STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
CATHY TASKER
EWA WARRIOR SERVICES LLC
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L0646511408 **Case Number 18.08-171A**

and

IN THE MATTER OF THE PROTEST OF
CRYSTAL CANTRALL
TEST & EVALUATION SERVICES AND TECHNOLOGIES LLC
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L0109640496 **Case Number 18.08-172A**

v. ***AHO D&O #20-15***

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER GRANTING SUMMARY JUDGMENT

A summary judgment hearing in the above-referenced and consolidated protests occurred on October 30, 2020, before Chris Romero, Esq., Hearing Officer. The hearing was conducted by videoconference due to the circumstances of the public health emergency presented by COVID-19 pursuant to Standing Order 20-02 of the Chief Hearing Officer of the Administrative Hearings Office with additional agreement of the parties.

Mr. Kenneth Fladager, Esq., appeared representing the Taxation and Revenue Department ("Department"). Mr. Robert Desiderio, Esq. and Mr. Benjamin Roybal appeared representing EWA Warrior Services, LLC (hereinafter "EWA Warrior") and Test & Evaluation Services and Technologies, LLC (hereinafter "TEST") (collectively "Taxpayers"). The matter came before the Hearing Officer on Taxpayers' Motion for Summary Judgment and Memorandum in Support (hereinafter "Motion") filed on January 31, 2020, the Department's

Response to Taxpayers' Motion for Summary Judgment filed on February 14, 2020 (hereinafter "Response"), and Taxpayers' Reply to Department's Response to Taxpayers' Motion for Summary Judgment (hereinafter "Reply") filed on March 13, 2020.

Taxpayers' Motion presented a statement of facts that the Department did not effectively challenge and which the Hearing Officer ultimately determined to be undisputed. Based on the undisputed facts, review of exhibits and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

Procedural History

1. On March 8, 2018, the Department issued to TEST a Notice of Assessment of Taxes and Demand for Payment under Letter ID No. L0109640496 in the amounts of $344,665.38 in gross receipts tax, $68,933.10 in penalty, and $25,698.24 in interest for a total assessed amount of $439,296.72 for the periods from January 31, 2015 to March 31, 2017. [*See* Administrative File]

2. On March 8, 2018, the Department issued to EWA Warrior a Notice of Assessment of Taxes and Demand for Payment under Letter ID No. L0646511408 in the amounts of $18,336.23 in gross receipts tax, $5,620.25 in gross receipts penalty, $1,621.14 in gross receipts interest, $2,503.41 in withholding tax, $382.18 in withholding tax penalty, and $107.39 in withholding tax interest for a total assessed amount of $28,570.60 for the periods from January 31, 2015 to March 31, 2017. [*See* Administrative File]

3. On June 4, 2018, TEST, by and through its counsel of record, Mr. Roybal, submitted its formal protest of the assessment to the Department's Protest Office. [*See* Administrative File]

4. On June 4, 2018, EWA Warrior, by and through its counsel of record, Mr. Roybal, submitted its formal protest of the assessment to the Department's Protest Office. EWA Warrior did not protest the portion of the relevant assessment attributable to withholdings tax, withholding tax interest, or withholding tax penalty. [*See* Administrative File]

5. On June 18, 2018, the Department acknowledged TEST's Formal Protest under Letter ID No. L0714766128. [*See* Administrative File]

6. On June 18, 2018, the Department acknowledged EWA Warrior's Formal Protest under Letter ID No. L0237580080. [*See* Administrative File]

7. On August 1, 2018, the Department filed a Hearing Request in the matter of the protest of TEST. The Department requested a scheduling hearing. [*See* Administrative File]

8. On August 1, 2018, the Department filed a Hearing Request in the matter of the protest of EWA Warrior. The Department requested a scheduling hearing. [*See* Administrative File]

9. On August 2, 2018, the Administrative Hearings Office entered a Notice of Telephonic Scheduling Conference in the matter of the protest of TEST that set a scheduling hearing in reference to Taxpayer's protest for August 24, 2018. [*See* Administrative File]

10. On August 2, 2018, the Administrative Hearings Office entered a Notice of Telephonic Scheduling Conference in the matter of the protest of EWA Warrior that set a scheduling hearing in reference to Taxpayer's protest for August 24, 2018. [*See* Administrative File]

11. A telephonic scheduling conference in the matter of the protest of TEST occurred on August 24, 2018. The parties did not object that the hearing was within 90 days of the Taxpayer's protest as provided by NMSA 1978, Section 7-1B-8 (A) (2015) (amended 2019).

[*See* Administrative File]

12. A telephonic scheduling conference in the matter of the protest of EWA Warrior occurred on August 24, 2018. The parties did not object that the hearing was within 90 days of the Taxpayer's protest as provided by NMSA 1978, Section 7-1B-8 (A) (2015) (amended 2019). [*See* Administrative File]

13. On August 24, 2018, the Administrative Hearings Office entered a Notice of Second Telephonic Scheduling Conference that upon suggestion of TEST and concurrence of the Department set a subsequent scheduling hearing on November 30, 2018. [*See* Administrative File]

14. On August 24, 2018, the Administrative Hearings Office entered a Notice of Second Telephonic Scheduling Conference that upon suggestion of EWA Warrior and concurrence of the Department set a subsequent scheduling hearing on November 30, 2018. [*See* Administrative File]

15. On October 5, 2018, Mr. Desiderio entered his appearance as co-counsel to Mr. Roybal on behalf of TEST. [*See* Administrative File]

16. On October 5, 2018, Mr. Desiderio entered his appearance as co-counsel to Mr. Roybal on behalf of EWA Warrior. [*See* Administrative File]

