STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
THE GEO GROUP INC.
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0928375088

v. **AHO D&O No. 20-17**

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

On May 22, 2019, May 23, 2019, and May 24, 2019, Chief Hearing Officer Brian VanDenzen, Esq., conducted a merits administrative hearing in the matter of the tax protest of The GEO Group, Inc. (Taxpayer) pursuant to the Tax Administration Act and the Administrative Hearings Office Act. At the hearing, Attorneys Justin Sawyer and Tim Van Valen appeared representing Taxpayer, along with Taxpayer employee Mariel Maier. Chief Legal Counsel Tanya Noonan Herring, Attorney Matthew Jackson, and Attorney Mark Baker appeared, representing the opposing party in the protest, the Taxation and Revenue Department (Department).

Taxpayer called Mr. Maier and Lizzy Ratnaraj (née Vedamanikam) as witnesses. As agreed upon by the parties, Taxpayer also presented the depositions of Rebecca Abbo, Josh Kilian, and Joshua Cohen through designation and counter-designation of the Department. The Department called Auditor Shurong Li, Auditor Joe Alejandro, and Protest Auditor Mary Griego as witnesses in this matter. Taxpayer Exhibits #1- 27 were admitted into the record through stipulation and Taxpayer Exhibits #28-34 were admitted into the record without objection. Department Exhibits A-Z and AA-II were admitted into the record through stipulation. Department Exhibit JJ was admitted into the record as a demonstrative exhibit only. All exhibits are more thoroughly described in the exhibit log.

The main issue in this protest is whether Taxpayer's receipts from its housing of New Mexico Corrections Department (NMCD) inmates on behalf of Guadalupe County and Lea County at its privately-run prison facilities within those counties qualify for the deduction under NMSA 1978, Section 7-9-47 (1994) for the sale of a license for resale. Taxpayer filed a claim for refund for tax year 2008 premised on the Section 7-9-47 deduction in 2008. After initially denying that refund claim, following a high-level review, the Department ultimately approved the refund for tax year 2008. Based on that refund approval, Taxpayer submitted an additional refund claim that was approved and beginning in April of 2012, Taxpayer stopped remitting gross receipts tax from the housing of NMCD inmates for Guadalupe County and Lea County, believing those receipts were deductible under Section 7-9-47. However, upon issuance of another decision and order rejecting the applicability of the Section 7-9-47 deduction for private entities providing prison services to public entities, the Department initiated an audit, rejected the applicability of the Section 7-9-47 deduction, and issued the assessment for the reporting periods from January 2010 through September 2015 that Taxpayer challenges in this protest. In light of that history, in addition to questions about the applicability of the deduction, this protest also involves an issue of whether the Department is equitably estopped from issuing the disputed assessment, whether Taxpayer is entitled to the safe harbor acceptance of NTTCs that the Department had authorized the counties to issue during the previous refund claim, and whether civil negligence penalty applies to Taxpayer. In brief summary, the hearing officer denies Taxpayer's protest to all issues except for abatement of civil negligence penalty. IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

Jurisdictional Background

1. On December 27, 2016, the Department issued Taxpayer a notice of assessment of tax for the combined reporting periods of ending January 31, 2010 through September 30, 2015. Under that notice of assessment, Taxpayer owed $14,758,903.76 in gross receipts tax, $2,951,780.74 in civil penalty, and $1,845,395.27 in interest for a total assessed liability of $19,556,079.77. [Department Exhibit B; Administrative Record, hearing request packet].

2. On March 22, 2017, Taxpayer protested the assessment. [Department Exhibit C; Administrative Record, hearing request packet].

3. On April 5, 2017, the Department acknowledged receipt of Taxpayer's protest. [Administrative Record, hearing request packet].

4. On April 12, 2017, the Department requested a hearing with the Administrative Hearings Office on Taxpayer's protest. [Administrative Record, hearing request packet].

5. On May 19, 2017, a scheduling hearing in this matter occurred within 90-days of the hearing request. At that hearing, neither party objected that conducting the hearing satisfied the 90-day statutory hearing requirement. [Administrative Record].

Witness Background

6. Marcel Maier is head of the tax department for Taxpayer. He has a bachelor's degree in business administration and a master's degree in taxation. [Direct of Mr. Maier].

7. Josh Killian works as a Director of Transactional Tax at Ryan, LLC, specializing in state and local taxation. He's worked at Ryan, LLC, for over 11 years and has served as

director for three years. He has a bachelor's degree in finance. [Taxpayer Ex. #33 (Deposition of Killian), 11:2-13:7, 14:11-16].

8. Josh Cohen works as a principal practice leader at Ryan, LLC. He has a bachelor's degree in business administration [Taxpayer Ex. #34 (Deposition of Cohen), 55:9-56:25[1]].

9. Lizzy Ratnaraj worked for the New Mexico Taxation and Revenue Department from 2000 through 2014. While employed at the Department, Ms. Ratnaraj went by the last name of Ms. Vedamanikam[2]. During her time at the Department, she sequentially worked as an administrator, an auditor, a senior auditor, an audit supervisor, an audit manager at the Protest Office, and a division director. She has a bachelor's degree in science, a master's degree in business administration, and is a certified public accountant. [Direct of Ms. Ratnaraj].

10. Rebecca Abbo worked for the New Mexico Taxation and Revenue Department from 1991 through 2014. She has a bachelor's degree in finance and a master's degree in accounting. During her time at the Department, she sequentially worked as a collector, revenue agent, auditor, an audit supervisor, field auditor, and audit bureau chief. Ms. Abbo also participated in the tax policy council at the Department and had a great deal of experience in assessing the validity of claimed deductions, NTTCs, and specifically the license for resale deduction. [Taxpayer Ex. #32 (Deposition of Abbo), 8:3-25; 9:16-19; 11:1-13:10].

11. Shurong Li is an employee of the Taxation and Revenue Department. She has worked as an auditor for 4 years, including one year in her current role as an auditor IV. Ms. Li

[1] Although this deposition testimony was not formerly designated by either party, the hearing officer takes administrative notice of this background information for the sole purpose of providing context and background of Mr. Cohen's role in this matter. Given the uncontroverted testimony of Ms. Vedamanikam, and the depositions of Ms. Abbo, and Mr. Killian about Mr. Cohen's role in this matter, the record is clear that Mr. Cohen worked for Ryan, LLC, and was the lead representative from the firm in this matter.

[2] Since the evidentiary record refers to Ms. Ratnaraj as Ms. Vedamanikam, in order to avoid confusion, the findings of fact will refer to her as Ms. Vedamanikam. However, the citation to testimony will be to Ms. Ratanaraj.

has a bachelor's degree in physics, a master's degree in physics, a master's degree in computer science, and a master's degree in accounting. [Direct of Ms. Li].

12. Joseph Alejandro is a tax auditor supervisor at the Taxation and Revenue Department. He has been employed at the Department for 14 years, including work as an auditor, field auditor, tax audit reviewer with the audit technical support program, and a tax auditor IV (the highest-level non-supervisor auditor position at the Department. Mr. Alejandro has a Bachelor of Science degree in accounting. [Direct of Mr. Alejandro].

13. Mary Griego is a protest auditor with the Taxation and Revenue Department. She has held that position since 2012. She was assigned Taxpayer's protest for review. [Direct of Ms. Griego].

Substantive Findings

Taxpayer's Agreement with Guadalupe County to House Inmates.

14. Taxpayer had an agreement[3] with Guadalupe County, New Mexico for the housing of inmates at Taxpayer's facility in Guadalupe County. [Dept. Ex. D; Direct of Mr. Maier].

15. Under the Guadalupe County and Taxpayer agreement, Taxpayer is compensated by Guadalupe County with a daily service fee determined on a per diem rate for every inmate housed in the facility as of midnight. [Department Ex. D014(¶5.1-2); Direct of Mr. Maier].

16. Under the Guadalupe County and Taxpayer agreement, Guadalupe County paid Taxpayer a specific per diem rate for the housing of Guadalupe County inmates, another higher rate for housing up to 570 NMCD inmates, and a discounted rate for housing every NMCD

[3]The agreement references Guadalupe County's agreement with Wackenhut Corrections Corporation. Taxpayer was formerly known as Wackenhut Corrections Corporation.

inmate above 570 inmates to a maximum of 600 NMCD inmates. [Department Ex. D014(¶5.2); Department Ex. D014; Cross-Examination of Mr. Maier].

17. Taxpayer financed, constructed, and owned the facility, including the land, in Guadalupe County and bore all costs for such development of the facility. [Direct of Mr. Maier; Taxpayer Exhibit #13; Cross Examination of Mr. Maier; Dept. Ex. D006; Redirect of Ms. Li].

18. Taxpayer's cost for the construction of the Guadalupe County facility was approximately $30 million. [Direct of Mr. Maier; Taxpayer Exhibit #11; Taxpayer Exhibit #25].

19. Under the Guadalupe County and Taxpayer agreement, Taxpayer bore responsibility to pay all applicable New Mexico gross receipts tax. [Cross-Examination of Mr. Maier; Department Ex. D3-D4 (¶2.1.7)].

20. Under the Guadalupe County and Taxpayer agreement, Taxpayer agreed as part of the scope of services to provide the following services:

a. Operate a jail for the county. [¶4.1].

b. Provide the facility to county for continuing and exclusive basis. [¶4.1.1].

c. Training of all correctional officers and staff. [¶4.3.1].

d. Provide adequate staffing. [¶4.3.2].

e. Provide religious space, services, and programming to the inmates. [¶4.3.4].

f. Provide food service to the inmates. [¶4.3.5].

g. Provide and launder clothing for inmates. [¶4.3.6].

h. Inmate transportation and security. [¶4.3.7].

i. Provide inmate educational and vocational programming. [¶4.3.9].

j. Provide inmate health care services, including medical, dental, and pharmaceutical services. [¶4.3.11].

k. Provide a recreation and exercise program. [¶4.3.12].

l. Provide a library, books, and librarian. [¶4.3.13].

m. Provide a commissary to inmates. [¶4.3.15].

n. Provide all essentials for running the facility. [¶4.3.16].

o. Disciplinary rules, regulations and grievance procedure. [¶4.4].

p. Comply with New Mexico and federal law on the use of force in the facility. [¶4.5].

q. Obtain and maintain American Correctional Association accreditation. [¶4.8].

