STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
MICHAEL ANDREW & MEREDITH L. HARTNAGLE
TO ASSESSMENT ISSUED UNDER LETTER ID NO. L0941329712

v. **D&O 18-26**

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on July 17, 2018 before Hearing Officer, Chris Romero, Esq., in Santa Fe, New Mexico. The Taxation and Revenue Department (hereinafter "Department") was represented by Mr. Peter Breen, Staff Attorney. Mr. Nicholas Pacheco, Auditor, also appeared and testified as a witness on behalf of the Department. Mr. Michael Andrew Hartnagle and Ms. Meredith L. Hartnagle appeared representing themselves *pro se* (hereinafter "Taxpayers").

As a preliminary matter, Taxpayers identified an error in the caption of the protest which originated with a mistake in the original assessment. The assessment referred incorrectly to Michael *Andres* & Meredith L. Hartnagle." Mr. Hartnagle's correct name is Michael *Andrew*. The caption is revised to reflect this correction.

The Hearing Officer took notice of all documents in the administrative file, including Department Exhibits A, and C through J, which the Department proffered on February 22, 2018 after the Taxpayers' failure to appear.

Taxpayer Exhibits 1 – 10 and Department Exhibits J-1 were admitted into the evidentiary record of the hearing without objection. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On July 10, 2017, the Department issued a Notice of Assessment of Taxes and Demand for Payment for $4,535.24 in gross receipts tax, $907.04 in gross receipts tax penalty, and $439.92 in gross receipts tax interest for a total assessment of $5,882.20 under Letter ID No. L0941329712 (hereinafter "Assessment"). [*See* Administrative File].

2. On October 5, 2017, Taxpayers executed a Formal Protest that was received by the Department's Protest Office on October 11, 2017. [*See* Administrative File].

3. On November 7, 2017, the Department acknowledged receipt of Taxpayers' Formal Protest under Letter ID No. L1036575536. [*See* Administrative File].

4. On November 29, 2017, the Department filed a Hearing Request with the Administrative Hearings Office in which it requested a hearing on the merits of Taxpayer's protest. [*See* Administrative File].

5. On November 30, 2017, the Administrative Hearings Office entered a Notice of Administrative Hearing setting a hearing on the merits of Taxpayers' protest for January 3, 2018. [*See* Administrative File].

6. On December 27, 2017, Taxpayers submitted a request for a continuance in which they expressly waived the 90-day hearing requirement under NMSA 1978, Section 7-1B-8 (A) (2015). [*See* Administrative File].

7. Noting that the Department did not express any position regarding the request for a continuance, the Administrative Hearings Office entered a Continuance Order and Amended Notice of Administrative Hearing on January 2, 2018 that set a hearing on the merits of Taxpayers' protest for February 22, 2018. [*See* Administrative File].

8. On February 22, 2018, Taxpayers failed to appear for the hearing on the merits of their protest. The Administrative Hearings Office entered a Decision and Order on February 26, 2018 that denied their protest as a result of their failure to appear. [*See* Administrative File].

9. On March 2, 2018, Taxpayers submitted correspondence explaining their failure to appear and requested reconsideration of the Decision and Order denying their protest. [*See* Administrative File].

10. On March 27, 2018, observing that the Department had not expressed opposition to the request to set aside the Decision and Order, the Administrative Hearings Office entered an Order Setting Aside Decision and Order and Notice of Administrative Hearing. A hearing on the merits was set for July 17, 2018. [*See* Administrative File].

11. On July 17, 2018, all parties appeared and presented evidence and argument in reference to the subject matter of the protest. [*See* Administrative File].

12. Mr. Michael Andrew Hartnagle and Ms. Meredith Lanier Hartnagle are married. [Testimony of Ms. Hartnagle].

13. In 2013 and 2014, Taxpayers resided in Colorado and New Mexico, although they considered themselves to be domiciled in New Mexico with the intention of eventually moving fulltime to Colorado in the future. [Testimony of Ms. Hartnagle; *See* Taxpayer Exhibit 10].

14. In 2013 and 2014, Taxpayers were present in New Mexico during the warm-weather months of April or May through September or October of those years, and in Colorado for the remainder of time. [Testimony of Ms. Hartnagle].

15. When present in New Mexico, Taxpayers were employed by Manzano Mountain Retreat and Cow Creek Ranch. They were compensated as employees and their wages were reported on Forms W-2. [Testimony of Ms. Hartnagle].

16. For all other periods during the relevant time, Taxpayers resided in the State of Colorado where they owned and operated two businesses relevant to their protest: 1) Michael Hartnagle, LTD; and 2) Meredith Investments. [Testimony of Ms. Hartnagle].

