to abatement despite its unpreparedness at the hearing.

The Hearing Officer entered a Post Hearing Scheduling Order on January 25, 2018 establishing a deadline for Taxpayer's submission, a deadline for the Department to make objections, and deadlines for the parties to file their written closing arguments. Taxpayer's Specification of Abatements Requested (hereinafter "Specification") was filed March 8, 2018.

At no time within the period for making objections or thereafter, did the Department file any objections to the Specification. Consequently, Taxpayer seeks what amounts to a default order in its favor, suggesting that the Hearing Officer should essentially accept its recapitulation as undisputed fact.

Taxpayer's Motion for Directed Order is not well-taken and should be denied. Taxpayer's Specification was not only submitted with the concurrence of the Department, but practically upon its suggestion after Taxpayer acknowledged that it was unprepared to provide such evidence during its case-in-chief. The Hearing Officer perceived the Department's suggestion as an extension of a professional courtesy which it was not obligated to provide, but which it nevertheless extended in good faith. To thereafter penalize the Department for not objecting to Taxpayer's Specification would not only discourage the extension of such courtesies in the future, but also betray the goodwill underlying the Department's disposition to accommodate Taxpayer and its counsel in this protest.

Moreover, the Hearing Officer does not perceive the failure to lodge objections in this instance as tantamount to conceding Taxpayer's claims. Rather, the lack of an objection only demonstrates that the Department does not oppose admittance of Taxpayer's Specification into the record of the proceeding, consistent with the position it took at the hearing. The weight that should be given to the Specification remains strictly within the purview of the Hearing Officer.

Burden of Proof

Assessments by the Department are presumed to be correct. *See* NMSA 1978, Sec. 7-1-17. Tax includes, by definition, the amount of tax principal imposed and, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." *See* NMSA 1978, Sec. 7-1-3. *See also El Centro Villa Nursing Ctr. v. Taxation & Revenue Dep't*, 1989-NMCA-070, 108 N.M. 795, 779 P.2d 982. Therefore, the assessment issued to Taxpayer is presumed to be correct, and it is Taxpayer's burden to present evidence and legal argument to show that it is entitled to an abatement.

The burden is also on Taxpayer to prove that it is entitled to an exemption or deduction, if one should conceivably apply. *See Pub. Serv. Co. v. N.M. Taxation & Revenue Dep't*, 2007-NMCA-050, ¶141 N.M. 520, 157 P.3d 85. *See also Till v. Jones*, 1972-NMCA-046, 83 N.M. 743, 497 P.2d 745. "Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer." *See Sec. Escrow Corp. v. State Taxation & Revenue Dep't*, 1988-NMCA-068, ¶8, 107 N.M. 540, 760 P.2d 1306. *See also Wing Pawn Shop v. Taxation & Revenue Dep't*, 1991-NMCA-024, ¶16, 111 N.M. 735, 809 P.2d 649. *See also Chavez v. Comm'r of Revenue*, 1970-NMCA-116, ¶7, 82 N.M. 97, 476 P.2d 67.

Gross Receipts Tax

For the privilege of engaging in business, New Mexico imposes a gross receipts tax on the receipts of any person engaged in business. *See* NMSA 1978, Section 7-9-4 (2002). "Engaging in business" is defined as "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." *See* NMSA 1978, Section 7-9-3.3 (2003). Services are subject to the gross receipts tax. *See* Regulation 3.2.1.18 (A) NMAC.

Under the Gross Receipts and Compensating Tax Act, there is a statutory presumption that all receipts of a person engaged in business are taxable. *See* NMSA 1978, Section 7-9-5 (2002). Despite the general presumption of taxability, taxpayers may qualify for the benefits of various deductions and exemptions.

Whether the Department erred in disallowing deductions for receipts from services sold to MCE.

Neither during the course of the hearing nor in its closing argument did Taxpayer assert which deductions should apply to the types of transactions at issue in this protest, particularly in reference to transactions with MCE. However, the Hearing Officer notes reference to NMSA 1978, Section 7-9-54 and NMSA 1978, Section 7-9-75 in Taxpayer's original protest from 2011, and NMSA 1978, Section 7-9-57 in the Department's audit work papers.