[Cross-Examination of Mr. Maier; Department Ex. D5-D13, (Article 4, Scope of Services)]

21. Under the Guadalupe County and Taxpayer agreement, Guadalupe County recognized that Taxpayer offered to perform the services articulated in the agreement. [Cross-Examination of Mr. Maier; Department Ex. D015 (¶5.7)].

22. Guadalupe County entered into an agreement with NMCD to house inmates at Taxpayer's Guadalupe County facility. [Direct of Mr. Maier; Taxpayer Exhibit #1; Department Ex. D].

23. Under the Guadalupe County and Taxpayer agreement, Taxpayer was aware of and accepted Guadalupe County's obligations to house NMCD inmates. [Department Ex. D5 (¶4.1)].

24. Under Guadalupe County's agreement with NMCD, Guadalupe County charged NMCD a per diem rate for the housing of NMCD's inmates at Taxpayer's Guadalupe County Facility. [Direct of Mr. Maier; Taxpayer Exhibit #1.2(¶2); Department Ex. D].

25. Guadalupe County appointed Taxpayer as its billing agent with NMCD for purposes of monthly billing. [Direct of Mr. Maier; Cross-examination; Taxpayer Exhibit #26.3].

26. Guadalupe County and Taxpayer appointed an unidentified bank as the escrow agent for the receipt of payments from NMCD. Both Taxpayer and Guadalupe County had access to the escrow account. [Cross-examination of Mr. Maier (escrow agreement of Lea County substantially same as Guadalupe County); Dept. Ex. O001 (Lea County Escrow Agreement)].

27. Taxpayer billed NMCD directly on a monthly basis for the housing of inmates at the Guadalupe County facility, directing NMCD to remit payment to the escrow account for Guadalupe County. [Direct of Mr. Maier; Taxpayer Exhibit #6].

28. When Taxpayer submitted an invoice to NMCD on behalf of Guadalupe County, it described the "invoice" as "for correctional services" and listed a total payment for provided "services." [Dept. Ex. X001; Taxpayer Ex. #6.1].

29. Under the Guadalupe County and Taxpayer agreement, Taxpayer granted Guadalupe County and NMCD reasonable access to the facility at all times. [Cross-Examination of Mr. Maier; Department Ex. D028 (¶10.2)].

Taxpayer's Agreement with Lea County to House Inmates.

30. Taxpayer had an agreement with Lea County, New Mexico for the housing of inmates at Taxpayer's facility in Lea County. [Dept. Ex. F; Direct of Mr. Maier].

31. Under its agreement, Taxpayer accepted Lea County's obligations to house NMCD inmates. [Department Ex. F5 (¶4.1)].

32. Taxpayer owns the Lea County facility through a wholly owned subsidiary's 2007 purchase of the facility for $68,187,232.00. [Taxpayer Ex. 25.1; Direct of Mr. Maier].

33. Taxpayer bore all costs associated with development of the facility in Lea County. [Dept. Ex. F006].

34. Taxpayer leased the land where the Lea County facility is located under a 99-year land lease. [Cross-Examination of Mr. Maier; Taxpayer Ex. #15].

35. Under the Lea County and Taxpayer agreement, Taxpayer is compensated by Lea County with a daily service fee based on the per diem rates for inmates present at midnight. [Department Ex. F013(¶5.1-2)].

36. Under the Lea County and Taxpayer agreement, Lea paid Taxpayer a specific per diem rate for the housing of Lea County inmates, another higher rate for housing up to 1140 NMCD inmates, and a discounted rate for housing every NMCD inmate above 1140 inmates to a maximum of 1200 NMCD inmates. [Department Ex. F014(¶5.2)].

37. Under the Lea County and Taxpayer agreement, Taxpayer bore responsibility to pay all applicable New Mexico gross receipts tax. [Cross-Examination of Mr. Maier; Department Ex. F003-F004 (¶2.1.7)].

38. Under the Lea County and Taxpayer agreement, Taxpayer agreed as part of its scope of services to provide the following services:

a. Operate a jail for the county. [¶4.1].

b. Provide the facility to county for continuing and exclusive basis. [¶4.1.1].

c. Training of all correctional officers and staff. [¶4.3.1].

d. Provide adequate staffing. [¶4.3.2].

e. Provide religious space, services, and programming to the inmates. [¶4.3.4].

f. Provide food service to the inmates. [¶4.3.5].

g. Provide and launder clothing for inmates. [¶4.3.6].

h. Inmate transportation and security. [¶4.3.7].

i. Provide inmate educational and vocational programming. [¶4.3.9].

j. Provide inmate health care services, including medical, dental, and pharmaceutical services. [¶4.3.11].

k. Provide a recreation and exercise program. [¶4.3.12].

l. Provide a library, books, and librarian. [¶4.3.13].

m. Provide a commissary to inmates. [¶4.3.15].

n. Provide all essentials for running the facility. [¶4.3.16].

o. Impose disciplinary rules, regulations and grievance procedure. [¶4.4].

p. Comply with New Mexico and federal law on the use of force in the facility. [¶4.5].

q. Obtain and maintain American Correctional Association accreditation. [¶4.8].

[Cross-Examination of Mr. Maier[4]; Department Ex. F005-F013, (Article 4, Scope of Services)]

39. Lea County recognized that Taxpayer offered to perform the services articulated in the agreement. [Cross-Examination of Mr. Maier; Department Ex. F014-F015 (¶5.7)].

40. Taxpayer granted Lea County and NMCD reasonable access to the facility at all times. [Cross-Examination of Mr. Maier; Department Ex. F028 (¶10.2)].

41. Lea County entered into an agreement with NMCD to house inmates at Taxpayer's Lea County facility. [Direct of Mr. Maier; Taxpayer Exhibit #2].

42. Lea County charged NMCD a per diem rate for the housing of NMCD's inmates at Taxpayer's Lea County Facility. [Direct of Mr. Maier; Taxpayer Exhibit #2.2(¶2)].

[4] On Cross-Examination, in the interest of efficiency of time, Mr. Maier acknowledged that his previous cross-examination testimony regarding the items performed under Taxpayer's agreement with Guadalupe County were substantially similar to its agreement with Lea County with a few minor exceptions. All items listed here are contained in the Taxpayer-Lea County agreement contained in Exhibit F.

43. Lea County appointed Taxpayer as its billing agent with NMCD for purposes of monthly billing. [Direct of Mr. Maier; Cross Examination of Mr. Maier; Taxpayer Exhibit #20.3].

44. Lea County and Taxpayer appointed Western Commerce Bank as the escrow agent for the receipt of payments from NMCD in an account that both Taxpayer and Lea County had access to. [Dept. Ex. O001].

45. Taxpayer billed NMCD directly on a monthly basis for the housing of inmates at the Lea County facility, directing NMCD to remit payment to the escrow account for Lea County. [Direct of Mr. Maier; Taxpayer Exhibit #5].

46. When Taxpayer submitted an invoice to NMCD on behalf of Lea County, it described the "invoice" as "for correctional services" and listed a total payment for provided "services." [Dept. Ex. T001, U001; Taxpayer Ex. #5].

47. The vast majority of inmates at both county facilities were in fact NMCD inmates rather than county inmates. [Cross-Examination of Mr. Maier, Taxpayer Ex. # 3.15-3.17; Taxpayer Ex. #27].

The Tax Year 2008 Refund Claim, Protest, and Approval.

48. In 2011, Taxpayer engaged with Ryan, LLC, to review Taxpayer's state tax obligations across the country, including Taxpayer's New Mexico tax obligations. For this review, Taxpayer agreed to compensate Ryan, LLC, on a contingency basis for all successfully identified tax obligations for which a valid deduction, exemption, or credit applied. [Direct of Mr. Maier; Cross-Examination of Mr. Maier; Redirect of Mr. Maier; Taxpayer Ex. #33 (Deposition of Killian), 82:20-84:4].

49. Ryan, LLC identified a potential deduction under Section 7-9-47 for Taxpayer to claim related to the counties' housing of NMCD inmates at Taxpayer's facilities as a claimed sale of a license for resale. [Direct of Mr. Maier].

50. On December 29, 2011, Taxpayer submitted a refund claim prepared by Ryan, LLC, to the Department, claiming a deduction from gross receipts tax for the licensing of its correctional facilities to the counties for the housing of inmates during the 2008 tax year. The claim applied to the two facilities at issue in this protest—Guadalupe County and Lea County—as well as a third facility in the City of Clayton, Union County. [Direct of Mr. Maier; Taxpayer Exhibit #3; Taxpayer Ex. #28; Taxpayer Ex. #33 (Deposition of Killian), 17:21-20:20].

51. At the time of the December 29, 2011 refund claim, Taxpayer was unable to obtain a Type 2 nontaxable transaction certificate (NTTC) from the counties to support its refund claim at time of submittal of its refund claim. [Direct of Mr. Maier; Cross-Examination of Mr. Maier].

52. At the time of the December 29, 2011 refund claim, the counties were able to provide Taxpayer with inapplicable Type 9 NTTCs. [Direct of Mr. Maier].

53. In the absence of the necessary supporting NTTCs at the time of the submittal of the refund claim, Mr. Maier understood that Taxpayer's refund claim would likely be denied. [Cross-Examination of Mr. Maier].

54. Despite Taxpayer's understanding that the refund claim would likely be denied in the absence of supporting NTTCs, Taxpayer filed its December 29, 2011 refund claim because it believed the statute of limitations on such a refund claim was December 31, 2011.

55. On January 10, 2012, the Department denied Taxpayer's claim for refund. [Direct of Mr. Maier; Taxpayer Ex. 4; Department Ex. H; [Taxpayer Ex. #34 (Deposition of Cohen), 59:22-60:2].

56. At some point on or after the filing of the refund claim, Taxpayer's representatives contacted the Department seeking authorization for the counties to issue a Type 2 NTTC to Taxpayer. [Taxpayer Ex. #10; Taxpayer Ex. #32 (Deposition of Abbo), 13:25-15:22; 45:18-46:1].

57. Ryan, LLC, understood from communication with Department Employee Rebecca Abbo that the Department was in process of opening up the system to allow the counties to issue NTTCs. [Redirect of Mr. Maier; Taxpayer Ex. #33 (Deposition of Killian), 37:8-17].