17. On November 5, 2018, the parties filed a Joint Motion to Consolidate Protests of TEST and EWA Warrior. [*See* Administrative File]

18. On November 21, 2018, the Administrative Hearing Officer entered a Consolidation Order that consolidated the protests of TEST and EWA Warrior. [*See* Administrative File]

19. On December 3, 2018, the Administrative Hearing Office entered a Scheduling

Order and Notice of Administrative Hearing which in addition to establishing relevant deadlines, set a hearing on the merits of the consolidated protests for July 29, 2019. [*See* Administrative File]

20. On June 11 2019 the parties filed a Joint Motion to Amend Scheduling Order to Vacate and Continue Merits Hearing and Extend Deadlines in which the parties sought to vacate the hearing on the merits of the protest set for July 29, 2019 and reschedule on a date after November 30, 2019. [*See* Administrative File]

21. On July 1, 2019, the Administrative Hearings Office entered an Order Vacating Merits Hearing and Notice of Telephonic Scheduling which vacated the hearing on the merits of the protest set for July 29, 2019 and set a scheduling hearing for July 19, 2019. [*See* Administrative File]

22. On July 19, 2019, the Administrative Hearings Office entered a Scheduling Order and Notice of Administrative Hearing which in addition to establishing various deadlines, set a hearing on the merits of the consolidated protests for December 11, 2019. [*See* Administrative File]

23. On September 24 2019, the parties filed a Joint Motion to Amend Scheduling Order to Vacate and Continue Merits Hearing and Extend Deadlines in which the parties sought to vacate the hearing on the merits of the protest set for December 11, 2019 and reschedule on a date after March 30, 2020. [*See* Administrative File]

24. On October 18, 2019, the Administrative Hearings Office entered an Amended Scheduling Order and Notice of Administrative Hearing which in addition to establishing various deadlines, set a hearing on the merits of the consolidated protests for March 30, 2020. [*See* Administrative File]

25. On December 4, 2019, the Administrative Hearings Office entered a Second Amended Scheduling Order and Notice of Administrative Hearing. [*See* Administrative File]

26. On December 11, 2019, the parties filed a Joint Motion to Amend Scheduling Order to Extend Deadline for Dispositive Motions. [*See* Administrative File]

27. On December 11, 2019, the Administrative Hearings Office entered an Order Extending Deadline to File Dispositive Motions. [*See* Administrative File]

28. On January 31, 2020, Taxpayers filed their Motion. [*See* Administrative File]

29. On February 14, 2020, the Chief Hearing Officer of the Administrative Hearings Office reassigned the consolidated protests to Hearing Officer Monica Ontiveros, Esq. and advised the parties of their right to exercise a peremptory excusal within 10 days of the reassignment. [*See* Administrative File]

30. On February 14, 2020, the Department filed its Response and its Peremptory Excusal of Hearing Officer Ontiveros. [*See* Administrative File]

31. On February 20, 2020, the Chief Hearing Officer entered a Notice of Reinstatement of Presiding Hearing Officer, transferring the consolidated protests back to the undersigned Hearing Officer. [*See* Administrative File]

32. On February 25, 2020, Taxpayers filed a Request for Hearing requesting that the Administrative Hearings Office set a hearing to discuss Taxpayers' request that the hearing on the merits of the protest be converted to a hearing on its Motion. [*See* Administrative File]

33. On February 25, 2020, Taxpayers filed an unopposed Motion for Leave to File Reply Brief. [*See* Administrative File]

34. On February 27, 2020, the Administrative Hearings Office entered an Order Granting Leave to File Reply Brief and an Order Converting Merits Hearing to Motion Hearing.

[*See* Administrative File]

35. On March 13, 2020, Taxpayers filed their Reply. [*See* Administrative File]

36. On March 16, 2020, the Administrative Hearings Office entered a Notice of Videoconference Administrative Hearing which converted the in-person hearing set on March 30, 2020 into a videoconference hearing. [*See* Administrative File]

37. On March 23, 2020, Taxpayers filed an unopposed Motion to Continue and Reschedule Hearing on Motion for Summary Judgment. [*See* Administrative File]

38. On March 25, 2020, the Administrative Hearings Office entered an Order Continuing Motion Hearing from March 30, 2020 to August 31, 2020. [*See* Administrative File]

39. On August 12, 2020, Taxpayers filed an unopposed Motion to Continue and Reschedule Hearing on Motion for Summary Judgment. Taxpayers motion expressed optimism that the hearing could be reset at a time when the public health emergency might subside and permit the conduct of an in-person hearing. [*See* Administrative File]

40. On August 26, 2020, the Administrative Hearings Office entered a Second Order Continuing Motion Hearing setting a hearing for October 29, 2020. The order explained that the Hearing Officer selected the date with the expectation that the circumstances could by that time permit in-person hearings but that appropriate adjustments may need to occur as circumstances might otherwise require. [*See* Administrative File]

41. On October 21, 2020, the Administrative Hearings Office, noting that the circumstances prohibiting an in-person hearing had not yet subsided to the point that an in-person hearing could safely occur, converted the hearing set for October 29, 2020 from in-person to videoconference. [See Administrative File]