However, the Hearing Officer will not further consider the application of NMSA 1978, Section 7-9-54 because that deduction is applicable only to receipts from selling tangible personal property, and expressly excludes services. The evidence in this protest clearly established that Taxpayer was engaged in the business of providing services rather than selling tangible personal property. Mr. Ford described the essence of Taxpayer's business activities as painting large architectural structures, applying coatings for a variety of customers, and performing coating and blasting services for clients requiring engineered coating systems.

With respect to transactions with MCE, Taxpayer did not sell tangible personal property. Rather, Mr. Ford's testimony was that it performed such services on components engineered by MCE that MCE, not Taxpayer, would then supply to Louisiana Energy Services for installation or incorporation into the National Enrichment Facility. [Testimony of Mr. Ford]. Taxpayer seemingly acknowledged the same in its closing argument, in which it explained that MCE

engaged Taxpayer "to provide coating services to materials to be used in a project[.]" Therefore, Taxpayer is not entitled to a deduction under NMSA 1978, Section 7-9-54.

Rather, any deductions to which the Taxpayer may be entitled stem from NMSA 1978, Section 7-9-75 or NMSA 1978, Section 7-9-57. Taxpayer's formal protest correspondence specifically makes reference to Section 7-9-75 which provides:

> **7-9-75. Deduction; gross receipts tax; sale of certain services performed directly on product manufactured.**
>
> Receipts from selling the service of combining or processing components or materials may be deducted from gross receipts if the sale is made to a person engaged in the business of manufacturing who delivers *a nontaxable transaction certificate to the seller*. The buyer delivering the nontaxable transaction certificate must have the service performed directly upon tangible personal property which he is in the business of manufacturing or upon ingredients or component parts thereof.
>
> (Emphasis Added)

The Department's audit similarly makes reference to Section 7-9-57 which states:

> **7-9-57. Deduction; gross receipts tax; sale of certain services to an out-of-state buyer.**
>
> A. Receipts from performing a service may be deducted from gross receipts if the sale of the service is made to an out-of-state buyer *who delivers to the seller either an appropriate nontaxable transaction certificate or other evidence acceptable to the secretary unless the buyer of the service or any of the buyer's employees or agents makes initial use of the product of the service in New Mexico or takes delivery of the product of the service in New Mexico*.
>
> B. Receipts from performing a service that initially qualified for the deduction provided in this section but that no longer meets the criteria set forth in Subsection A of this section shall be deductible for the period prior to the disqualification.
>
> (Emphasis Added)

Both statutes clearly require a delivery of a NTTC, although the latter also provides an opportunity to deliver "other evidence acceptable to the secretary." The Hearing Officer will first address the issue of NTTCs.

Non-Taxable Transaction Certificates

On their face, Sections 7-9-57 and 7-9-75 both permit deductions from receipts that are potentially applicable in the protest at hand. The Department did not dispute the potential applicability of those deductions. The crux of the dispute centers on the evidence presented to satisfy their requirements.

It was undisputed that Taxpayer did not possess valid NTTCs for the services it performed. Since the only method through which the Taxpayer could satisfy Section 7-9-75 was through possession of a valid NTTC, the nonexistence of such certificate is conclusive to its claim to that deduction unless the Taxpayer demonstrates relief under the safe harbor provision of NMSA 1978, Section 7-9-43, which will be addressed in more detail below.

The Hearing Officer makes the same observation with respect to Section 7-9-57, although this section requires some additional discussion based on the evidence presented. Specifically, even if Taxpayer was in possession of a valid NTTC from MCE under Section 7-9-57, there is no evidence to establish that the buyer of the service or any of the buyer's employees or agents did not make initial use of the product of the service in New Mexico, or take delivery of the product of the service in New Mexico. This is significant because even with appropriate documentation in the form of an NTTC or other evidence acceptable to the Department, the deduction does not apply if "the buyer of the service or any of the buyer's employees or agents makes initial use of the product of the service in New Mexico or takes delivery of the product of the service in New Mexico."

The evidence established that the product of the service was for inclusion in a construction project in New Mexico, and given the uniqueness of the project, the components were unlikely to be initially used anywhere other than the facility for which they were specifically designed and manufactured. Department Ex. C-B4.5 further suggests that buyer took delivery of the product of Taxpayer's services in New Mexico. Department Ex. A reached a similar conclusion which the Taxpayer did not dispute. Accordingly, with respect for the application of NMSA 1978, Section 7-9-57, Taxpayer has failed to establish entitlement to a deduction because there is no evidence to establish that the initial use of the product of the services was anywhere other than New Mexico or that the buyer of its services took delivery of the product outside its boundaries.