58. On April 2, 2012, Rebecca Abbo informed Taxpayer's representatives that the Department would allow the counties to issue Type 2 NTTCs to Taxpayer and that she would assist the counties in that process. [Taxpayer Ex. #10; Taxpayer Ex. #32 (Deposition of Abbo), 26:15-27:22].

59. On April 5, 2012, Guadalupe County executed a Type 2 NTTC to Taxpayer. [Direct of Mr. Maier; Cross-Examination of Mr. Maier; Taxpayer Ex. #7.1].

60. On April 9, 2012, Taxpayer protested the Department's denial of Taxpayer's claim for refund. [Direct of Mr. Maier; Cross-Examination of Mr. Maier; Department Ex. I; Taxpayer Ex. #34 (Deposition of Cohen), 62:1-63:13].

61. On April 23, 2012, Lea County executed a Type 2 NTTC to Taxpayer. [Direct of Mr. Maier; Cross-Examination of Mr. Maier; Taxpayer Ex. #8.1].

62. Protest Audit Manager Vedamanikam assigned herself Taxpayer's protest because of the apparent complexity of the protest. [Direct of Ms. Ratnaraj].

63. Ms. Vedamanikam reviewed the entire protest packet, including most of the supporting documentation (with exception of one irrelevant taxpayer information authorization) including the refund claim, the refund denial, and the contracts between Taxpayer and each respective facility. [Direct of Ms. Ratnaraj; Dept. Ex. I].

64. Ms. Vedamanikam had numerous telephone and email communications with Mr. Cohen of Ryan, LLC, about Taxpayer's Protest. [Direct of Ms. Ratnaraj; Taxpayer Ex. #34 (Deposition of Cohen), 63:1-66:1; Taxpayer Ex. #9].

65. Ms. Vedamanikam initially had concerns with Taxpayer's reliance on Type 2 NTTCs to support the deduction because Type 2 NTTCs are not normally permitted to be executed by governmental agencies. [Direct of Ms. Ratnaraj; Hearing Officer Questions of Ms. Ratnaraj; [Taxpayer Ex. #32 (Deposition of Abbo), 75:1-76:4].

66. Type 2 NTTCs were never issued by governmental agencies during Ms. Vedamanikam's 15-year career at the Department. [Cross Examination of Ms. Ratnaraj].

67. Because of her concerns about the appropriateness of the Type 2 NTTCs in this matter, Ms. Vedamanikam emailed Rebecca Abbo of the Audit and Compliance Division (ACD) about what criteria ACD had used to approve the counties execution of those type of NTTCs. Ms. Abbo responded that Taxpayer provided documentation showing that it was a lease for resale. [Cross Examination of Ms. Ratnaraj; Hearing Officer Questions of Ms. Ratnaraj; Department Ex. HH].

68. Finding Ms. Abbo's answer unsatisfactory, Ms. Vedamanikam further discussed the Type 2 NTTC issue further with the Chief Legal Counsel Nelson Goodin. Ms. Vedamanikam recalls that the Chief Legal Counsel agreed to meet with Ms. Abbo to discuss the issue further. [Cross Examination of Ms. Ratnaraj].

69. At some point between March 28, 2012 and April 2, 2012, the Department's tax policy council, which included the Cabinet Secretary, the Chief Legal Counsel, the Tax Policy Director, and Rebecca Abbo among others met to discuss the appropriateness of the Type 2 NTTC for Taxpayer, who normally would not qualify for that type of NTTC. After extensive discussion, the tax policy council concluded that the Department would permit a Type 2 NTTC. [Taxpayer Ex. #32 (Deposition of Abbo), 16:21-21:11, 43:2-19, 72:17-73:18; Taxpayer Ex. #10].

70. On April 2, 2012, Rebecca Abbo emailed Taxpayer's representative Tim Van Valen approving Guadalupe County and Lea County's execution of Type 2 NTTCs to Taxpayer. [Taxpayer Ex. #32 (Deposition of Abbo), 24:15-30:20; Taxpayer Ex. #10].

71. The Chief Legal Counsel Nelson Goodin indicated to Ms. Vedamanikam that ACD was satisfied by the Type 2 NTTCs and based on that information, Ms. Vedamanikam recommended approval of the refund claim. [Direct of Ms. Ratnaraj; Cross-examination of Ms. Ratnaraj; Redirect of Ms. Ratnaraj; Taxpayer Ex. #17; Department Ex. HH; Taxpayer Ex. #10].

72. On May 10, 2012, Ms. Vedamanikam emailed Taxpayer's representative Mr. Cohen of Ryan, LLC, indicating she was recommending approval of Taxpayer's claim for deduction regarding the Guadalupe County and Lea County facilities for tax year 2008. [Direct of Ms. Ratnaraj; Taxpayer Ex. #9.8-9.9]. In that email, Ms. Vedamanikam noted that:

a. She had reviewed in detail Taxpayer's application for refund and the supporting documentation;

b. She determined that Taxpayer's receipts from the Guadalupe County and Lea County facilities qualified for the deduction of the sale of a license to use real property for resale in the ordinary course of business;

c. She determined that Taxpayer's receipts from the Clayton facility were not eligible for the license to use real property resale deduction because Taxpayer did not own that facility;

d. She requested approval for the refund receipts derived from the Guadalupe County and Lea County facilities.

e. She requested amended returns and substantiation of the amounts related specifically to the Guadalupe County and Lea County facilities.

73. On May 11, 2012. Mr. Cohen of Ryan, LLC, provided Ms. Vedamanikam the requested amended returns, workbooks, and supporting documentation. [Direct of Ms. Ratnaraj; Taxpayer Ex. #9.8; Taxpayer Ex. #33 (Deposition of Killian), 105:5-106:7; Taxpayer Ex. #34 (Deposition of Cohen), 69:15-72:23].

74. Taxpayer's protested refund claim regarding the Guadalupe County and Lea County facilities was ultimately granted in the amount of $2,722,810.46 after review by Ms. Vedamanikam, and approval by Chief Legal Counsel Nelson Goodin, ACD Director David Fergeson, and Cabinet Secretary Demesia Padilla. [Taxpayer Ex. #9.3; Taxpayer Ex. #32 (Deposition of Abbo), 40:13-21; Taxpayer Ex. #34 (Deposition of Cohen), 67:4-68:7].

75. On My 17, 2012, Ms. Vedamanikam emailed Taxpayer's representative Mr. Cohen three times to inform him:

a. that after a discussion of the finer details of the claim with her office, everything seemed to be in order on the refund claim;

b. to subsequently inform him that all approvals were in place for the refund;

c. to formally indicate the Department's approval of a refund in the amount of $2,722,810.46.

[Direct of Ms. Ratnaraj; Taxpayer Ex. #9.3-9.4].

76. Ms. Vedamanikam did not tell Taxpayer's representatives that the refund approval would shield Taxpayer from any subsequent audit, as the Department had authority to do such a subsequent audit and had done so with other taxpayers successfully in the past (through issuance of notice of audit and assessment). [Cross Examination of Ms. Ratnaraj; Redirect of Ms. Ratnaraj; Taxpayer Ex. #32 (Deposition of Abbo), 50:21-23].

77. On May 17, 2012, Ms. Vedamanikam entered a detailed note into the GenTax system documenting in detail her approval of Taxpayer's refund claim. She entered this note because she still had some discomfort with the refund approval because the Revenue Processing Division raised numerous questions about whether the claim truly involved a license to use, the use of a Type 2 NTTC that would not normally be executed by a governmental agency, and because she wanted a detailed explanation to anyone who might succeed her. [Direct of Ms. Ratnaraj; Cross Examination of Ms. Ratnaraj; Taxpayer Ex. #17].

78. In light of the refund approval, Taxpayer withdrew its April 9, 2012, protest regarding the Guadalupe County and Lea County receipts but maintained its protest as to the Clayton facility's receipts, an issue that ultimately went to a hearing. [Taxpayer Ex. #33 (Deposition of Killian), 35:15-18, 113:21-116:4; Taxpayer Ex. #34 (Deposition of Cohen), 74:2-23].

Taxpayer's post-refund actions, Department Audit and Assessment, and Protest.

79. In April of 2012, Taxpayer stopped remitting gross receipts tax on receipts from Guadalupe County and Lea County in light of the Department's approval of the tax year 2008 refund claim for those counties. [Direct of Mr. Maier; Direct of Ms. Ratnaraj; Taxpayer Ex. #9.1].

80. On June 11, 2012, Taxpayer submitted a claim for refund for the reporting periods from January 2009 through March 2012 for the Guadalupe County and Lea County receipts premised on the same deduction under Section 7-9-47 previously approved by the Department. That refund claim was granted by the Department in an amount of $8,289,984.00. $2,628,658.70 of that refunded amount was related to the reporting periods from January through December 2009 reports. [Direct of Mr. Maier; Taxpayer Ex. #33 (Deposition of Killian), 35:19-37:2; Taxpayer Ex. #34 (Deposition of Cohen), 74:2-23; Department Ex. K; Department Ex. K017].

81. The remaining Clayton facility issue at protest under the tax year 2008 refund claim ultimately went to hearing before the undersigned hearing officer. Taxpayer refund and protest regarding the Clayton facility was denied by the decision and order issued *In the Matter of the GEO Group, Inc*., Decision and Order No. 14-36, 2014 WL 6751183, (November 20, 2014). [Direct of Mr. Maier].

82. Taxpayer learned of the decision regarding the Clayton facility from its auditing firm, Ryan, LLC, which explained that the deduction did not apply to a non-owned facility even though the decision was much clearer than the operation of private prison facilities for government agencies predominately involved the performance of a service rather than the sale of any real property interest. [Direct of Mr. Maier].

83. After learning of the decision from Ryan, LLC, Mr. Maier also read the decision and order regarding the Clayton facility. Mr. Maier also read another related decision and order issued by the undersigned hearing officer on the same date as the Clayton facility: *In the Matter of Cornell Corrections of Texas,* Decision and Order No. 14-35, 2014 WL 6751182 (November 20, 2014). [Cross-Examination of Mr. Maier].

84. Taxpayer still believed after those decisions and orders that the deduction applied to its facilities in Guadalupe County and Lea County because unlike the Clayton facility it had leased, Taxpayer owned that facilities in Guadalupe County and Lea County. [Direct of Mr. Maier; Cross-examination of Mr. Maier].