Undisputed Material Facts

1 42. At all relevant times, TEST was a Delaware limited liability company engaged in
2 research, development, testing and evaluation (hereinafter "RDT&E") services in and outside the
3 state of New Mexico. [*See* Administrative File (Protest of Test & Evaluation Services and
4 Technologies LLC filed on June 4, 2018 at Schedule A-1(A)]
5 43. At all relevant times, EWA Warrior was a Delaware limited liability company
6 which engaged in RDT&E services in and outside the state of New Mexico. [*See* Administrative
7 File (Protest of EWA Warrior Services, LLC filed on June 4, 2018 at Schedule A-1(A)]
8 44. The United States Department of Defense (hereinafter "DOD") is the agency of
9 the federal government responsible for equipping and supporting the military forces in its efforts
10 to promote national security. [*See* U.S. Department of Defense Website (January 31, 2020),
11 https://www.defense.gov]
12 45. In October of 2001, the Secretary of Defense established an Office of Force
13 Transformation (hereinafter "OFT") in the DOD as part of its response to the terrorist attacks of
14 September 11, 2001. [*See* Motion (Exhibit 1, 1-001 to 1-008 (Affidavit of Michael W. Kelly)
15 (hereinafter "Kelly Affidavit"), ¶7)]
16 46. The OFT was established in the Office of the Secretary of Defense and was
17 administered by a "Director, Force Transformation" during each of the five years that it existed
18 as a separate office. [*See* Motion (Kelly Affidavit, ¶11; Exhibit 2, 2-001 to 2-004 (Affidavit of
19 Katherine E. Bower) (hereinafter "Bower Affidavit"), ¶8)]
20 47. The objective of the OFT was to manage and direct DOD force transformation
21 functions, including the development and acquisition of transformational military weapons and
22 systems to better address emerging threats to national security. [*See* Motion (Kelly Affidavit,
23 ¶8)]

48. Force transformation focuses on achieving critical operational goals through four essential components or pillars, including: (a) strengthening joint operations; (b) exploiting United States intelligence advantages; (c) innovative concept development and experimentation; and (d) developing transformational capabilities. [*See* Motion (Kelly Affidavit, ¶9)]

49. Concept development and experimentation involves experimentation with new approaches to warfare through war gaming, simulations, and field exercises focused on emerging challenges and opportunities. [*See* Motion (Kelly Affidavit, ¶10)]

50. In 2006, the executive reorganized the DOD and, as a result, the functions of the OFT, including force transformation military weapons acquisitions, were transferred to other divisions of the DOD, including the Office of Secretary of Defense for Acquisitions, Technology, and Logistics (hereinafter "OSD-AT&L"). [*See* Motion (Kelly Affidavit, ¶12; Bower Affidavit, ¶9)]

51. OSD-AT&L manages all matters relating to the DOD acquisition system, research and development, modeling and simulation, systems engineering, advanced technology, developmental testing, production, systems integration, logistics, DOD manufacturing management policy and guidance in the acquisition of defense systems, and is the office to whom each military department and defense agency must report regarding their defense system acquisition programs. [*See* Motion (Kelly Affidavit, ¶13; Bower Affidavit, ¶10)]

52. OSD-AT&L delegates responsibility for defense system development, acquisition, and implementation to the different United States Armed Forces military service branches for defense system acquisitions related to that service branch, including the Office of the Assistant Secretary of the Army for Acquisitions, Logistics, and Technology (hereinafter "ASA (ALT)"). [*See* Motion (Kelly Affidavit, ¶14; Bower Affidavit, ¶11)]

53. ASA (ALT) subsequently delegates purchasing responsibility for defense system acquisitions related to United States Army Program Executive Offices, which includes the Program Executive Office for Simulation, Training and Instrumentation (PEO STRI), one of the ten Program Executive Offices within ASA (ALT). [*See* Motion (Kelly Affidavit, ¶15; Bower Affidavit, ¶12)]

54. OSD-AT&L, through the defense system acquisition chain, continued to acquire military systems that qualify as force transformation, including concept development and experimentation projects, after OFT's functions were transferred to other DOD divisions. [*See* Motion (Kelly Affidavit, ¶16; Bower Affidavit, ¶13)]

55. On November 19, 2014, TEST and PEO STRI entered into a contract (hereinafter "TEST Contract") for TEST to provide RDT&E services to the DOD at the White Sands Missile Range in New Mexico. [*See* Motion (Kelly Affidavit, ¶17; Bower Affidavit, ¶14)]

56. Pursuant to the Test Contract (as modified and amended from time to time), TEST developed, delivered, operated and maintained an Electronic Warfare Threat Network comprised of select threat systems designed to evaluate and test the capabilities of the following transformational military weapons:

a. F35 Lightning II Stealth Aircraft;
b. AH-64E Apache Helicopter;
c. Integrated Air and Missile Defense System;
d. Joint Light Tactical Vehicles;
e. UH-60M Black Hawk Helicopter;
f. Warfighter Information Network-Tactical Increments 2 and 3;
g. EA-18G Growler Electronic Warfare Aircraft;
h. Joint Tactical Radio System Handheld Manpack and Small Form-Fit;
i. Distributed Common Ground System-Army Increments 1 and 2;
j. MQ-1C Gray Eagle Unmanned Aircraft;
k. Airborne Maritime Fixed-Station Joint Tactical Radio System;
l. RQ-7B Shadow Unmanned Aerial Vehicle;
m. Armored Multipurpose Vehicle;
n. F-15 Eagle Passive/Active Warning and Survivability System;

o. PAC-3 Missile Segment Enhancement.