Although this Decision and Order will continue to discuss both Section 7-9-57 and 7-9-75, the prior is fundamentally eliminated from potential application leaving Section 7-9-75 as the only viable deduction to apply to the transactions at issue, especially in reference to MCE as an out-of-state buyer.

Good Faith Safe Harbor Provision

Despite the previously noted deficiency with regard for any claim under Section 7-9-57, Section 7-9-43 provides a safe harbor from taxation in some circumstances when a seller accepts an NTTC in good faith. Although the 53rd Legislature of the State of New Mexico enacted House Bill 194 which amended Section 7-9-43 to permit alternative evidence demonstrating facts necessary to support entitlement to a deduction, the facts underlying the present protest arose more than 14 years prior to that enactment becoming effective on March 2, 2018.

Neither party suggests that the recent amendment should be applied retroactively under the facts of this protest, nor in the absence of the Legislature's clear intention will the Hearing

Officer do so on his own initiative. *See* NMSA 1978, Section 12-2A-8 (C) ("[a] statute or rule operates prospectively only unless the statute or rule expressly provides otherwise or its context requires that it operate retrospectively.").

Therefore, the applicable provision representing the core component of Taxpayer's protest states in relevant part:

> [w]hen the seller or lessor accepts a nontaxable transaction certificate within the required time and in good faith that the buyer or lessee will employ the property or service transferred in a nontaxable manner, the properly executed nontaxable transaction certificate shall be conclusive evidence, and the only material evidence, that the proceeds from the transaction are deductible from the seller's or lessor's gross receipts.

Consequently, the statute grants the seller of the service safe harbor from taxation when the seller timely accepts a properly executed NTTC in good faith from the buyer. Regulation 3.2.201.14 NMAC (05/31/01) discusses good faith acceptance of an NTTC:

> Acceptance of nontaxable transaction certificates (nttcs) in good faith that the property or service sold thereunder will be employed by the purchaser in a nontaxable manner *is determined at the time of each transaction*. The taxpayer claiming the protection of a certificate continues to be responsible that the goods delivered or services performed thereafter are of the type covered by the certificate.
>
> (Emphasis added)

The Administrative Hearings Office, and its predecessor the Hearings Bureau, have employed a broader view of the good-faith, safe harbor protection since the 2013 issuance of the decision and order *In the Matter of the Protest of Case Manager*, No. 13-12 (non-precedential) and *In the Matter of the Protest of Rio Grande Electric Co., Inc*, No. 13-16 (non-precedential). In an unpublished decision, the New Mexico Court of Appeals affirmed the ruling in *Case Manager* under a right for any reason standard. *See New Mexico Taxation and Revenue Dep't. v. Case Manager*, No. 32,940 (N.M. Ct. App. April 29, 2015) (non-precedential).

However, even under the broader reading of the safe harbor provision since *Case Manager* and *Rio Grande Electric*, the good-faith, safe-harbor provision is limited to cases where the underlying transaction is deductible under a recognized statutory deduction. *See In the Matter of the Protest of Adecco USA, Inc.*, Decision and Order No. 14-16 (non-precedential); *See also In the Matter of the Protest of The GEO Group, Inc.*, Decision and Order No. 14-36 (non-precedential). Those decisions and orders have consistently determined that the safe harbor provision cannot serve to make a taxable transaction, not covered by any recognized statutory deduction, into a nontaxable transaction merely by possession of an NTTC.

In *McKinley Ambulance Serv. v. Bureau of Revenue*, 1979-NMCA-026, ¶10, 92 N.M. 599, 592 P.2d 515, the Court of Appeals held that the good faith safe harbor provision did not protect a seller from taxation "unless the certificate covered the receipts in question." The court went on to say that since there was "no certificate applicable" for the type of services that taxpayer provided, the Department's denial of the deduction was proper. *See* ¶13.