85. By the time of the issuance of the decision regarding the tax year 2008 refund for the Clayton facility, Ms. Vedamanikam had taken a new position in the Department as Director ACD. [Direct of Ms. Ratnaraj; Cross-examination of Ms. Ratnaraj].

86. In her new capacity as ACD Director, and in response to her reading of the decision on the Clayton facility, Ms. Vedamanikam raised during an executive meeting with the cabinet secretary and the new Chief Legal Counsel her concerns that Taxpayer was not entitled to the Section 7-9-47 resale of a license for receipts at Taxpayer's facilities in Guadalupe County and Lea County. [Cross-examination of Ms. Ratnaraj; Hearing Officer Questions of Ms. Ratnaraj].

87. In March of 2015, Ms. Vedamanikam confirmed with her ACD staff via email that in light of the decision and order on the Clayton facility, ACD should evaluate those prison companies—including Taxpayer—that were using the deduction at issue in this case for a possible field audit. [Direct of Ms. Ratnaraj; Cross-examination of Ms. Ratnaraj; Taxpayer Ex. #19.7-19.8].

88. On October 20, 2015, the Department selected Taxpayer for an audit for gross receipts tax, compensating and withholding tax, worker's comp fees, and income tax. [Department Exhibit A001; Direct of Mr. Maier; Direct of Mr. Alejandro].

89. The October 20, 2015 audit selection letter did not indicate it was related in any manner to the Department's previous determination regarding the applicability of the deduction to the Guadalupe County and Lea County receipts. [Direct of Mr. Maier].

90. Department auditor Shurong Li primarily conducted the audit of Taxpayer and generated the audit workpapers and the audit narrative. [Direct of Ms. Li].

91. During the audit, Auditor Li determined that Taxpayer was predominately providing a service rather than selling a license to Guadalupe County and Lea County and that Taxpayer was not reselling a license because Taxpayer billed NMCD directly rather than billing the counties. Thus, the audit concluded that Taxpayer was not entitled to the claimed deduction. [Dept. Ex. R159-169; Direct of Ms. Li].

92. During the audit, Auditor Li concluded that Taxpayer was not protected by acceptance of the Type 2 NTTC in this case because no eligible deduction applied to the transaction at issue. [Dept. Ex. R167; Direct of Ms. Li].

93. Auditor Li circulated her audit of Taxpayer for peer review within the Department consistent with Department protocols. [Direct of Mr. Alejandro].

94. In his role as supervisor, Mr. Alejandro reviewed Ms. Li's audit process, audit work, audit narrative, and audit findings. After that review, Mr. Alejandro agreed with Ms. Li's audit findings. [Direct of Mr. Alejandro].

95. Additionally, as part of its normal audit process, the Department's Audit Technical Support Services performed an independent review of Ms. Li's audit and approved of Ms. Li's audit findings. [Direct of Mr. Alejandro].

96. After Audit Technical Support Services approved of Ms. Li's audit, the Department sent a draft audit report to Taxpayer to give Taxpayer a 10-day period to review the draft audit. [Department Ex. R168; Direct of Mr. Alejandro].

97. Although aware of their previous roles in approving issuance of the NTTC and recommending the refund for tax year 2008, Auditor Li did not consult with either Ms. Vedamanikam or Ms. Abbo about whether acceptance of the NTTCs was made in good faith or whether imposition of civil negligence penalty was appropriate. [Cross-examination of Ms. Li].

98. Based on the audit, on December 27, 2016, the Department issued the assessment referenced in Finding of Fact #1 for the reporting periods from January 31, 2010 through September 30, 2015.

99. As part of the protest process, Taxpayer created spreadsheet analysis for the Guadalupe County and Lea County facilities in the respective, relevant years, purporting to distinguish between labor costs related to programming for inmates as compared to labor costs for providing "secured services" at facility. [Taxpayer Exhibit #23; Direct of Mr. Maier; "Secured Services" 02:22:15-26]. Under Taxpayer analysis of its labor costs, Taxpayer postulated that:

a. In 2008 at the Lea County facility, 19.11% of Taxpayer's labor costs were related to providing inmate programming and incidental services and 80.89% was related to operating, maintaining, and providing a secured facility. [Taxpayer Exhibit #23.1; Direct of Mr. Maier].

b. In 2008 at the Guadalupe County facility, 14.99% of Taxpayer's labor costs were related to providing inmate programming and incidental services and

85.01% was related to operating, maintaining, and providing a secured facility. [Taxpayer Exhibit #23.2; Direct of Mr. Maier].

c. In 2009 at the Lea County facility, 17.26% of Taxpayer's labor costs were related to providing inmate programming and incidental services and 82.74% was related to operating, maintaining, and providing a secured facility. [Taxpayer Exhibit #23.3; Direct of Mr. Maier].

d. In 2009 at the Guadalupe County facility, 13.66% of Taxpayer's labor costs were related to providing inmate programming and incidental services and 86.34% was related to operating, maintaining, and providing a secured facility. [Taxpayer Exhibit #23.4; Direct of Mr. Maier].

e. In 2010 at the Lea County facility, 18.24% of Taxpayer's labor costs were related to providing inmate programming and incidental services and 81.76% was related to operating, maintaining, and providing a secured facility. [Taxpayer Exhibit #23.5; Direct of Mr. Maier].

f. In 2010 at the Guadalupe County facility, 13.55% of Taxpayer's labor costs were related to providing inmate programming and incidental services and 86.45% was related to operating, maintaining, and providing a secured facility. [Taxpayer Exhibit #23.6; Direct of Mr. Maier].

100. Taxpayer then applied its labor cost analysis purportedly to allocate its total costs at each facility in each respective year between "license costs" and "open costs." Taxpayer's analysis led it to conclude that in all cases, less that 20% of its costs was related to providing inmate programming and ancillary services as opposed to over 80% of its costs to providing secured facilities. [Taxpayer Exhibit #24; Direct of Mr. Maier].

101. Upon assignment of the protest, Department Protest Auditor Mary Griego reviewed the audit carefully and prepared a detailed log of all other materials she reviewed. After that review, Ms. Griego agreed with Ms. Li's audit findings that Taxpayer was predominately providing a service in the operations of the prison facilities. [Dept. Ex. R001; Direct of Ms. Griego].

DISCUSSION

In this protest, Taxpayer argued that it is substantively entitled to claim the deduction under Section 7-9-47 for the sale of a license for resale related to its receipts from the operation of private prison facilities in Guadalupe County and Lea County during the relevant tax periods at issue of January 31, 2010 through September 20, 2010. Alternatively, Taxpayer argued that even if it did not qualify for the deduction under Section 7-9-47, Taxpayer is entitled to the safe harbor protection of acceptance of NTTCs in good faith. Short of that, Taxpayer avers that the Department is equitably estopped from assessing Taxpayer based on the Department's previous approval of a refund for tax year 2008[5] premised on the same deduction. In the event that Taxpayer is found liable for gross receipts tax under the assessment, Taxpayer finally argues that civil negligence must be abated because it made a good faith, mistake of law and relied on the advice of Department employees in not paying gross receipts tax on its receipts from the operation of the prison facilities.

Presumption of Correctness.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessment issued in this case is presumed correct. Consequently, Taxpayer has the burden to overcome the assessment. *See*

[5] Although it provides important context to this protest, the approved refund claim in tax year 2008 is not at issue in this case, as it was beyond that statute of limitations at the time of the Department's assessment.

Archuleta v. O'Cheskey, 1972-NMCA-165, ¶11, 84 N.M. 428. *See also N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8. Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, §7-1-3 (X) (2013). Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department's assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight). Accordingly, it is Taxpayer's burden to present some countervailing evidence or legal argument to show that they are entitled to an abatement, in full or in part, of the assessment issued in the protest. *See N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8. When a taxpayer presents sufficient evidence to rebut the presumption, the burden shifts to the Department to show that the assessment is correct. *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 2003-NMCA-21, ¶13, 133 N.M. 217.

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, § 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." NMSA 1978, § 7-9-3.3 (2003). Under the Gross Receipts and Compensating Tax Act, NMSA 1978, Section 7-9-5 (2002), there is a statutory presumption that all receipts of a person engaged in business are taxable. *See Rauscher, Pierce, Refsnes, Inc. v. Taxation & Revenue Dep't*, 2002-NMSC-013, ¶11, 132 N.M. 226, 46 P.3d 687. Taxpayer is engaged in business in New Mexico in provisioning, operating, and managing the prison facilities in Guadalupe County and Lea County. As such, all receipts of Taxpayer are presumed subject to New Mexico's gross receipts tax under Section 7-9-5 unless Taxpayer can establish entitlement to the claimed

deduction "within the letter as well as the spirit of the law." *Kewanee Indus., Inc. v. Reese*, 1993-NMSC-006, ¶29, 114 N.M. 784, 791, 845 P.2d 1238, 1245 (internal citations omitted).

Because Taxpayer claims a deduction from taxation in this case, Taxpayer carries the burden to establish entitlement to the claimed deduction. *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." *Wing Pawn Shop v. Taxation and Revenue Department*, 1991-NMCA-024, ¶16, 111 N.M. 735 (internal citation omitted); *See also TPL, Inc. v. N.M. Taxation & Revenue Dep't*, 2003-NMSC-7, ¶9, 133 N.M. 447 (any deductions are construed strictly against the taxpayer).

Issue One: Taxpayer is not selling a license for resale for purposes of the deduction

Taxpayer claims that under its service contracts with Guadalupe County and Lea County, it is selling a license to the respective counties to house prison inmates, who in turn resell that license to NMCD for the housing the Correction Department inmates. As such, Taxpayer claims its receipts from Guadalupe County and Lea County are not taxable gross receipts because those receipts are deductible as the sale of tangible personal property or licenses for resale found under Section 7-9-47. Section 7-9-47 states that:

> Receipts from selling tangible personal property or licenses may be deducted from gross receipts or from governmental gross receipts if the sale is made to a person who delivers a nontaxable transaction certificate to the seller. The buyer delivering the nontaxable transaction certificate must resell the tangible personal property or license either by itself or in combination with other tangible personal property or licenses in the ordinary course of business.