[*See* Motion (Kelly Affidavit, ¶18)]

57. Among other work, the TEST Contract requires TEST to provide the following services utilized in or in connection with DOD war gaming, simulations and field exercises:

a. Deploy, operate, repair, maintain, fuel and redeploy current and emerging foreign threat systems, including, among other things, unique injection jamming devices (that simulate actual jamming of electronic systems), virtual training (software based simulation tools to train warfighters for real world situations), virtual infrastructure (that simulate an opposing force's command structure), foreign commercial cell phone systems (replicates an adversaries' wireless communication network) and foreign air defense systems in the live and virtual electronic warfare environment.

b. Design, fabricate, install, calibrate and maintain specialized electronic warfare instrumentation and data acquisition systems for ground threats and support equipment including simulators, hardware protection systems, power generation equipment, and control systems.

c. Develop, integrate, store, train, test and demonstrate foreign threat representative electronic surveillance and electronic attack systems.

d. Operate, maintain, and sustain validated electronic warfare and air defense threat systems for test and training events.

e. Plan personnel and equipment resources and data collection for threat electronic warfare field exercises and test events.

f. Prepare test event plans and conduct test events through, for example, delivery of electronic signatures and sensing that replicate adversary electronic surveillance and electronic attack capabilities.

g. Demonstrate electronic warfare threat systems hardware, including static displays and also fully integrated operational setups.

h. Evaluate, analyze and recommend upgrades to instrumentation components and designs.

i. Test and evaluate hardware and software capabilities for multiple transformational systems, including electronic warfare threat systems, communications networks, precision navigation, and computer systems.

j. Test system and subsystem level operations, including electronic warfare test tools, test procedures, test execution and test results to ensure overall war gaming simulation performance.

k. Perform technical acceptance testing to demonstrate that the actual threat assets and threat simulators constitute a valid representation of the actual electronic warfare threat.

l. Analyze electronic surveillance and electronic attack systems functional performance to identify performance characteristics to be tested and determine needed test instrumentation and facility requirements, prepare the test plan, and conduct the test.

m. Conduct tests and evaluation, including systems integration testing (to verify functional, performance and reliability of electronic warfare threat systems), qualification testing (to confirm a system meets or exceeds technical and operational specifications), field testing (to demonstrate the threat system in development meets or exceeds technical and

operational specifications) electromagnetic interference testing (to identify potential interference issues).

n. Perform radio frequency propagation analysis to evaluate the impact of environmental factors on electronic warfare systems and targets.

o. Provide verification and validation services for, among other things, comparison of electronic warfare threat simulators and targets to approved emerging electronic warfare threat profiles and intelligence data.

p. Facilitate development of emerging threat concepts and capabilities and development of transformational capabilities to counter known and anticipated electronic warfare threats.

[*See* Motion (Kelly Affidavit, ¶19)]

58. TEST subcontracted certain RDT&E services to EWA TRIAD, LLC, which in turn subcontracted those services to EWA Warrior ("EWA Subcontract"). [*See* Motion (Bower Affidavit, ¶15)]

59. None of the systems tested and evaluated by TEST or EWA Warrior pursuant to the TEST Contract (or the EWA Subcontract) was physically tested in New Mexico prior to July 1, 2005. [*See* Motion (Bower Affidavit, ¶16)]

60. All of the systems tested and evaluated by TEST pursuant to the TEST Contract (or the EWA Subcontract) were tested at the White Sands Missile Range in New Mexico. [*See* Motion (Bower Affidavit,¶17)]

61. In addition to services provided under the TEST Contract (and the EWA

Subcontract), TEST also sold tangibles to the DOD pursuant to the TEST Contract, including amplifiers, power meter bands, various repair parts and selected off-the-shelf software. [*See* Motion, (Bower Affidavit, ¶18)]

DISCUSSION

This is a consolidated protest of two assessments for gross receipts tax, penalty, and interest arising from the same underlying facts. In 2014, TEST entered into a contract with the United States Department of Defense to provide research, development, and testing and evaluation services at White Sands Missile Range[1] in New Mexico. TEST thereafter subcontracted certain services to EWA TRIAD, LLC which then subcontracted with EWA Warrior. The Department alleges that the gross receipts of TEST and EWA Warrior, all of which derived from the contract with the United States Department of Defense, are taxable pursuant to the Gross Receipts and Compensating Tax Act.

In contrast, Taxpayers dispute the taxability of the receipts derived through the contract asserting that the receipts generated from services performed, and tangible personal property sold to the United States Department of Defense, are deductible from gross receipts tax under NMSA 1978, Sections 7-9-94 and 7-9-54 of the Gross Receipts and Compensating Tax Act.

Presumption of Correctness

Consideration of the issues in dispute begins with the presumption that the Department's assessments of tax are correct pursuant to NMSA 1978, Section 7-1-17 (C) (2007). Consequently, Taxpayers carry the burden of overcoming the correctness of the assessments

[1] "White Sands Missile Range, DoD's largest, fully-instrumented, open air range, provides America's Armed Forces, allies, partners, and defense technology innovators with the world's premiere research, development, test, evaluation (RDT&E), experimentation, and training facilities to ensure our nation's defense readiness." *See* Mission Statement, https://www.wsmr.army.mil/Pages/home.aspx (as of November 3, 2020)

central to this consolidated protest. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428, 504 P.2d 638. Unsubstantiated statements that the assessments are incorrect are insufficient to 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.

Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" includes 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-050, ¶16, 139 N.M. 498, 134 P.3d 785 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight).

Gross Receipts and Applicable Deductions

For the privilege of engaging in business within this state, New Mexico imposes a gross receipts tax on the receipts of any person engaged in business. *See* NMSA 1978, Section 7-9-4 (2002). Under NMSA 1978, Section 7-9-3.5 (A) (1) (2007), the term "gross receipts" is defined 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.

Under the Gross Receipts and Compensating Tax Act, there is a statutory presumption that all gross receipts of a person engaged in business are taxable. *See* NMSA 1978, Section 7-9-5 (2002). Yet, despite the general presumption of taxability, taxpayers may also avail themselves of the benefits of various deductions and exemptions when applicable, in which case, "[w]here 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 Wing Pawn Shop v. Taxation & Revenue Dep't*, 1991-NMCA-024, ¶16, 111 N.M. 735, 809 P.2d 649.