Consistent with *McKinley*, the Court of Appeals stated in *Gas Co. of N.M. v. O'Cheskey*, 1980-NMCA-085, ¶12, 94 N.M. 630, 614 P.2d 547 that "[t]he issuance of a 'Nontaxable Transaction Certificate' does not operate to transform an otherwise taxable transaction into a nontaxable transaction." Further, in *Arco Materials, Inc. v. Taxation & Revenue Dep't*, 1994-NMCA-062, 118 N.M. 12, 878 P.2d 330 (overturned on other grounds), the New Mexico Court of Appeals relied on a taxpayer's continuing obligation to ensure that the NTTC covers the type of goods sold in finding that a taxpayer was not entitled to a deduction when the transaction was no longer subject to a deduction. While *Leaco Rural Tel. Coop., Inc. v. Bureau of Revenue*, 1974-NMCA-076, ¶15, 86 N.M. 629, 526 P.2d 426 and *Continental Inn of Albuquerque, Inc. v. N.M. Taxation & Revenue Dep't*, 1992-NMCA-030, 113 N.M. 588, 829 P.2d 946 suggest that timely,

good faith acceptance of a properly executed NTTC is sufficient for a taxpayer to claim a deduction even if the transaction itself did not fall under any recognized deduction, those cases must be interpreted in the context of the cases that followed, *McKinley , Gas Co*., and *Arco Materials*.

The obstacle to applying the good-faith, safe harbor provision to the application of Section 7-9-57, and what makes this case distinguishable from *Continental Inn*, is that under no circumstance could transactions under Section 7-9-57 qualify for a deduction in the absence of evidence upon which to find that the initial use of the product of the services was anywhere other than New Mexico or that the buyer of its services took delivery of the product outside New Mexico. Because the transactions at issue in this protest are not deductible unless those mandatory elements are also satisfied, possession of a non-taxable transaction certificate or any other evidence potentially satisfactory to the Department, would not be sufficient to satisfy the minimum requirements for deductibility. The result is analogous to *McKinley* in which possession of a non-taxable transaction certificate alone does not convert a taxable transaction into a nontaxable one. *See McKinley,* ¶13; *See also Gas Co*. ¶12.

As mentioned, the *Continental Inn* case is distinguishable from the facts of the present protest because in that case, the transactions were potentially deductible under a recognized deduction if the buyer in that case had adhered with the usual requirements of the Gross Receipts and Compensating Tax Act. In *Continental Inn*, a general contractor constructing an inn issued NTTCs to subcontractors. *See id*. at ¶1 – 3. The Court of Appeals noted that the transactions themselves were potentially deductible under two recognized deductions if the general contractor ultimately paid gross receipts tax on the sale of the constructed inn. *See id*. at ¶7. However, for uncertain reasons, the general contractor chose not to pay gross receipts tax on the constructed inn. *See id*. The Department pursued the general contractor with a compensating tax assessment,

which the Court of Appeals ultimately upheld. In addressing one of the taxpayer's arguments, the Court of Appeals in *Continental Inn* reviewed the good-faith, safe harbor provision under Section 7-9-43 and found that the general contractor's issuance of the NTTCs to the subcontractors "represented to the subcontractors that the use of the NTTCs was such that the subcontractors were entitled to the deduction from gross receipts." *Id*. ¶13. This statement is arguably dicta, since the case involved Taxpayer's liability for compensating tax rather than the subcontractors' ability to claim a deduction. But even if applicable, *Continental Inn* is still distinguishable from the present protest in that the transactions with the subcontractors in *Continental Inn* would have qualified for a recognized deduction but for the buyer's failure to otherwise proceed as expected in the transaction. In this protest, there is no circumstance where the transaction could have qualified for any recognized deduction because there was insufficient evidence upon which to find that Taxpayer satisfied all elements necessary to claim a deduction under Section 7-9-57.

With respect for the potential application of Section 7-9-75, Taxpayer acknowledges that it does not, nor has it ever possessed a non-taxable transaction certificate. Rather, Taxpayer relies on a Resale Certificate provided by MCE and application of Article V, Section 2 of the Multistate Tax Compact, NMSA 1978, Section 7-5-1, which provides:

> Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate state or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction

New Mexico, like other participating states, retains the authority to determine whether a certificate under the compact will satisfy the requirements of a deduction or exemption under its taxation structure. *See Southwest Mobile Service v. N.M. Taxation and Revenue Dep't.*, No.