Breaking down the 7-9-47 deduction further as it relates to this case, the deduction applies when Taxpayer establishes three conditions. First, Taxpayer must be selling a license. Second, the buyer of that license must deliver a NTTC to Taxpayer. And third, the buyer of Taxpayer's license must resell that license in the ordinary course of business. Taxpayer, who bears the burden of establishing entitlement to a claimed deduction both legally and factually, is unable to persuasively establish that it sold a license and that license was resold in the ordinary course of business.

As for the licensing requirement, the term license is not specifically defined either under Section 7-9-47, the Gross Receipts and Compensating Tax Act, or under the Tax Administration Act. *See Quantum Corp. v. State Taxation & Revenue Dep't,* 1998-NMCA-050, ¶10, 125 N.M. 49. In the absence of a statutory definition, the New Mexico Court of Appeals turned to Black's Law Dictionary to define "license" as "[a] permission, by a competent authority to do some act which without such authorization would be illegal, or would be a trespass or a tort…" *N.M. Sheriffs & Police Ass'n v. Bureau of Revenue*, 1973-NMCA-130, ¶7, 85 N.M. 565; *See also Quantum Corp*., ¶10.

The Administrative Hearings Office and its predecessor Hearings Bureau[6] has considered and rejected the claim that the operations of private prisons on behalf of governmental entities, including housing NMCD inmates under contract with the local governmental entity, amounts to the resale of license for the purpose of the Section 7-9-47 deduction. In 2014, the undersigned hearing officer issued two decisions and orders rejecting Taxpayer's claim for application of the deduction under Section 7-9-47. *See In the Matter of the GEO Group, Inc*., Decision and Order No. 14-36,

[6] On July 1, 2015, pursuant to enacted Senate Bill 356, the Taxation and Revenue Department's Hearings Bureau became the Administrative Hearings Office ("AHO"), an agency independent of the Taxation and Revenue Department. *See* NMSA 1978, Section 7-1B-1 through 8 (2015). The Hearings Bureau was responsible for Decisions and Orders issued before July 1, 2015, while decisions and orders issued after that date originated from the Administrative Hearings Office.

2014 WL 6751183, (November 20, 2014) (non-precedential); *See also In the Matter of Cornell Corrections of Texas,* Decision and Order No. 14-35, 2014 WL 6751182 (November 20, 2014) (non-precedential). In those cases, the undersigned hearing officer expressly held that rather than selling a lease to the relevant government organizations for resale, Taxpayer was predominately and fundamentally performing the service of providing a secured prison facility and therefore the deduction under Section 7-9-47 was not applicable. *See id*. Similarly, in 2018, Hearing Officer Chris Romero of the Administrative Hearings Office similarly held that Section 7-9-47 did not apply to another private prison company claiming that deduction for predominately providing correction services by housing NMCD inmates on behalf of a county government. *See In the Matter of CCA of Tennessee*, Decision and Order No. 18-21, 2018 WL 3621109 (July 19, 2018) (non-precedential).

Although not directly on point to defining a license for the purposes of Section 7-9-47, the New Mexico Court of Appeals considered the applicability of gross receipts tax on the receipts of private prison companies from governmental entities in *Corrections Corp. of America v. State of N.M.*, 2007-NMCA-148, 142 N.M. 779. In that case, that taxpayer sought a refund of gross receipts tax paid on the theory that its agreements to house prisoners for governmental agencies at facilities that taxpayer owned and operated constituted a lease not subject to gross receipts tax. *See id.*, ¶1. Although the Court of Appeals did not consider the question under the rubric of the Section 7-9-47 license for resale deduction, its analysis is nevertheless helpful in this protest given the factual similarities between the protests. The agreements in *Corrections Corp.*, ¶3-10, were quite similar to the agreements at issue in this case. *See id.*, ¶3-10. Like in this protest, the taxpayer in *Corrections Corp.*, charged the governmental entities on a per diem basis. *See id.*, ¶6. Like in the present protest, *Corrections Corp.* taxpayer owned the prison facilities outright. *See id*. Like in the present protest,

the agreements did involve some elements suggestive of a real property lease interest, some elements of a service, and sometimes complicated and conflicting facts that made the analysis challenging *See id.*, ¶24-25.

Despite these challenges, the Court of Appeals resolved that case by looking at the method of payment between the parties in contrast to other cases involving a lease. *See id.* Because, like here, the taxpayer in *Corrections Corp.* was compensated on a per diem rate depending on the numbers of inmates rather than a fixed rate regardless of the number of inmates, and because the taxpayer had the ability to fill empty beds with inmates from other jurisdictions, the Court of Appeals held that the contracts at issues were not leases. *See id.*, ¶27-28. As the Court of Appeals explained,

> [w]e assume that part of the reason the governmental entities contracted with CCA to pay based on a "per-diem" rate is because CCA provides services, the cost of which depends on the number of inmates. Regardless of the rationale, however, this payment arrangement and the ability of CCA to accept inmates from others militates against any notion that these contracts are leases. Because the governmental entities did not pay a fixed amount in exchange for the guarantee of physical real property to house inmates, there is no lease for real property as contemplated by the Gross Receipts Act.

Id., ¶28.

After reaching the conclusion that the agreement at issue was not a lease, the Court of Appeals in *Corrections Corp.* suggested that the arrangement between that taxpayer and the governmental agencies was "more like" the arrangement between hotels and lodgers than leases of real property. *See id*. ¶28. Taxpayer relies on this language in arguing that its arrangements with the counties to house NMCD prisoners amounted to a license for resale. Although the Court of Appeals comparison with hotels and lodgers is suggestive of a potential license, that does not necessarily mean that Court of Appeals expressly found that agreements between private prison companies and

governmental entities for the housing of inmates constitutes a license deductible under Section 7-9-47. After finding that the agreement did not constitute the claimed lease at issue, the court's statement that the arrangement between the parties were more like an arrangement between hotels and lodgers appears to be dicta not essential to the court's holding. *See Bassett v. Sheehan*, 2008-NMCA-072, ¶9, 144 N.M. 178, 184 P.3d 1072 (defining "dictum" as a statement that is unnecessary to a holding). Moreover, since the Court of Appeals was not considering whether the arrangement amounted to a license for the purposes of the deduction under Section 7-9-47, the court's "more like" an arrangement between a hotel and a lodger is not dispositive of the license question. *See State v. Erickson K.*, 2002-NMCA-058, ¶20, 132 N.M. 258, 46 P.3d 1258 (cases are not authority for propositions not considered).

In summarizing this holding that the contracts at issue were not for leases, the Court of Appeals returned to the presumption of the taxability in considering claims for deductions. And under that view, the Court of Appeals noted that it found nothing under the Gross Receipts and Compensating Tax Act that would allow a private prison company to claim its receipts from a governmental entity would constitute a lease not subject to taxation. *See id*. ¶29. Although the current protest involves the deduction for a license for resale under Section 7-9-47 rather than the lease at issue in that case, the same principal that the *Corrections Corp*.'s Court of Appeals relied on in needing to find a clear factual and legal basis to support the deduction applies here to Taxpayer's claim for a license.

Just as the Court of Appeals did in *Corrections Corp.*, resolving the main issue in this protest requires careful review of the largely substantively identical contracts between Taxpayer and Guadalupe County and Lea County in addition to the predominant ingredient analysis under NMSA 1978, Section 7-9-3 (M) (2007). Section 7-9-3 (M) defines "service" as "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." Section 7-9-3 (M) indicates that "[i]n determining what is a service, the intended use, principal objective or ultimate objective of the contracting parties shall not be controlling."

As the Department persuasively argues, those contracts are predominately service contracts, and to the extent there is any license implied in the agreements, it is incidental to the predominate services Taxpayer performs under the agreement. Although looking at the intent of the parties does not control the formal predominate ingredient analysis under Section 7-9-3 (M), in this instance the entire contents of the agreements dovetails with an analysis of inputs and outputs under the predominate ingredient analysis.

Under these contracts, the counties entered into agreement with Taxpayer to house county and NMCD inmates at Taxpayer's prison facilities in those counties. Although the agreements required Taxpayer to provide for a prison facility in each county, such facility was to be built entirely at Taxpayer's expense without any payment from the counties for those facilities. Under the agreements, Taxpayer bore the burden to pay all state and local taxation, and neither party used or expressed any language to suggest that they contemplated that the transaction would involve a licensing agreement not subject to gross receipts tax. Under its agreements with the counties, Taxpayer agreed among other services to operate the jail, provide the facility for continuing and exclusive use to the counties, hire and train all correctional officers and staff, provide educational, rehabilitation service, vocational, and religious services for the inmates, provide food services to the inmates, and provide inmate health care services. In summary, the agreements made clear that the overall, predominant element of the contract was Taxpayer's provisioning of correctional services for the securing inmates.

Without performance of most of these services, Taxpayer could not have operated the county facilities as correctional facilities because these services were necessary for Taxpayer to fulfill its duty of maintaining public order and holding prisoners in secure custody. *See Methola v. County of Eddy*, 1980 NMSC 145, ¶17, 95 N.M. 329 (jailers are charged with a public duty to maintain order and hold persons in custody). Moreover, rather than merely providing real property, the performance of these core services is essential to compliance with the controlling federal law for the constitutional housing of inmates. *See Farmer v. Brennan*, 511 U.S. 825, 832-833 (1994) (internal citations omitted) (establishing duty under the constitution for prison officials to provide adequate services of food, shelter, clothing, medical care, and safety for inmates). Without these core contracted services involving security, training, staffing, and operational standards, the counties could not have entered into agreement with Taxpayer. *See* NMSA 1978, Section 33-3-27 (2007) (setting minimum comprehensive standards for a private independent contractor for the operation of jail before approval of operation agreement). And given New Mexico's tragic history with failure to provide adequate conditions for confinement, such services are especially important to the operation of prison facilities in this state. *See e.g. Duran v. Anaya*, 642 F. Supp. 510, 527 (D.N.M. 1986).