Meanwhile, summary judgment is appropriate if no genuine issue as to any material fact exists and the movant is entitled to a judgment as a matter of law. *See Juneau v. Intel Corp.*, 2006-NMSC-002, ¶8, 139 N.M. 12. In considering a motion for summary judgment, the Hearing Officer in similar fashion to a trial court will view pleadings, affidavits, depositions, and other evidence in the light most favorable to the opposing party, or in this case, the Department. *See Juneau*, 2006-NMSC-002, ¶8.

In this case, Taxpayers, the movants, bear the initial burden of demonstrating entitlement to summary judgment; once the movant makes out a prima facie showing, the burden then shifts to the opposing party, the Department, to demonstrate through admissible evidence that a genuine issue of material fact indeed exists. *See Koenig v. Perez*, 1986-NMSC-066, ¶9, 104 N.M. 664.

Summary judgment "may be proper even though some disputed issues remain, if there are sufficient undisputed facts to support a judgment and the disputed facts relate to immaterial issues." *See Oschwald v. Christie*, 1980-NMSC-136, ¶6, 95 N.M. 251.

Thus, it is with this well-established framework in mind that the Hearing Officer evaluated Taxpayers' Motion, and having carefully considered the respective presumptions and burdens placed upon the parties, as well as the evidence and argument presented, the Hearing Officer was persuaded that summary judgment is appropriate because there are no genuine issues as to any material fact and Taxpayers are entitled to judgment as a matter of law. For the reasons that follow, Taxpayers' Motion should be granted.

Application of NMSA 1978, Section 7-9-94 (2015)

NMSA 1978, Section 7-9-94 establishes a deduction from gross receipts for revenue derived from "transformational acquisition programs performing research and development, test and evaluation at New Mexico major range and test facility bases pursuant to contracts entered into with the United States department of defense[.]" *See* Section 7-9-94 (A) (2015).

The deduction is not without its limitations. Receipts generated from programs existing on or before July 1, 2005 are not eligible. *See* Section 7-9-94 (C) (2015). Otherwise, in order to qualify for the deduction, a taxpayer's receipts must be derived from: (1) a "transformational acquisition program;" (2) performing research and development, test and evaluation services; (3) at a major New Mexico range and test facility base; (4) pursuant to a DOD contract; (5) that began after July 1, 2005.

The evidence accompanying Taxpayers' Motion persuaded the Hearing Officer that Taxpayers engaged in the business of research and development, and test and evaluation services pursuant to a contract with the United States department of defense. Moreover, receipts generated from services under the relevant contract were performed at White Sands Missile Range which is a major range and test facility base in New Mexico, and those services were provided several years after July 1, 2005. Indeed, the Department devotes minimal effort to presenting contradictory evidence on any of these particulars. Accordingly, Taxpayers satisfy items listed 2, 3, 4, and 5 above.

The principal disagreement among the parties therefore concentrates on the first element listed above; whether the receipts central to the assessment were derived from a "transformational acquisition program" as that term is employed in the statute.

The definition provides that "'transformational acquisition program' means a military acquisition program authorized by the office of the secretary of defense force transformation and

not physically tested in New Mexico on or before July 1, 2005." *See* NMSA 1978, Section 7-9-94 (B).

The Department contends that Taxpayers' exhibits and affidavits are insufficient to establish that Taxpayers' receipts derived through a contract with a "transformational acquisition program" that was "authorized by the office of the secretary of defense force transformation."

The Department explains that the secretary of defense established the Office of Force Transformation on October 29, 2001 with the purpose of pursuing "force transformation" within the U.S. military, but the office had dissolved amid additional department reorganization by October 1, 2006. Therefore, the Department contends in order to qualify for the deduction provided by Section 7-9-94, Taxpayers must submit evidence that the DOD designated particular acquisition programs as transformational because the mere assertion that a program is transformational is inadequate. Accordingly, the Department argues,"[a]bsent official DOD documentation that Taxpayers were engaged in a 'transformational acquisition program,' they cannot meet their burden of establishing that they are entitled to this specific deduction." The Hearing Officer is unpersuaded by the Department's logic. Neither the Legislature by enactment nor the Department by rule has imposed such a requirement. Moreover, the Department's argument ostensibly exalts form over substance which is an approach our courts have repeatedly disfavored and discouraged. *See Proficient Food Co. v. N.M. Taxation & Revenue Dep't*, 1988-NMCA-042, ¶22, 107 N.M. 392, 758 P.2d 806.

Section 7-9-94 (B) defines a "transformational acquisition program" as "a military acquisition program authorized by the office of the secretary of defense force transformation and not physically tested in New Mexico on or before July 1, 2005." Taxpayer correctly asserts that the definition contains three essential components: (1) it must be a military acquisition program;

(2) it must be authorized by the "office of the secretary of defense force transformation;" and (3), it has not been physically tested in New Mexico on or before July 1, 2005.

Taxpayers assert that the first and third components of the definition are satisfied. The Hearing Officer concurs finding that the TEST Contract is a contract for services for a military acquisition program in which Taxpayers provided research and development and test and evaluation services. The contract also did not begin until November 2014 and none of the systems tested and evaluated by Taxpayers under the contract were physically tested in New Mexico prior to July 1, 2005.

The critical question is then whether the TEST Contract was authorized by the "office of the secretary of defense force transformation." The evidence established that at the time Section 7-9-94 was initially enacted in 2005, there was a DOD office named "Office of Force Transformation" (also referred to herein as "OFT"). It was established within the Office of the Secretary of Defense and was administered by a "Director, Force Transformation." Thus, it was not remarkable that in 2005, when the Legislature initially enacted Section 7-9-94, that it would reference the relevant office by its then-proper name. However, in 2006, the executive implemented a reorganization of the DOD which essentially dissolved the OFT and distributed its responsibilities among other DOD divisions which further divided and delegated those responsibilities.