17. Michael Hartnagle, LTD and Meredith Investments are both organized under the laws of the State of Colorado and were operated from Taxpayers' residence, which during the relevant years was in Broomfield, Colorado. [Testimony of Ms. Hartnagle; *See* Taxpayer Exhibits 7-13, 8-14, 9-2; and 9-3].

18. Michael Hartnagle, LTD engages primarily in the business of construction and Meredith Investments focuses on real estate investment, with both providing occasional consulting services. [Testimony of Ms. Hartnagle].

19. Taxpayers' certified public accountant acknowledged that income derived from providing services in Colorado was erroneously reported as income earned in New Mexico which may have contributed to a Schedule C mismatch. [*See* Taxpayer Exhibits 7; 8; and 10].

20. Income that was erroneously reported as being earned in New Mexico was actually generated from services that Taxpayers performed as independent contractors in Colorado for New Mexico clientele: Manzano Mountain Retreat in Albuquerque, New Mexico; and Cow Creek Ranch in Pecos, New Mexico. [Testimony of Ms. Hartnagle; Testimony of Mr. Hartnagle].

21. More specifically, Ms. Hartnagle, through Meredith Investments, LLC, provided consulting services to Manzano Mountain Retreat in the Fall of 2013 and the Spring of 2014 regarding a variety of business-related issues. All services were performed exclusively from Colorado by telephone and internet. [Testimony of Ms. Hartnagle; Testimony of Mr. Pacheco; *See* Taxpayer Exhibits 6-3; 7-3 – 7-7].

22. Mr. Hartnagle, through Michael Hartnagle, LTD, provided consulting services for Cow Creek Ranch regarding matters related to post-wildfire rehabilitation and flood control. All services were performed exclusively from Colorado by telephone and internet. [Testimony of Ms. Hartnagle; Testimony of Mr. Hartnagle; Testimony of Mr. Pacheco; *See* Taxpayer Exhibits 6-2; 8-5 – 8-13].

23. Mr. Pacheco agreed that all services were provided in Colorado and that the Taxpayers did not travel to New Mexico for any purpose in the provision of services to Manzano Mountain Retreat or Cow Creek Ranch. [Testimony of Mr. Pacheco].

24. Taxpayers did not have formalized written contracts to provide services to Manzano Mountain Retreat and Cow Creek Ranch. Relevant agreements to provide services were oral. [Testimony of Mr. Hartnagle; Testimony of Ms. Hartnagle].

DISCUSSION

The primary issue in this case is whether gross receipts derived from services performed exclusively in Colorado, for a New Mexico purchaser, are taxable in New Mexico under the Gross Receipts and Compensating Tax Act, NMSA 1978, Sections 7-9-1 to -115.

Presumption of Correctness and Burden of Proof.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessment from which this protest arises is presumed correct and the burden is on Taxpayers to overcome the presumption. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428, 504 P.2d 638. Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, Section 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, 134 P.3d 785, 791 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight).

For these reasons, Taxpayers carry the burden of presenting countervailing evidence or legal argument to show that they are entitled to an abatement of the assessment. *See N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8, 336 P.3d 436. "Unsubstantiated statements that the assessment is incorrect cannot overcome the presumption of correctness." *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 2003-NMCA-021, ¶13, 133 N.M. 217, 62 P.3d 308; *See also* Regulation 3.1.6.12 NMAC. If a taxpayer presents sufficient evidence to rebut the presumption, then the burden shifts to the Department to re-establish the correctness of the assessment. *See MPC*, 2003-NMCA-021, ¶13.

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 (2017). The Gross Receipts and Compensating Tax Act establishes a presumption that *all* receipts of a person engaged in business are taxable. *See* NMSA 1978, Section 7-9-5 (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). The term "gross receipts" is defined at NMSA 1978, Section 7-9-3.5 (A) (1) (2007) to mean:

> the total amount of money or the value of other consideration received from selling property in New Mexico, from leasing or licensing property employed in New Mexico, from granting a right to use a franchise employed in New Mexico, *from selling services performed outside New Mexico, the product of which is initially used in New Mexico, or from performing services in New Mexico*.
>
> (Emphasis Added)

The term "service" is defined to mean "all activities engaged in for other persons for a consideration, which activities involve predominantly the performance of a service as distinguished from selling or leasing property." *See* NMSA 1978, Section 7-9-3 (M).

Despite the presumption that all receipts of a person engaged in business are taxable, a taxpayer may also avail itself of any number of exemptions or deductions. If a taxpayer asserts entitlement to an exemption or deduction from gross receipts, then the burden is on the taxpayer to prove the entitlement. *See Pub. Serv. Co. v. N.M. Taxation & Revenue Dep't*, 2007-NMCA-050, ¶32, 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.

Whether Taxpayers' Receipts are Excluded or Exempt from Taxation.