Like in the previous decisions and orders of this agency, Taxpayer continues to argue that the services contracted for and rendered are merely incidental to the license in a similar manner to the incidental services rendered by a hotel as part of the guest's license to use the room for the evening. This argument still does not persuade. A hotel may still provide its essential function—the licensing of a room for the evening—even when an incidental service like providing cable television, laundry services, room cleaning, room service, or climate control do not function. If the complimentary breakfast promised at a hotel never materializes, a person may leave the hotel grounds to get something to eat around the corner. However, if a jail fails to provide food service, a

prisoner is not at liberty to walk to the local coffee shop for breakfast. And in any case, given that deductions are to be read narrowly and Taxpayer has the burden to establish entitlement to any claimed deduction, it is highly doubtful that any plain meaning of the word license in the deduction under Section 7-9-47 would encompass the housing of inmates at a private prison facility in the way that a hotel licenses rooms to lodgers.

Unlike the incidental services of a hotel, the contracted services Taxpayer provided are critical to providing a functioning and lawful correctional facility. Without trained guards, security protocols, and maintained premises, a jail cannot meet its essential function as a secure detention facility. Nor can a correctional facility meet its rehabilitation purpose without the programming services contained in these agreements. Without appropriate medical care, legal visits, and court transportation services, a correctional facility cannot comply with its legal obligations. Without all of those services, the ostensible license that Taxpayer claims would be meaningless for the purposes of housing NMCD prisoners because there would not be a functional correctional facility. *See* Section 33-3-27 (setting minimum comprehensive standards for a private independent contractor for the operation of jail before approval of operation agreement).

Like in *Corrections Corp.*, Taxpayer was paid a per diem rate based on the number of inmates present during the nightly census. As the Court of Appeals observed in *Corrections Corp.*, the per diem rate structure allowed the counties and NMCD to pay Taxpayer for provided services, the cost of which depend on the number of inmates in the facilities. *Corrections Corp.*, ¶28. While the agreements did provide counties exclusive use to the facility, and access to county and state officials at all reasonable times, the per diem rates did not depend or compensate Taxpayer for these license-like incidental features under the contract.

Consistent with the review of the contract, under the predominant ingredient analysis of Section 7-9-3, Taxpayer fails to show that the license predominated the transaction. Although Taxpayer did pay to construct the prison facilities in each county, Taxpayer bore the responsibility for construction under the contracts and received no renumeration from the counties or NMCD for construction of the facilities. Since Taxpayer received no compensation for the construction, it is unclear why Taxpayer should receive credit for these costs in the predominant ingredient analysis: as the Department argued, the prison facilities that Taxpayer built in this case are fixed assets and are not consumed as part of the performance of the correctional services. Instead, Taxpayer maintains ownership of these facilities even if the counties terminate the agreements.

Nor are Taxpayer's attempt to segregate costs by license or service, as shown on Exhibits #23-24, compelling because they are built on faulty assumptions and self-serving categorizations. Mr. Maier attributed labor costs related to providing secured services to the lease costs. However, as discussed above, providing secured services is required for operating a prison facility. Those are not costs attributable to a purported license, but costs needed to perform the core correctional services contracted for by the parties. As the Department persuasively argues, Taxpayer's cost segregation approach appears to completely ignore the previous decisions and orders of this agency in categorizing activities, is highly conclusory as to which activities fall into licensing activities and appears to be done solely for the purposes of litigation rather than part of Taxpayer's (or even counties) regular business analysis of the transaction. Indeed, at the time of the transaction, it does not appear that any party anticipated it was entering into a licensing agreement making Taxpayer's faulty categorizations self-serving rather than reflective of a true cost-allocation. The hearing officer finds Taxpayer's purported categorizations as part of this analysis implausible and therefore affords little weight to exhibits #23-24.

A review of the contract and other timelines in this case shows that the parties never envisioned this transaction as encompassing the resale of a license in the regular course of business for the purposes of the Section 7-9-47 deduction. Under the contractual agreement, Taxpayer bore the responsibility of paying applicable gross receipts tax. If the parties truly intended the sale of a license for resale deductible under Section 7-9-47, they failed to include such a contractual requirement specifying the sale of a license for resale or requiring the execution of the requisite NTTC. Indeed, the fact that no one bothered to pursue or execute the requisite NTTC until many years after the formation of the contractual relationship and commencement of the housing of inmates began indicates that none of the parties believed that the transaction involved the sale of a license deductible under Section 7-9-47.

Nor does Taxpayer clearly establish in this case that the counties resold any alleged license in their regular course of business. It is true, as Taxpayer argued, that the counties have been housing NMCD inmates at Taxpayer's facilities for 20 years. However, as the Department persuasively argued, even if the activity has happened regularly, counties are not in the business of reselling licenses to access property. Instead, they are in the business of providing core governmental activities and services to, and on the behalf of, their constituents. Certainly, counties do regularly contract out the performance of some core government services to third parties like corrections, sanitation, utilities, and myriad other services. To perform some of those core governmental services, a county may grant a third party an incidental license to access county property and facilities for the purpose of performing the contracted governmental service. A county has no regular business interest in the sale of licenses, let alone the resale of a license that is required for the deduction under Section 7-9-47. It is not this incidental license that the county is interested in selling or reselling but the performance of the contracted-governmental service.

The billing structure between the parties does not support that the county was in the business of reselling a license from Taxpayer to NMCD. Taxpayer, the county, and NMCD were aware of their structural relationship at the formation of the agreement. Taxpayer billed NMCD directly on behalf of the counties for the housing of NMCD inmates. NMCD paid the invoices into an escrow account from which both the counties and Taxpayer had access. Without any release, work or intervention from the counties, Taxpayer collected NMCD-paid amounts directly from the escrow account. As the Department argued in closing through its demonstrative exhibit, rather than showing a resale between NMCD and the counties, this billing structure affectively amounted to a direct transaction between Taxpayer and NMCD, with the counties only serving as a name on the bank account.

To the extent that the contract contained some elements of a license, again the predominate components of these transactions were Taxpayer's provision of correctional facilities for the secure housing of the counties' and NMCD's inmates. Like in *Corrections Corp.*, even when a contract bears some elements of a service and some elements of a real estate transaction that can make it difficult to definitively state whether something amounts to a lease, or in this case a license, it is Taxpayer who then fails to meet the burden of establishing both factually and legally that it fits squarely within the statutory deduction. *See Corrections Corp.*, ¶29. Factually, these contracts simply do not clearly establish that the parties contemplated a transaction deductible as the sale of license for resale, especially given the provision in the contracts that Taxpayer was liable for payment of state taxation and the fact that no one contemplated the deduction at issue at the time of the transaction. Legally, Taxpayer simply fails to persuade that the Legislature ever intended the sale of a license for resale deduction to apply to Taxpayer's operation of private prison facilities on

behalf of governmental agencies in New Mexico given the critically important and regulated public interest at stake in the operations of prisons.

Issue Two: Taxpayer did not accept the NTTCs in Good Faith.

In the alternative, Taxpayer argued that even if the transaction did not involve the sale of a license for resale, its acceptance of the NTTCs from Guadalupe County and Lea County entitled Taxpayer to the safe harbor protection of NMSA 1978, Section 7-9-43 (A) (2011). Taxpayer's argument is not persuasive.

NMSA 1978, Section 7-9-43(A) (2011) grants taxpayers a good faith acceptance, conclusive evidence safe harbor in some circumstances:

> [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.

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

> Acceptance of [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.

The Administrative Hearings Office, and its predecessor the Hearings Bureau, began employing a broader view of the good faith, safe harbor protection with the 2013 issuance of the decision and order *In the Matter of the Protest of Case Manager*, No. 13-12, 2013 WL 3148402, (non-precedential) and *In the Matter of the Protest of Rio Grande Electric Co., Inc*, No. 13-16, 2013

WL 3777282, (non-precedential). Part of this broadening of the safe harbor protection stems from a closer evaluation of the 1974 decision in *Leaco Rural Tel. Coop. v. Bureau of Revenue*, 1974-NMCA-076, ¶15, 86 N.M. 629, where the Court of Appeals found that the safe harbor provision protected a seller when the buyer improperly issued a NTTC.

Essentially, the Administrative Hearings Office broader interpretation of the safe harbor protection is that so long as the transaction at issue otherwise would qualify for a recognized statutory deduction, a timely and properly executed but inappropriate series NTTC accepted in good faith by a taxpayer may still entitle a taxpayer to the deduction under the good faith, safe harbor statutory provision. In an unpublished decision, the New Mexico Court of Appeals affirmed the ruling in the *Case Manager* decision and order narrowly under a right for any reason standard. *See New Mexico Taxation and Revenue Dep't. v. Case Manager (Maestas)*, No. 32,940 2015 WL 2329031 (N.M. Ct. App. Apr. 29, 2015) (non-precedential). In 2016, the Court of Appeals looked favorably upon the good faith, safe harbor provision as previously applied by the Administrative Hearings Office/Hearings Bureau in *Case Manager*. *See Southwest Mobile Service and Richard Cameron v. New Mexico Taxation and Revenue Department*, No. 34,551, mem. op. ¶15, 2016 WL 4334159, (N.M. Ct. App. July 25, 2016) (non-precedential) (although the Court of Appeals overturned that decision on whether the good faith analysis applies to a multijurisdictional uniform sales and use tax certificate rather than just a state NTTC, it cited the *Case Manager* Administrative Hearings Office analysis of NTTCs positively in reaching its conclusion). In 2016, the Administrative Hearings Office continued with that broader interpretation of the good faith, safe harbor provision by finding other taxpayers were protected from an assessment by acceptance a timely executed but incorrect type of NTTC for a transaction that otherwise qualified for a potential deduction but for the type of NTTC error. *See Decision and Order in the Matter of the Protest of*

SPMC, Inc., No. 16-45, 2016 WL 5348969, (non-precedential); See also *Decision and Order in the Matter of the Protest of US Field Service, Inc.*, No. 16-56, 2016 WL 7406793, (non-precedential).

However, even under the Administrative Hearings Office's broader view of the good faith, safe harbor protection since 2013, the Administrative Hearings Office has only applied the safe harbor protection in cases where the underlying transaction is covered by a recognized, valid, and applicable deduction. That is, the Administrative Hearings Office had held that the safe harbor provision cannot serve to make a taxable transaction not covered by any applicable deduction into a nontaxable transaction merely by possession of a NTTC. *See In the Matter of the Protest of Adecco USA*, No. 14-16, 2014 WL 2559155, (May 22, 2014) (non-precedential); *see also In the Matter of the Protest of Hubbard Lovell & Co.,* No. 16-12, 2016 WL 1729944, (April 26, 2016) (non-precedential); *see also In the Matter of the Protest of Hector Martinez,* No. 16-46, 2016 WL 5641159, (September 23, 2016) (non-precedential); *See also In the Matter of the Protest of Highland Construction, LLC,* No. 17-41, 2017 WL 4479666, (September 28, 2017) (non-precedential); *See also In the Matter of the Protest of JTC, Inc.,* No. 18-17, 2018 WL 2772640, (May 31, 2018) (non-precedential).