Because the original enactment was intended to expire on June 30, 2008, the New Mexico Legislature subsequently amended Section 7-9-94 in 2006 and then again in 2015 to ultimately extend the availability of the deduction through June 20, 2025. *See* Section 7-9-94 (A)

(2005); Section 7-9-94 (A) (2006); Section 7-9-94 (A) (2015)[2]. Despite the fact that the Legislature was cognizant of the deduction's impending expiration and on two occasions enacted amendments to extend it, it did not disturb its reference to OFT despite the fact it no longer existed as it had at the time of its original enactment in 2005.

Taxpayers argued that amending Section 7-9-94 in 2006 and 2015 in order to extend its sunset date through 2025 exemplified a clear legislative intent to continue the deduction even if OFT no longer existed in the same form as it had in 2005, perhaps because the most essential component of the statute concerned the type and location of services being performed, not the proper name of the office in the DOD through which the contract derived. *See Bybee v. City of Albuquerque*, 1995-NMCA-061, ¶11, 120 N.M. 17 (it is presumed that the Legislature "knows the law and acts rationally"). The Hearing Officer concurs.

By referring to "office of the secretary of defense force transformation," the Legislature intended to attract "force transformation" projects to New Mexico. This conclusion is reinforced considering the ultimate goal of statutory interpretation which is to give effect to legislative intent. *See State ex rel. Helman*, 1994-NMSC-023, ¶ 25. If statutory language is clear and unambiguous, it must be applied according to its plain language without further investigation. *See Id.* ¶18. If, however, a statute is ambiguous, contains a clear legislative error, or applying its plain language would lead to absurd or unreasonable results, there must be "a willingness to depart from the literal wording of a statute" in order to construe it "according to its obvious spirit or reason." *See Id.* ¶ 19 (internal citations and quotations omitted); *see id.* ¶¶ 18-25 (summarizing New Mexico caselaw on the limitations of the plain meaning rule and when courts should

[2] The 2015 amendment imposed a reporting requirement on the Department which is not relevant to this protest. *See* NMSA 1978, Section 7-9-94 (D) (2015). Otherwise, there have been no substantive changes to subsection B and C, and the only amendments to subsection A have been to extend the law's sunset date.

deviate from literal statutory language to achieve the Legislature's purpose). The interpreting tribunal may even "substitute, disregard or eliminate, or insert or add words to a statute, if it is necessary to do so to carry out the legislative intent or to express the clearly manifested meaning of the statute." *See Nat'l Council on Comp. Ins. v. New Mexico State Corp. Comm'n.*, 1986-NMSC-005, ¶5, 103 N.M. 707. The tribunal may also depart from legislative definitions when "a particular definition would result in an unreasonable classification." *See Inc. Cty. of Los Alamos v. Johnson*, 1989-NMSC-045, ¶4, 108 N.M. 633.

In *Helman*, the New Mexico Supreme Court upheld a rule that contradicted the plain language in its governing statute because the statute contained an error that "everyone knew ran contrary to the legislature's intent" and was "apparent on the face of the statute[.]" *See Helman*, 1994-NMSC-023, ¶38. The error arose from an amendment to the Public Employees Retirement Act that if read literally permitted public employees to purchase credit toward early retirement at one-twelfth of the pre-amendment cost. *See Helman*, 1994-NMSC-023, ¶11. The Court found no justification in logic or legislative intent for such a drastic shift in policy, observing that there was simply no purpose served by permitting inequitable treatment of employees who had purchased credit the year before and employees purchasing in the current year, not to mention the absence of any legislative acknowledgement of the fiscal consequences that such a drastic reduction would cause. *See Helman*, 1994-NMSC-023, ¶37. The Court therefore departed from the plain language of the statute in favor of the regulation, which it found corrected the error and accomplished the Legislature's intended purpose. *See Helman*, 1994-NMSC-023, ¶38. In this case, Section 7-9-94 utilizes an outdated reference which if read literally requires that the relevant DOD contract be authorized by a DOD office that has not existed since 2006, despite the fact that the Legislature as recently as 2015, amended the deduction permitting its availability

for another decade. This evidences the clear intent of the Legislature to attract and incentivize transformation acquisition programs in New Mexico consistent with the elements contained in Section 7-9-94.

This conclusion is reinforced when considering legislative documentation that discusses the deduction's goal of attracting substantive programs to New Mexico, rather than programs authorized by a particular office within the DOD. *See* New Mexico Legislative Finance Committee, Fiscal Impact Report, Military Acquisition Gross Receipts End Dates, New Mexico Legislature Website (March 18, 2015, accessed November 10, 2020), https://www.nmlegis.gov/Sessions/15%20Regular/firs/SB0448.PDF (hereinafter "FIR") (indicating that the deduction incentivizes "military transformational acquisition programs" and "military mission related projects" to locate in New Mexico, without referencing the OFT or any other DOD department); *see Helman*, 1994-NMSC-023, ¶ 35 (legislative documents "presented to and presumably considered by the Legislature during the course of enactment of a statute" may be considered in determining legislative intent). These documents confirm the deduction's purpose is to encourage transformational military projects in New Mexico, and that the proper name of the office within the DOD authorizing the contract for such work is irrelevant.