The material facts at issue in this case are generally undisputed. All services were performed exclusively in Colorado and did not relate to research and development. Taxpayers only contacts with New Mexico during the provision of such services occurred through email and telephone. The Department acknowledged as much, but asserted that the substance of those emails or telephone communications represented deliverables, which when conveyed to New Mexico, gave rise to an obligation to also pay gross receipts tax in New Mexico.

Because the parties did not dispute that the services at issue were performed *exclusively* in Colorado, the Hearing Officer will focus the following discussion on taxing receipts from performing services outside of New Mexico in which the product of the service is initially used in New Mexico under Section 7-9-3.5 (A) (1). As a practical matter, distinguishing between the methods through which the Department extends its taxing authority in this case is inconsequential to the outcome of this protest.

When read in isolation, Section 7-9-3.5 (A) (1) establishes that services performed outside New Mexico are taxable where the product of the service is initially used in New Mexico. If that were the extent of the rule, then the Department's position might be solidified based on the evidence presented. Mr. Pacheco testified that Taxpayers performed out-of-state services, the product which was transmitted to New Mexico by telephone and email, where it was "initially used."

However, that is not the extent of the rule. Instead, that portion of the definition of gross receipts is generally regarded as applying only to services in the area of research and development since another statute, NMSA 1978, Section 7-9-13.1 (A), specifically *exempts* "from gross receipts tax the receipts from selling services performed outside New Mexico the product of which is initially used in New Mexico[,]" with the exclusion of "research and development services[.]" *See* NMSA 1978, Section 7-9-13.1 (B). Accordingly, that which the Legislature gave in Section 7-9-3.5, it also took away in Section 7-9-13.1, with a solitary exception for out-of-state services relating to research and development.

The Department has acknowledged the relationship between Section 7-9-3.5 and Section 7-9-13.1 on various occasions. In Regulation 3.2.1.18 (E) (1) NMAC, it stated that "[r]eceipts from performing services, except research and development services, outside New Mexico are not subject to the gross receipts tax under the provisions of Section 7-9-13.1 NMSA 1978." As previously

recognized, agency regulations interpreting a statute are presumed proper and are given substantial weight. *See Chevron*, 2006-NMCA-50, ¶16.

The Department has also circulated no less than two publications addressing the relationship between NMSA 1978, Section 7-9-3.5 and Section 7-9-13.1. In *FYI-105 (Gross Receipts & Compensating Taxes: An Overview)*, the Department summarized the general definition of "gross receipts" as "the total amount of money or other consideration received from selling property in New Mexico, leasing or licensing property employed in New Mexico, granting a right to use a franchise employed in New Mexico, performing services in New Mexico *or selling research and development services performed outside New Mexico the product of which is initially used in New Mexico*." *See* FYI-105, Rev. 05/18, Page 4 (Emphasis Added). This definition mostly adopted the statutory definition of "gross receipts" contained in Section 7-9-3.5, with obvious deviation for the purpose of integrating the exemption contained in Section 7-9-13.1 (A).

Likewise, in *FYI-270 (Information on Research and Development)*, the Department explained that "[r]esearch and development services performed outside New Mexico the product of which is initially used in New Mexico are subject to the gross receipts tax . . . *All other services performed outside New Mexico are exempt from the gross receipts tax (Section 7-9-13.1)*." *See* FYI-270, Rev. 3/14, Page 4 (Emphasis Added).

Accordingly, the Hearing Officer finds that the applicable statutes, regulations, and the Department's publications establish a definite and unambiguous rule that services performed outside New Mexico are exempt from the gross receipts tax, subject to an exception not germane to the facts of this protest because Taxpayers were not engaged in research and development.

Nevertheless, the Hearing Officer, acknowledging some difficulty reconciling the Department's legal position at the hearing with the foregoing, requested that the Department discuss

the application of Regulation 3.2.1.18 (E) NMAC to the facts of this protest, including Example 2 at Regulation 3.2.1.18 (E) (3) which states:

> D is a data processing bureau located in Lone Tree, Iowa. X, a New Mexico accounting and bookkeeping firm, mails accounting data to D. D then processes this material into general ledgers, payroll journals and other journals and then returns this material by mail to X. The receipts of D are receipts from performing services entirely outside New Mexico and therefore are not subject to the gross receipts tax.

The Department explained that Example 2 was not applicable to the facts in the present matter because the out-of-state business did not have nexus in New Mexico, assuming facts not actually contained in the example. Nevertheless, the Department's reliance on nexus is misplaced. Nexus is not relevant to establishing a claim for an exemption under Section 7-9-13.1. Consider Example 1 from FYI-270:

> A Colorado architectural firm with a branch office in Las Cruces, New Mexico has been hired by a New Mexico client to design a building in Raton, New Mexico. The Colorado firm performs all the work in Colorado and upon completion of the architectural plans, sends them to its New Mexico client. Because the service is performed outside New Mexico but the product of the service is initially used (that is, first employed for its intended purpose) in New Mexico, the Colorado firm does have gross receipts in New Mexico. Its receipts, however, are exempt from gross receipts tax under Section 7-9-13.1(A) NMSA 1978 because architectural design of a building is not a research and development service.