The Administrative Hearings Office's limitation on the application of the safe harbor provision is consistent with two other more recent Court of Appeals cases that followed the *Leaco* decision. In *McKinley Ambulance Serv. v. Bureau of Revenu*e, 1979-NMCA-026, ¶10, 92 N.M. 599, 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 McKinley,* ¶13. Although perhaps dicta, the Court of Appeals stated in *Gas Co. v. O'Cheskey*, 1980-NMCA-085, ¶12, 94 N.M. 630 that "[t]he

issuance of a 'Nontaxable Transaction Certificate' does not operate to transform an otherwise taxable transaction into a nontaxable transaction." In order for the safe harbor provision to apply, the receipts in question must otherwise be covered by a recognized deduction. As discussed in the previous section, that is not the case in this protest and therefore Taxpayer is not entitled to the safe harbor protection because Taxpayer was selling a service for which no deduction applied.

Moreover, the timing and circumstances of Taxpayer's acceptance of the NTTCs raises doubts about whether the good faith, safe harbor provision is applicable in this protest. The Court of Appeals in *O'Cheskey*, described the purpose of a NTTC in the safe harbor context as "represent[ing] a statement by the purchaser of goods that its use is such that the seller is entitled to a deduction from its taxable receipts." *O'Cheskey*, 1980-NMCA-085, ¶12. Neither Lea County nor Guadalupe County executed any NTTCs to Taxpayer at the time of the contract or at the time of the initial transactions between the parties. At the time of the refund claim, the counties had executed NTTCs that the parties knew were incorrect precisely because the parties were also aware that the counties were ineligible to execute the correct type 2 of NTTCs. This is why Taxpayer needed to pursue special permission directly from the Department to allow the counties to issue the type 2 NTTCs. Only after it filed its initial refund claim, and after Taxpayer sought permission directly with the Department to grant the counties permission to execute the NTTCS, did Taxpayer receive executed Type 2 NTTCs from Guadalupe County and Lea County.

The buyer of a license, not the seller, is required to seek permission from the Department to issue a NTTC. *See* §7-9-43 (E); *See also* Regulation 3.2.201.9 NMAC. Yet in this case it was Taxpayer as the seller of the ostensible license, not Lea County or Guadalupe County as the buyers of the license, who went directly to the Department to seek approval for those counties to issue the correct type of NTTCs. Although not necessarily indicative of any bad-faith by either Taxpayer or

the counties, it is hard to say that Taxpayer could develop a good faith belief that the buyer intended to use the seller's ostensible license in a nontaxable manner when the Taxpayer was aware that the counties were unable to use the NTTCS and it was Taxpayer as the seller rather than the buyer that solicited permission from the Department to authorize the sellers to issue NTTCs. In this situation, where it was the seller of the goods that sought permission from the Department for the buyer to issue the NTTC, the purpose of that safe harbor protection described in *O'Cheskey* cannot be fully achieved. Thus, even if the safe harbor provision could render a taxable transaction not supported by applicable deduction into non-taxable transaction by mere possession of a NTTC, giving the timing and circumstance of the NTTCs in this case, Taxpayer could not develop the good faith protection contemplated under the structure and purpose of the safe harbor provision.

Because Taxpayer did not establish it was entitled to the Section 7-9-47 deduction, the transaction is not covered by a recognized deduction and Taxpayer cannot rely on its acceptance of the NTTC to convert this taxable transaction into a nontaxable transaction.

Issue Three: Taxpayer is not entitled to equitable relief.

Taxpayer further argued that it is entitled to equitable relief in this case because of the Department's previous approval of a refund claim premised on the Section 7-9-47 deduction and the high-level Department employee's communications with Taxpayer during that earlier refund approval. While Taxpayer has a somewhat strong and sympathetic factual basis for this argument, the claim for equitable estoppel cannot legally be granted. Thus, after discussion of the factual underpinnings of the claim and outlining the legal factors in this section, Taxpayer's claim is ultimately unpersuasive.

Factually, there is a lot to support Taxpayer's claim for relief, as the Department's decision to approve the initial tax year 2008 refund claim involved a careful and detailed review by highly

competent staff and upper-level management. When Taxpayer protested the denial of the first refund claim for tax year 2008, the manager of the protest office, Lizzy Vedamanikam, assigned the protest to herself. Ms. Vedamanikam had years of experience at the Department and would go on to eventually serve as the Audit and Compliance Division Director. In her years of testimony before the Administrative Hearings Office, Ms. Vedamanikam has always distinguished herself as a person with high degree of knowledge, expertise, and integrity. In addition to her own expertise, Ms. Vedamanikam consulted with the Chief Legal Counsel about the merits of this protest. In turn, the Chief Legal Counsel brought the matter to the Department's Tax Policy Group, which included the Tax Policy Director, the Audit and Compliance Director, and the Cabinet Secretary.

As a result of all of those high-level discussions, the Department eventually approved the counties to issue the correct type of NTTCs to Taxpayer and approved of the refund claim under Section 7-9-47 for tax year 2008. Ms. Vedamanikam sent Taxpayer a series of detailed emails outlining her recommendation for approval of the refund claim pursuant to the Section 7-9-47 deduction for the Guadalupe County and Lea County facilities but denying the refund claim for Taxpayer's facility in the City of Clayton. Taxpayer withdrew its protest of the earlier tax year 2008 refund denial relating to the Guadalupe County and Lea County receipts but continued its protest related to the Clayton facility. Taxpayer also submitted a refund claim for the January 2009 through March 2012 reporting periods on the same grounds, which the Department also approved. Based on that process on the earlier refund claim, Taxpayer believed that the deduction under Section 7-9-47 applied to its receipts from Guadalupe County and Lea County, and thus stopped remitting gross receipts tax on or after April of 2012.

On November 20, 2014, the undersigned hearing officer issued a decision addressing Taxpayer's Clayton facility (as well as another decision), finding that the deduction under Section

7-9-47 did not apply to the operation of private prison facilities because Taxpayer (and a similar company in the other matter) were fundamentally providing services rather than selling licenses for resale. After that decision, the Department initiated an audit of Taxpayer that eventually led to the assessment at issue in this protest.

Based on these facts, Taxpayer asks for equitable relief given its reliance on the Department's earlier approval of application of the deduction under Section 7-9-47 in tax year 2008 and the size of the unexpected assessment for subsequent periods after Taxpayer had stopping remitting gross receipts tax. However, equitable estoppel may not be a possible remedy in an administrative protest hearing. *See AA Oilfield Service v. New Mexico State Corporation Commission*, 1994-NMSC-085, ¶18, 118 N.M. 273 (equitable remedies are not part of the "quasi-judicial" powers of administrative agencies)[7]. Even if it is available in this context, courts are reluctant to apply the doctrine of equitable estoppel against the state in cases involving the assessment and collection of taxes. *See Taxation & Revenue Dep't v. Bien Mur Indian Mkt. Ctr., Inc.*, 1989-NMSC-015, ¶9, 108 N.M. 22. In such cases, estoppel applies only pursuant to statute or when "right and justice demand it." *Bien Mur Indian Market*, ¶9.

Estoppel cannot lie against the state when the act sought would be contrary to the requirements expressed by statute. *See Rainaldi v. Public Employees Retirement Board,* 1993-NMSC-028, ¶18-19, 115 N.M. 650. Under NMSA 1978, Section 7-1-17 (A) (2007), shall assess any tax liability exceeding $25.00. In this case, because Taxpayer is not factually or legally

[7] The appellate courts have yet to consider whether the Administrative Hearings Office, as an independent administrative tribunal tasked solely with conducting fair administrative hearings independent of the supervision of the administrative agency involved in the hearing, may consider or rule upon equitable estoppel. It is possible that since the Administrative Hearings Office now serves a similar function as a tax court, it *may* have some more latitude than other administrative agencies to consider some form of quasi-equitable relief. But under current case law, the nature of an administrative agency being limited to those powers proscribed by statute, and the fact that equitable powers under the law are well understood to be limited to the judiciary, the Administrative Hearings Office remains generally reluctant to consider equitable relief.

entitled to the claimed deduction under Section 7-9-47 and the liability exceeds $25.00, the Department lacked discretionary authority and granting estoppel would be contrary to statutory requirements. *See Waters-Haskins v. New Mexico Human Services Dept., Income Support Div.*, 2009-NMSC-031, ¶17, 146 N.M. 391, 399, 210 P.3d 817, 825; *see also Millar v. New Mexico Dept. of Workforce Sols.*, 2013-NMCA-055, ¶¶ 18-24, 304 P.3d 427, 432–34 (Court of Appeals rejected availability of equitable estoppel when the statute imposed a mandatory shall collect provision on the governmental agency). Thus, regardless of the remaining analysis, equitable estoppel is not a permissible remedy in this case regardless of the merits of the estoppel analysis.

Nevertheless, in the interest of completeness in the event of appeal, it is worth articulating the relevant estoppel factors and the application of the facts in this case to those factors. In *Waters-Haskins*, the New Mexico Court of Appeals articulated six elements for equitable relief against a governmental agency when it is applicable to a discretionary act. Those six elements are

> (1) the agency's conduct amounting to a false representation or concealment of material facts or, at least, that is calculated to convey the impression that the facts are otherwise than, and inconsistent with, those which the party subsequently attempts to assert; (2) the agency's intention, or at least expectation, that the other party will act upon such conduct; and (3) the agency's knowledge, actual or constructive, of the real facts. The essential elements that apply to the party raising equitable estoppel as a defense are "(1) [l]ack of knowledge and of the means of knowledge of the truth as to the facts in question; (2) reliance upon the conduct of the party estopped; and (3) action based thereon of such a character as to change his position prejudicially.

Id., ¶22 (internal citations omitted).

If these elements did apply to this case, the undersigned hearing officer would find that Taxpayer satisfied each of the first six the *Water-Haskins* elements at least until the issuance of the

undersigned's decisions on November 20, 2014 (after that date, Taxpayer was made aware that its contracts were service contracts, not contracts for the sale of license).