34,551 (N.M. Ct. App.) (non-precedential). In doing so, "New Mexico will accept an MTC only from buyers not required to be registered with the Department and only for the purchase of tangible personal property." *Id*., ¶3; *See* NMSA 1978, Section 7-9-43 (A); Regulation 3.2.201.13 NMAC. A significant deficiency in the Taxpayer's position stems from the fact that MCE was procuring services rather than tangible personal property.

The secondary deficiency stems from the evidence it presented in the form of the Resale Certificate. First, Section 7-9-75 requires a non-taxable transaction certificate which Taxpayer admittedly does not possess. In the alternative, Taxpayer relies on a Resale Certificate and the good faith provision under Article V, Section 2 of the Multistate Tax Compact, NMSA 1978, Section 7-5-1. Although distinct from one another, our courts have recognized and held that the good faith provisions of the Multistate Tax Compact are "virtually identical to [the court's] treatment of NTTCs, which serve the same purpose in intrastate transactions that are served by MTCs for interstate [transactions]." *See Siemens Energy & Automation, Inc. v. N.M. Taxation & Revenue Dep't*, 1994-NMCA-173, ¶16, 119 N.M. 316, 889 P.2d 1238; *See Southwest Mobile Service v. N.M. Taxation and Revenue Dep't.*, No. 34,551 (N.M. Ct. App.) (non-precedential)

The obvious problem in this protest is that the Resale Certificate relied upon by Taxpayer lacks essential information which diminishes its evidentiary reliability. First and foremost is that the Resale Certificate is incomplete. The document fails to identify the name of the seller, its effective date, its expiration date, or the date on which it was purportedly executed.

This observation is significant because the perceptible insufficiencies of the Resale Certificate make it appear irregular on its face, and that it was *not properly executed* because the Resale Certificate was not complete. *See Leaco Rural Tel. Coop., Inc. v. Bureau of Revenue*, 1974-NMCA-076, ¶14, 86 N.M. 629, 526 P.2d 426 (the phrase "properly executed" is "used in

the sense of completing -- filling out and signing -- the NTTCs."). The State of Washington, the jurisdiction from which the Resale Certificate originated requires in all circumstances, that the Resale Certificate indicate the date on which it was provided, and contain the name of the seller. *See* WAC §458-20-102 (1970). Moreover, "[t]he resale certificate used by the buyer must, in all cases, be completed in its entirety." *Id.* Unfortunately, that is not what MCE did, which is problematic to Taxpayer's argument because a finding that the Resale Certificate relieves the Taxpayer of liability would require that the Hearing Officer disregard obvious deficiencies in the document.

Correspondence from MCE (Taxpayer Ex. 1-2) and Louisiana Energy Services (Taxpayer Ex. 4) are also of nominal value because, although the Rules of Evidence do not apply in administrative hearings before the Administrative Hearings Office, the legal residuum rule requires that an agency's administrative decision be "supported by some evidence that would be admissible under the rules" of evidence. *See Chavez v. City of Albuquerque*, 1997-NMCA-111, ¶4, 124 N.M. 239, 947 P.2d 1059. As the New Mexico Court of Appeals explained in *Anaya v. N.M. State Pers. Bd.*, 1988-NMCA-077, ¶15, 107 N.M. 622, 762 P.2d 909, [t]he legal residuum rule does not require that all evidence considered by the administrative agency be legally admissible evidence, but only "that an administrative action be supported by *some* evidence that would be admissible in a jury trial". In this instance, both statements come within the definition of hearsay. *See* NMRA 2017, Rule 11-801.

Even if the statements came within a recognized exception to the rule against hearsay, both statements have minimal evidentiary value. Taxpayer Ex. 1-2, from MCE, fails to reference the Resale Certificate or explain its origin or content in such a manner that any deficiencies with the document might be cured. Taxpayer Ex. 2, an NTTC executed by Lea County Board of

Commissioners to MCE raises additional questions when viewed in conjunction with other evidence. The Hearing Officer notes that the NTTC from Lea County Board of Commissioners was issued by the Department and executed to MCE on December 17, 2009. However, Taxpayer Ex. 7 indicates that all of the services Taxpayer provided were invoiced between January 31, 2009 and August 14, 2009, months before MCE had itself received an NTTC from the Lea County Board of Commissioners. Prior to that, Taxpayer apparently relied on verbal assurances from MCE that its work should not be taxable, or perhaps on a Resale Certificate which was visibly incomplete.