Remarkably, the Hearing Officer further observed that two departments of state government were identified as contributors to the information contained in the FIR and neither department alerted the Legislature to the fact that the statute might contain a discrepancy in terminology by referring to the name of an office within the DOD that no longer existed. Those agencies were the Department of Military Affairs and the Taxation and Revenue Department. *See* FIR (sections headings "Sources of Information," "Substantive Issues," and "Technical Issues"). This observation is significant because it demonstrates how the Department perceived

no issues, either substantive or technical, with the enactment's reference to OFT in 2015. Had it the apprehensions then that it has now regarding the reference to OFT, it surely would have addressed them at that time as the entity responsible for implementing and enforcing the tax laws of this state. By 2015 when the Department contributed to the FIR, the OFT had been dismantled for nearly a decade.

As the Court did in *Helman*, the Hearing Officer must resolve this contradiction by departing from the literal language of the statute and interpret it to accomplish its intended statutory purpose.

The Hearing Officer was persuaded that the Legislature's intent in referencing the "office of the secretary of defense force transformation" was not to provide taxpayers a deduction for working with a certain DOD office having a specific name, but to attract and incentivize "force transformation" projects in New Mexico. The OFT was merely the arm of the DOD that managed and directed force transformation initiatives until its functions were disbursed among other divisions of DOD, but that reorganization did not, nor could it nullify New Mexico tax law. To find otherwise would produce absurd results which the Legislature clearly did not intend.

The next question is whether Taxpayers' receipts were derived through the type of work contemplated by the Legislature when it enacted Section 7-9-94. Although the Legislature did not define "force transformation" when it referred to "office of the secretary of defense *force transformation*," Taxpayers persuasively explain through argument and supporting evidence that the term is defined by DOD and includes: (1) strengthening joint operations by developing joint concepts and architectures and improving interoperability; (2) exploiting U.S. intelligence advantages through intelligence collection, global surveillance and reconnaissance, and enhanced usage and dissemination; (3) innovative concept development by experimenting with new

1 approaches to warfare through war gaming, simulations, and field exercises; and (4)
2 development of transformational capabilities, which is achieved by the success of the above.
3 The terms "force transformation," "defense transformation," and "defense force
4 transformation" are all synonymous. *See Motion* (Exhibit 1, 1-009 to 1-029 ("Elements of
5 Defense Transformation") (using the terms interchangeably)).
6 Moreover, both DOD and independent third parties such as the Congressional Research
7 Service recognize these four "pillars" as the essential components of force transformation. *See*
8 *Motion* (Exhibit 1, 1- 009 to 1-029 ("Elements of Defense Transformation"); Exhibit 1, 1-030 to
9 1-053 ("Defense Transformation: Background and Oversight Issues for Congress")).
10 In viewing Taxpayer's evidence in the light most favorable to the Department, and noting
11 the absence of any reliable evidence to the contrary, the Hearing Officer finds that if a DOD
12 acquisition program fits within one of these pillars, then the logical conclusion is that the
13 program is within the realm of programs contemplated by Section 7-9-94 when the Legislature
14 referred to "transformation acquisition programs."
15 Although OFT no longer exists in the same form as it did in 2005, the DOD's demand for
16 force transformation services continued. The evidence established that transformation
17 acquisitions projects are now authorized by the DOD's general acquisitions arm, not by any
18 particular force transformation office, division, or department. When the DOD was reorganized
19 in 2006, the Office of Force Transformation's functions and projects were transferred to various
20 other DOD departments in accordance with the DOD's new structure. One of those departments
21 was the OSD-AT&L, the branch of the DOD that oversees the DOD's acquisitions chain, as well
22 as its initiatives in research and development, modeling and simulation, advanced technology,
23 and more. When OFT was reorganized, therefore, its acquisition functions (among others) were

moved to OSD-AT&L.

After the reorganization, OSD-AT&L continued to acquire military systems that qualify as force transformation. OSD-AT&L delegates acquisitions functions to departments within each Armed Forces military service branch. One such service branch is ASA (ALT) which then delegates certain acquisition purchasing responsibilities to PEO STRI.

Following the relevant chain of command it becomes apparent that a force transformation acquisition contract authorized by OSD-AT&L (through PEO STRI) is a force transformation contract within the meaning of Section 7-9-94.

Therefore, the TEST Contract, under which Taxpayers provided services to DOD, qualifies as a "defense force transformation" project as contemplated by Section 7-9-94. First, the services Taxpayers performed for DOD include and consist of "innovative concept development," which is the third "pillar" of force transformation. "Innovative concept development" is defined as "experimentation with new approaches to warfare, operational concepts and capabilities, and organizational constructs through war gaming, simulations, and field exercises focused on emerging challenges and opportunities."

Taxpayers engaged in precisely these activities pursuant to the TEST Contract in which they developed and carried out war games, simulations, field tests, and other experimental projects to evaluate and test the capabilities of military weapons and equipment, including stealth and unmanned aircraft, missile defense systems, and warning and survivability systems.

Taxpayers developed and maintained a comprehensive set of devices, systems, resources, and procedures to accurately simulate a variety of modern threats including devices that simulated electronic warfare tactics such as jamming of electronic systems; software-based simulation tools to train warfighters for real-world situations; and virtual infrastructure to

simulate an opposing force's command structure, communication networks, and air defense systems. Taxpayers utilized these systems to carry out real-time simulations of foreign threats; applied the results of those simulations to recommend upgrades to military components and designs; tested various electronic warfare systems, procedures, and capabilities; facilitated development of transformational capabilities to counter known and anticipated electronic warfare threats; and much more. These activities clearly come within the meaning of "innovative concept development" and the mission of force transformation as preparing the US military to better respond to modern and emerging threats.