However, the analysis does not stop with these six elements. In addition to these six elements, any claimant for equitable relief against a governmental agency must show "affirmative misconduct on the part of the government." *Kilmer v. Goodwin*, 2004-NMCA-122, ¶27, 136 N.M. 440. (internal citations omitted). The conduct contemplated to support application of equitable estoppel against the government must show a shocking degree of aggravated overreach. *See Waters-Haskins*, ¶23. While the Department was wrong in its initial assessment to approve the application of the deduction under Section 7-9-47, the evidence failed to establish that the Department engaged in any affirmative misconduct or a shocking degree of aggravated overreach in this case.

In making the initial but incorrect decision to approve the refund claim regarding the Guadalupe County and Lea County facilities, the Department appeared to engage in a reasoned process with high-level management to analyze the factual and legal issue. The Department at that time made the decision that the deduction in question did apply to the receipts from Guadalupe County and Lea County but did not apply to the receipts from the Clayton facility. Taxpayer continued its protest regarding the Clayton facility, resulting in the November 20, 2014 decision and order that made relatively clear that Taxpayer's operations of private prison facilities did not qualify as the sale of licenses for the purposes of Section 7-9-47.

Only upon receiving that decision did the Department reassess its initial decision regarding the applicability of the deduction under Section 7-9-47 to the operations of private prison companies, a perfectly prudent and reasonable course of action from the Department's standpoint. The Department then initiated an audit of the periods that remained open. By statute,

the Department was compelled to assess any liability over $25.00, which it did in this instance for the periods still open under the statute of limitations for assessment.

It is important to note that the Department's subsequent assessment at issue in this protest does not encompass the initial approved refund claim in tax year 2008 or the months of January 2009 through December 2009 from the second approved refund claim. By the time of the Department's subsequent audit, those periods were beyond the statute of limitations for assessment. Thus, regardless of the fact that the Department initially erred on the substantive merits on the applicability of the Section 7-9-47 deduction, Taxpayer retains the in error refunded gross receipts tax for those periods in 2008 and 2009, which totaled $5,351,469.16[8]. Under an equity analysis of this last factor, it is important to note that Taxpayer has inured some gain from the Department's error even if it is only approximately a third of assessed gross receipts at issue in this protest. That said, even with that offset, the assessment remains for a substantial sum of money.

The hearing officer certainly agrees with Taxpayer that the Department's handling of this situation does not represent reliable tax policy or consistent tax administration. However, poor decision-making and inconsistent policy applications do not amount to the type of affirmative misconduct or rise to the level of aggravated overreach needed to support equitable estoppel against the government, especially regarding the non-discretionary act of pursuing a tax liability. As the Department now argues, unlike the petitioner in the *Water-Haskins* case, Taxpayer is a sophisticated entity with a tax department focused on planning and structuring its tax liabilities. Taxpayer had services of an accounting and legal firm, and upon receipt of the 2014 decisions and orders, certainly had the ability to reconsider the appropriateness of its decision to stop

[8] The Department approved $2,722,810.46 of Taxpayer's initial tax year 2008 refund claim. The Department subsequently approved Taxpayer's second claim for refund totaling $8,289,984 for the reporting periods from January 2009 through March of 2012, of which $2,628,658.70 came from the January to December 2009 reporting periods. The combined approved refund for these periods totaled $5,351,469.16.

remitting gross receipts tax for the Guadalupe County and Lea County facilities in light of the holding of those cases that Taxpayer was fundamentally performing services rather than selling a license. Given Taxpayer's own expertise and access to professional assistance, it had the ability to minimize the financial impact of any potential Department audit or assessment more so than the petitioner in *Waters-Haskins*.

In summary, Taxpayer's request for equitable estoppel against the Department fails because the Administrative Hearings Office does not have the power to grant equitable relief, because equitable estoppel cannot apply against a non-discretionary act like the collection of outstanding tax, and because while the Department made an error in initially approving the applicability of the deduction in the 2008 refund claim, its error did not rise to the level of affirmative misconduct or aggravated, overreach rising to level needed to support equitable relief against the Department.

Issue Four: Taxpayer is entitled to full abatement of penalty under the assessment.

While Taxpayer cannot establish equitable estoppel as a remedy in this case for the Department's changing position on the applicability of the deduction under Section 7-9-47, the Department's changing positions do provide clear grounds for abatement of the $2,951,780.75 in civil negligence penalty.

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

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

(*italics* added for emphasis).

The statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meets the legal definition of "negligence." *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary). Regulation 3.1.11.10 NMAC defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required"; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention."

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception: "[n]o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." A mistake of law is a "mistake about the legal effect of a known fact or situation," whereas a mistake of fact is a "mistake about a fact that is material to a transaction; any mistake other than a mistake of law." Black's Law Dictionary 1153-4 (10th ed. 2009). This provision generally requires evidence that a taxpayer engaged in an informed consultation and decision-making process that the tax was not legally due. *Cf. C & D Trailer Sales v. Taxation and Revenue Dep't*, 1979-NMCA-151, ¶8-9, 93 N.M. 697 (penalty upheld where there was no evidence that the taxpayer "relied on any informed consultation" in deciding not to pay tax). Moreover, Regulation 3.1.11.11 (A) NMAC allows for abatement of penalty when a taxpayer proves they were affirmatively misled by a Department employee.

In this protest, Taxpayer has demonstrated that it stopped remitting gross receipts tax on its receipts from Guadalupe County and Lea County after extensive discussions with high-level Department management staff and in reliance on the written communications of Department Protest Manager Lizzy Vedamanikam. The Department itself at one point believed that Taxpayer's receipts were deductible and communicated that information to Taxpayer, which supports that Taxpayer's decision to stop remitting gross receipts tax was a good faith, mistake of law. Additionally, Taxpayer's reliance on the written but incorrect advice of Ms. Vedamanikam satisfies the nonnegligence factor identified under Regulation 3.1.11.11 (A) NMAC. While the hearing officer ruled at hearing that penalty would be abated in this matter, the question of whether it would be a full or partial abatement remained open. Given Taxpayer's reliance on the Department's reasoned process and communications with high-level Department staff, it is now clear that Taxpayer is fully protected by Section 7-1-69 (B) and Regulation 3.1.11.11 (A) NMAC. Consequently, all civil negligence penalty shall be abated under Section 7-1-69 (B) and Regulation 3.1.11.11 (A) NMAC.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest of the Department's assessment, and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing was timely set and held within 90-days of protest under NMSA 1978, Section 7-1B-8 (2015).

C. Under NMSA 1978, § 7-9-3.3 (2003), Taxpayer is engaged in business in the provisioning and operation of prisons in Guadalupe County and Lea County.

D. Under NMSA 1978, Section 7-9-5 (2002), all of Taxpayer's receipts in New Mexico are presumed subject to New Mexico's gross receipts tax.

E. Taxpayer had the burden to establish entitlement to its claim for refund premised on the deduction articulated under NMSA 1978, Section 7-9-47 (1994), a deduction that must be narrowly construed. *See Corr. Corp. of Am. of Tenn. v. State*, 2007-NMCA-148, ¶17 & ¶29, 142 N.M. 779.

F. Taxpayers agreements with Guadalupe County and Lea County predominately involved the performance of services, satisfying the definition of "services" under NMSA 1978, Section 7-9-3 (M) (2007) subject to gross receipts tax.

G. As a matter of law, without establishing that the transaction involved the sale of a license for resale, Taxpayer did not meet its burden of establishing it was entitled to the deduction under NMSA 1978, Section 7-9-47 (1994). *See Corr. Corp. of Am. of Tenn. v. State*, ¶29.

H. Because no applicable deduction applied to the receipts in question, Taxpayer was not protected by the safe harbor provisions of NMSA 1978, Section 7-9-43 (B). *See McKinley Ambulance Serv. v. Bureau of Revenu*e, 1979-NMCA-026, ¶10, 92 N.M. 599; *see also Gas Co. v. O'Cheskey*, 1980-NMCA-085, ¶12, 94 N.M. 630.

I. Equitable estoppel is a not remedy available in this quasi-judicial administrative proceeding. *See AA Oilfield Service v. New Mexico State Corporation Commission*, 1994-NMSC-085, ¶18, 118 N.M. 273.

J. Even if equitable estoppel were an available remedy in this proceeding, equitable estoppel does not apply because the Department lacks discretion in assessing any tax liability exceeding $25.00 under NMSA 1978, Section 7-1-17 (A) (2007). *See Rainaldi v. Public Employees Retirement Board,* 1993-NMSC-028, ¶18-19, 115 N.M. 650; *see also Waters-Haskins v. New Mexico Human Services Dept., Income Support Div.*, 2009-NMSC-031, ¶17, 146 N.M. 391, 399, 210 P.3d 817, 825.

K. Even if equitable estoppel were an available remedy in this proceeding, equitable estoppel does not apply because Taxpayer cannot demonstrate that the Department's engaged in affirmative misconduct or a shocking degree of aggravated overreaching. *See Kilmer v. Goodwin*, 2004-NMCA-122, ¶27, 136 N.M. 440; see also *Waters-Haskins v. New Mexico Human Services Dept., Income Support Div.*, 2009-NMSC-031, ¶23, 146 N.M. 391, 399, 210 P.3d 817.

L. Taxpayer established entitlement to abatement of civil negligence penalty because the failure to remit gross receipts tax was a mistake of law made in good faith pursuant to NMSA 1978, Section 7-1-69 (B) and because Taxpayer was misled by a Department employee pursuant to Regulation 3.1.11.11 (A) NMAC.

M. Aside from abatement of penalty, Taxpayer failed to overcome the presumption of taxability and the presumption of correctness that attached to the assessment. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428. *See also N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8.

For the foregoing reasons, the Taxpayer's protest **IS PARTIALLY GRANTED AND PARTIALLY DENIED**. **IT IS ORDERED** that the Department abate the assessed penalty, but that Taxpayer is liable for the remaining assessment.

DATED: December 30, 2020.

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

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (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 December 30, 2020, a copy of the foregoing Decision and Order was submitted to the parties listed below in the following manner:

Email Only

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INTENTIONALLY BLANK

John Griego
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