"Questions of good faith belief . . . are questions of fact." *See Erica, Inc. v. N.M. Regulation & Licensing Dep't*, 2008-NMCA-65, ¶23, 144 N.M. 132, 184 P.3d 444 (Ct.App.2008) (*quoting State v. Vandenberg*, 2003-NMSC-30, ¶18, 134 N.M. 566, 81 P.3d 19).

In *Erica*, the New Mexico Court of Appeals referenced Black's Law Dictionary to define "good faith". The Court of Appeals stated

> [g]ood faith is a broad term: "The phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat with the context." Black's Law Dictionary 701 (7th ed. 1999) (internal quotation marks and citation omitted) (defining good faith as 'A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage"). *Id.* at ¶18.

The Hearing Officer did not doubt the testimony of Ms. Montoya or Mr. Ford. Both were candid and forthcoming and the Hearing Officer was persuaded that Taxpayer did not act with ill intention. Despite those observations, "every [taxpayer] is charged with the reasonable duty to ascertain the possible tax consequences" of its actions. *See Tiffany Construction Co. v. Bureau of Revenue*, 1976-NMCA-127, ¶5, 90 N.M. 16. Under the facts of this protest, there is insufficient

evidence to establish good faith reliance on MCE's incomplete Resale Certificate for the reasons previously discussed.

Second, any good faith that could be attributed to the NTTC from the Lea County Board of Commissioners to MCE is also questionable. Good faith "is determined at the time of each transaction" according to Regulation 3.2.201.14 NMAC, but as of the time Taxpayer was providing and billing its services, an NTTC to the Lea County Board of Commissioners had not been issued, nor had the Lea County Board of Commissioners executed an NTTC to MCE. [*See* Taxpayer Ex. 7 (invoice dates ranging from 1/31/2009 to 8/14/2009); Taxpayer Ex. 2 (Type 9 NTTC issued and executed on 12/17/2009). Accordingly, any reliance *as of the time of each transaction* was verbal, and not founded on the NTTC executed to MCE, according to Taxpayer's own exhibits.

Although this conclusion could potentially be perceived as exalting form over substance, Taxpayer's failure to possess an NTTC in the form prescribed by the Department, or other document acceptable to the Department, and to present the form in a timely and proper manner provided a valid basis for denying Taxpayer's claimed deduction. "Where a party claiming a right to an exemption or deduction fails to follow the method prescribed by statute or regulation, [it] waives [its] right thereto." *See Proficient Food Co. v. N.M. Taxation & Revenue Dep't*, 1988-NMCA-042, ¶22, 107 N.M. 392, 758 P.2d 806.

Whether the department erred in disallowing deductions for receipts from ABQ Manufacturing and other companies with which it conducted business.

As previously discussed, Taxpayer may deduct certain gross receipts when it possesses appropriate NTTCs from buyers. *See* NMSA 1978, Section 7-9-43. A taxpayer should be in possession of non-taxable transaction certificates when the taxes from the transaction are due, but may also produce them within a 60-day deadline set by the Department. *Id.*

The Department requested NTTCs at the time it conducted its audit. For some transactions, Taxpayer was simply never able to produce an appropriate NTTC. Admittedly, a significant difficulty arose with respect to transactions with ABQ Manufacturing and its affiliated entities. ABQ Manufacturing was allegedly not in good standing with the Department at the time Taxpayer sought NTTCs, and for that reason, ABQ Manufacturing was not authorized to execute them.

The Hearing Officer is understanding to Taxpayer's predicament. However, the parties to a non-taxable transaction should be diligent to assure, at the time of the transaction, that they are in possession of all documents they need in order to best protect their interests. Procrastination may have adverse consequences beyond the control of any party, including the loss of institutional knowledge, loss or destruction of documents, the failure or closure of business, or even diminished incentive to cooperate. By failing to obtain NTTCs at the time of the transactions, Taxpayer inadvertently prejudiced its ability to later prove entitlement to its claimed deductions.

If Taxpayer "is not in possession of the required non-taxable transaction certificates within sixty days from the date that the notice…is given…, deductions claimed by the seller or lessor that require delivery of these nontaxable transaction certificates shall be disallowed". *See* NMSA 1978, Section 7-9-43 (A) (emphasis added). The word "shall" indicates that the denial of the deduction is mandatory, not discretionary. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n, 2009-NMSC-013, ¶22, 146 N.M. 24, 206 P.3d 135*.