Furthermore, Taxpayers performed these services pursuant to an acquisition contract with PEO STRI. As explained above, PEO STRI's acquisitions functions are delegated to it by OSD-AT&L, and OSD-AT&L directs the acquisition functions of the former Office of Force Transformation. Therefore, Taxpayers' gross receipts derived from a force transformation program that was authorized by the DOD department that currently handles the acquisition of force transformation work. Taxpayers satisfied the requirements of Section 7-9-94 and are entitled to relief under that statute as a matter of law.

The Department does not agree suggesting during the hearing on Taxpayers' Motion that the DOD reorganization of 2006 rendered the deduction practically impossible to claim. But "bait and switch" was certainly not the intention of the Legislature when it extended the deduction in 2006 and again in 2015, ultimately extending availability of the deduction to mid-2025. Instead, the Legislature intended to attract force transformation projects to New Mexico as it had prior to the DOD reorganization and the deduction should be construed consistent with that purpose in mind. To do otherwise would produce results that the Legislature did not intend.

Application of NMSA 1978, Section 7-9-54

At the onset of the hearing, Taxpayers alerted the Hearing Officer that they would not be addressing the application of Section 7-9-54. The parties seemingly had no dispute over its application and concurred that Taxpayers should be entitled to the benefit of the deduction upon satisfactory documentation.

Nevertheless, approaching conclusion of the hearing, the Hearing Officer inquired whether a ruling in favor of Taxpayers on the issue of Section 7-9-94 would dispose of the protest in full, or if there would remain any residual issues concerning the application of Section 7-9-54 so that a final and appealable Decision and Order would be premature.

Taxpayers asserted that Section 7-9-54 would apply only if it does not prevail under Section 7-9-94. In other words, Section 7-9-54 represents an alternative and secondary claim for relief that need not be addressed if the Taxpayers should prevail under Section 7-9-94 since all receipts claimed to be deductible under Section 7-9-54 should also be deductible under Section 7-9-94. Taxpayers, according to counsel, do not intend to seek the benefit of multiple deductions to the same taxable event, but avail themselves primarily of the broader deduction afforded by Section 7-9-94.

The Department asserted that issues arising under Section 7-9-54 were not ripe for decision. However, given the strength of the evidence and subsequent decision that Taxpayers are entitled to a deduction afforded by Section 7-9-94, the Hearing Officer agrees that issues arising under the application of Section 7-9-54 are moot because tangible property sold to DOD under the TEST Contract is deductible under Section 7-9-94. The undisputed facts in this protest provide that TEST sold amplifiers, power meter bands, various repair parts and selected off-the-shelf software to PEO-STRI under the TEST Contract. Therefore, for the reasons previously discussed, Section 7-9-94 should also apply to the sales of tangible goods that could also be subject to deductions under

Section 7-9-54.

As Taxpayer emphasized, a finding in favor of Taxpayers on the applicability of Section 7-9-94 resolves all issues, including those that were presented in the alternative under Section 7-9-54. Since Taxpayers readily acknowledge that they do not intend to stack deductions, but seek relief under Section 7-9-54 only if they are denied relief under Section 7-9-94, the Hearing Officer need not further address the application of Section 7-9-54.

The Department's Arguments in Opposition to Motion

The Department argues that Taxpayers' Motion failed to present sufficient evidence to establish a prima facie case because the evidence presented by Taxpayers concerning the present status of "force transformation" initiatives in the DOD is assertedly speculative and outdated. The Department further claims that Taxpayers' affiants lack personal knowledge to testify regarding the DOD's force transformation projects or the meaning of force transformation and that it is uncertain what services Taxpayers performed under the TEST Contract, which apparently omits any reference to the terms "transformation" or "transformational."

These condemnations of Taxpayers' evidence, however, are insufficient to establish the existence of genuine issues of material fact. Instead, the non-moving party must demonstrate through admissible evidence that a genuine issue of material fact exists. *See Koenig*, 1986-NMSC-066; ¶9. Arguments of counsel are not evidence. *See Chevron U.S.A.*, 2006-NMCA-050, ¶36.

Contrary to the Department's perception, the Hearing Officer finds Taxpayers' evidence credible, uncontroverted, and persuasive. Taxpayers rely on documentation from the DOD and the Congressional Research Service and testimony from Taxpayers' affiants to establish that the DOD's force transformation initiatives continued after the OFT was dismantled in 2006 and that

force transformation has a specific, well-accepted definition within the DOD. Taxpayers, pursuant to their DOD contract, engaged in work that clearly fits within the definition of force transformation. The testimony of Taxpayers' affiants on these matters was within their personal knowledge and uncontroverted by any contradictory evidence presented by the Department.

Taxpayer's protest should be granted.

CONCLUSIONS OF LAW

A. Taxpayers filed timely, written protests of the Department's assessments and jurisdiction lies over the parties and the subject matter of this protest.

B. A hearing was held within 90 days of Taxpayers' protests. *See* NMSA 1978, Section 7-1B-6 (D).

C. There is no genuine dispute as to any material fact and summary judgment is appropriate in this matter. *See Romero v. Philip Morris, Inc.,* 2010-NMSC-035, ¶7, 148 NM 713.

D. Taxpayers are entitled to a deduction from gross receipts for receipts derived from transformation acquisition programs performing research and development, test and evaluation at New Mexico major range and test facility bases pursuant to contracts entered into with the United States Department of Defense under NMSA 1978, Section 7-9-94.

For the foregoing reasons, Taxpayer's protest is GRANTED.

DATED: November 13, 2020

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 November 13, 2020, a copy of the foregoing Decision and Order Granting Summary Judgment was emailed to the parties listed below:

Email Only

Email Only

____

John D. Griego
Legal Assistant
Administrative Hearings Office
Post Office Box 6400
Santa Fe, NM 87502
PH: (505)827-0466
FX: (505)827-9732
john.griego1@state.nm.us