This example suggests that nexus is irrelevant for the purpose of Section 7-9-13.1. The taxpayer in the example has a physical presence within the state in the form of a branch office, but that was of no significance to asserting entitlement the exemption. *See N.M. Taxation & Revenue Dep't v. Barnesandnoble.com LLC (In re Barnesandnoble.com LLC)*, 2012-NMCA-063, ¶15, 283 P.3d 298 (physical presence "can be established by the presence of in-state offices even when the activities of those offices are not related to the in-state activity being taxed.") *citing Nat'l*

Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 561, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977).

These examples are analogous with the facts underlying Taxpayers' protest. Taxpayers performed services entirely outside of New Mexico that did not relate to research and development. Taxpayers' receipts are exempt from taxation under Section 7-9-13.1.

Therefore, Taxpayers rebutted the presumption of correctness that attached to the assessment by establishing entitlement to the exemption under NMSA 1978, Section 7-9-13.1 (A). The Department did not re-establish the correctness of its assessment as provided by *MPC*, 2003-NMCA-021, ¶13.

At this time, the Hearing Officer will note that the Department proffered several exhibits at the previous hearing in which Taxpayers failed to appear. Those exhibits, consisting of Department Exhibits A, and C through J, have been in the administrative file since February 22, 2018.

Upon reviewing the contents of the administrative file at the onset of the hearing, Taxpayers' objected to the consideration of those exhibits because they had not been previously disclosed to them. The Department argued that Taxpayers waived their objections to the admissibility of those exhibits by virtue of their failure to appear at the previous hearing where they were proffered. Taxpayers were provided with an opportunity to seek a continuance, but declined. The Hearing Officer thereafter reserved ruling on the objection.

Interestingly, and despite its rigorous opposition to the objection, the Department never again, for any purpose, referred to Department Exhibits A, and C through J, leaving the Hearing Officer to simply speculate as to their significance to the issues in the case. Counsel for the Department even remarked that he could not recollect the content of the exhibits.

The Hearing Officer took administrative notice of the exhibits over Taxpayers' objection, and observed that the apparent relevance of the various exhibits was tenuous, at best, in the absence of further evidence or argument that might illuminate their significance to the Department's position.

Our courts have recognized that "[i]t is not the responsibility of . . . the trial court to search the record for evidence to support a claim or assertion. That responsibility belongs to the attorney." *See State v. Maestas*, 2018-NMSC-010, ¶51, 412 P.3d 79. The same observation is pertinent in tax protest hearings as well. Evidence pertinent to a material issue must be identified by some reference to the relevant portions of an exhibit. Without some minimal reference, a fact finder should not be expected to search the record in an effort to determine whether there exists dormant evidence which might have some bearing on the outcome of a case. *See Adler v. Wal-Mart Stores*, 144 F.3d 664, 672 (10th Cir. 1998) ("[courts] have a limited and neutral role in the adversarial process, and are wary of becoming advocates who comb the record of previously available evidence and make a party's case for it."); *See also United States v. Dunkel*, 927 F.2d 955, 956 (7th Cir.1991) ("Judges are not like pigs, hunting for truffles buried in briefs").

Accordingly, although the Hearing Officer took administrative notice of Department Exhibits A, and C through J, they are not afforded any weight since they are not relevant to whether Taxpayers are entitled to the exemption under NMSA 1978, Section 7-9-13.1, and Department did not find it necessary or beneficial to make any further reference to them beyond responding to Taxpayers' objection.

Taxpayers' protest should be GRANTED.

CONCLUSIONS OF LAW

A. Taxpayers filed a timely written protest to the Notice of Assessment of Taxes and Demand for Payment issued under Letter ID No. L0941329712, and jurisdiction lies over the parties and the subject matter of this protest.

B. Taxpayer waived the 90-day hearing requirement under NMSA 1978, Section 7-1B-8 (A) (2015).

C. Taxpayers' receipts from services performed in Colorado are exempt from gross receipts taxation under NMSA 1978, Section 7-9-13.1 and Regulation 3.2.1.18 (E) NMAC.

For the foregoing reasons, Taxpayers' protest **is GRANTED**. The Department is hereby **ORDERED** to abate tax, penalty, and interest under the Assessment.

DATED: August 10, 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

On August 10, 2018, a copy of the foregoing Decision and Order was mailed to the parties listed below in the following manner:

First Class Mail *Interagency Mail*

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