A right to a deduction must be established by the taxpayer claiming the deduction, and the failure of the taxpayer to possess an NTTC in the right form and within the time prescribed by the Department is a valid reason to deny the deduction. *See Proficient Food Co. v. N.M.*

Taxation and Revenue Dep't., 1988-NMCA-042, ¶22, 107 N.M. 392 (holding that the Department had properly denied the deduction when the taxpayer had not received the proper form from the buyer within the time limit).

Taxpayer seemingly accepts its predicament. However, it also asserts that the Department caused it to believe that it could obtain relevant NTTCs through alternative methods, primarily through its internal systems. However, such representations were made in error.

Again, sympathetic to Taxpayer's situation, the Hearing Officer is not persuaded that the Department's erroneous statements regarding how it might be able to assist Taxpayer in obtaining NTTCs actually prejudiced Taxpayer. It was undisputed that ABQ Manufacturing was not authorized to execute NTTCs. In other words, it was not any unfulfilled offer to assist the Taxpayer with obtaining NTTCs that frustrated its ability to prove entitlement to a deduction, but the fact that Taxpayer did not obtain the NTTCs at the time the transactions occurred, and when ABQ Manufacturing was able to execute NTTCs. Nothing the Department may have stated in an apparent effort to assist Taxpayer actually prevented Taxpayer from obtaining NTTCs because ABQ Manufacturing was simply unable to execute them.

Taxpayer acknowledges that the facts do not support a claim to equitable estoppel, but asserts that the Department's erroneous offers at assistance prevented Taxpayer from obtaining NTTCs through other sources. The Hearing Officer is not persuaded by Taxpayer's argument, and there is no evidence to support such finding.

Whether the Department erred in assessing gross receipts tax on income that was not "gross receipts.

The evidence presented established that some income detected during the audit was improperly identified as "gross receipts" and thereafter assessed. Taxpayer's Specification, filed

on March 8, 2018, further attempted to clarify those amounts which should not have been identified as gross receipts. The Taxpayer identified transactions totaling $8,381.12 which it asserted should not have been classified as gross receipts or subsequently taxed.

However, a comparison of the dates, sources of income, and amounts listed on Page 5 of Taxpayer's Specification, to the audit indicates that Taxpayer overstated the amounts actually assessed. It appears from such comparison that the items corresponding with the following dates, as listed on Page 5 of Taxpayer's Specification, were not actually assessed: 1/23/2004; 3/12/2004; 6/10/2005; 6/20/2005; 11/14/2005; 4/14/2006; 7/12/2006; 11/10/2006. *See* Department Ex. A. The sum of the items corresponding with the foregoing dates is $7,401.02. The difference between the amount suggested by Taxpayer and the comparison establish that the Department improperly assessed gross receipts tax on $980.10, not $8,381.12

Because the Taxpayer has demonstrated that gross receipts tax was incorrectly assessed on $980.10, the Department should abate tax assessed on that amount, plus any associated penalty and interest.

Taxpayer also uses its Specification to present evidence of other transactions which it *did not* address at the hearing. Taxpayer provides copies of various NTTCs, a spreadsheet, and essentially appeals to the Hearing Officer to perform what may be akin to an audit. The Department argues that it is prejudiced by the submission of the additional information which was not addressed at the hearing. The Hearing Officer agrees that relying on the Specification to drop documents into the record which were not previously addressed is inappropriate and prejudicial to the Department.

If Taxpayer intended for such transactions to be taken into consideration, it should have presented its evidence relevant to those transactions at the hearing. If the Taxpayer required

additional time to prepare for the hearing, it could have also requested a continuance. It did neither.

Accordingly, purported errors with the audit not specifically addressed on the record of the hearing will not be considered in the manner suggested by Taxpayer.

Penalty and Interest

When a taxpayer fails to make timely payment of taxes due to the state, "interest *shall* be paid to the state on that amount from the first day following the day on which the tax becomes due...until it is paid." *See* NMSA 1978, Sec. 7-1-67 (2007) (italics for emphasis). Under the statute, regardless of the reason for non-payment of the tax, the Department has no discretion in the imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory. *See Marbob*, ¶22. The language of Section 7-1-67 also makes it clear that interest begins to run from the original due date of the tax until the tax principal is paid in full. In this case, the Department has no discretion under Section 7-1-67 and must assess interest against Taxpayer from when the tax was originally due until Taxpayer pays the gross receipts tax principal in this matter.

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.
>
> (Emphasis Added).

Again, the statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meet the legal definition of "negligence." *See Marbob.*

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 (A) (B) & (C) NMAC, because Taxpayer failed to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances to report and pay gross receipts tax when due.

In instances where a taxpayer might fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception in that "[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 the services subject of this protest. *See C & D Trailer Sales v. Taxation & Revenue Dep't*, 1979-NMCA-151, ¶8-9, 93 N.M. 697, 604 P.2d 835 (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 provide for the 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 non-negligence where penalty

may be abated. However, Taxpayer did not present any argument or evidence to establish grounds for an abatement under any of the factors.

Unfortunately, in reference to the portion of the assessment stemming from transactions with MCE, Taxpayer seemingly relied substantially on its representations. There was no evidence, however, that it sought expert advice or that reliance on MCE was reasonable to determine the tax consequences of Taxpayer's actions. The Hearing Officer does not doubt Taxpayer's sincerity and that it relied on information from MCE. However, even with good intentions, reliance on MCE was unreasonable, and its subsequent actions resulted from inadvertence, erroneous belief, and inattention. *El Centro Villa Nursing Ctr.*, 1989-NMCA-070, established that the civil negligence penalty is appropriate, and Regulation 3.1.11.11 (D) NMAC does not provide grounds for abatement of the penalty.

"[E]very person is charged with the reasonable duty to ascertain the possible tax consequences" of his or her actions. *See Tiffany*, ¶5. The Department's assessment of penalty and interest in this matter was correct and there was no evidence or authority establishing entitlement to an abatement.

For the reasons stated herein, Taxpayer's protest should be denied, with the exception of that portion of tax, interest, and penalty assessed on $980.10 which was incorrectly determined to be gross receipts.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely written protest to the Notice of Assessment of gross receipts taxes issued under Letter ID Number L1659639360, and jurisdiction lies over the parties and the subject matter of this protest.

B. Except as provided in the discussion above, pertinent to the sum of $981.10, Taxpayer did not overcome the presumption of correctness that attached to the assessment under NMSA 1978, Section 7-1-17 (C) (2007) and *Archuleta v. O'Cheskey*, 1972-NMCA-165, 84 N.M. 428, 504 P.2d 638 and did not establishment entitlement to any pertinent statutory deduction.

C. Taxpayer did not establish good-faith acceptance of NTTCs or documents equivalent to NTTCs that might entitle it to the safe harbor protection under NMSA 1978, Section 7-9-43 (A) or NMSA 1978, Section 7-5-1, Article V, Section 2.

D. Under NMSA 1978, Sec. 7-1-67 (2007), Taxpayer is liable for accrued interest under the assessment. Interest continues to accrue until the tax principal is satisfied.

E. Under NMSA 1978, Sec. 7-1-69 (2007), Taxpayer is liable for civil negligence penalty under the negligence definition found under Regulation 3.1.11.10 (C) NMAC.

For the foregoing reasons, Taxpayer's protest **IS DENIED IN PART AND GRANTED IN PART.** Taxpayer shall be liable for the gross receipts tax, penalty and interest under the assessment, less a portion of gross receipts tax, interest and penalty deriving from $980.10.

DATED: May 31, 2018

Chris Romero
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 (2015), 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. If an appeal is not timely filed with the Court of Appeals within 30 days, this Decision and Order will become final. Rule of Appellate Procedure 12-601 NMRA articulates the requirements of perfecting an appeal of an administrative decision with the Court of Appeals. 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 begin preparing the record proper. The parties will each be provided with a copy of the record proper at the time of the filing of the record proper with the Court of Appeals, which occurs within 14-days of the Administrative Hearings Office receipt of the docketing statement from the appealing party. *See* Rule 12-209 NMRA.

CERTIFICATE OF SERVICE

I hereby certify that I mailed the foregoing Decision and Order to the parties listed below this _____ day of May, 2018 in the following manner:

First Class Mail *Interagency Mail*