STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
ITSQUEST INC.
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L1272563888

v. **Case Number 19.05-088A**
D&O No. 21-15

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

On July 10, 2020, Hearing Officer Chris Romero, Esq., conducted a hearing on the merits in the matter of the protest of ITSQuest, Inc. ("Taxpayer") pursuant to the Tax Administration Act and the Administrative Hearings Office Act. Mr. Wade Jackson, Esq. appeared representing Taxpayer and was accompanied by Mr. Jeff Reagan. Ms. Cordelia Friedman, Esq. appeared on behalf of the opposing party in the protest, the Taxation and Revenue Department ("Department") accompanied by Ms. Angelica Rodriguez, protest auditor. Mr. Reagan testified for Taxpayer. Ms. Rodriguez testified for the Department.

The hearing occurred by videoconference pursuant to NMSA 1978, Section 7-1B-8 (H) under the circumstances of the ongoing public health emergency presented by COVID-19, as discussed in greater detail in Standing Order 20-02, which is made part of the record of the proceeding.

Taxpayer Exhibits 6, 8, and 11 - 16 were proffered and admitted.[1] Department Exhibits A - H, and J were proffered and admitted.

The primary issues presented for consideration were whether: (1) Taxpayer's taxable gross

[1] The Department initially objected to the admission of Taxpayer Exhibits 12, 13, 14, 15, and 16, but upon further consideration, it withdrew its objections to those exhibits.

receipts were comprised of, or included, receipts that should have been rightly excluded as receipts received solely on behalf of another in a disclosed agency capacity under NMSA 1978, Section 7-9-3.5 (A) (3) (f); and (2) whether Taxpayer reasonably relied on the Department's advice or other representations thereby constituting a mistake of law made in good faith and on reasonable grounds justifying an abatement of penalty.

As explained in greater detail in the subsequent discussion, the Hearing Officer determined that Taxpayer failed to establish by a preponderance of evidence that its taxable gross receipts were comprised of, or included, receipts that should have been excluded as receipts received solely on behalf of another in a disclosed agency capacity under NMSA 1978, Section 7-9-3.5 (A) (3) (f). Taxpayer also failed to establish by a preponderance of evidence that it relied on the Department's advice or other representations justifying the abatement of penalty. Therefore, Taxpayer's protest should be denied. IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

Procedural History

1. On December 14, 2018, the Department issued a Notice of Assessment of Taxes and Demand for Payment under Letter ID No. L1272563888 ("Assessment") in the total amount of $4,031,804.68. The total amount due was comprised of $3,018,993.93 in gross receipts tax, $599,887.94 in penalty, and $412,922.81 in interest for the periods from January 31, 2011, to April 30, 2018. [Administrative File]

2. On March 15, 2019, Taxpayer, by and through its counsel of record submitted a protest of the Assessment to the Department's protest office. [Administrative File]

3. On March 27, 2019, the Department acknowledged the receipt of Taxpayer's protest under Letter ID No. L0832431280. [Administrative File]

4. On May 16, 2019, the Department submitted a Hearing Request. [Administrative File]

5. On May 17, 2019, the Administrative Hearings Office entered a Notice of Telephonic Scheduling Hearing that set an initial scheduling hearing to occur on June 14, 2019. [Administrative File]

6. On June 14, 2019, the Administrative Hearings Office conducted an initial scheduling hearing in which neither party objected that the hearing would satisfy the 90-day hearing requirement of NMSA 1978, Section 7-1B-8 (A). [Administrative File]

7. On June 14, 2019, the Administrative Hearings Office entered a Notice of Second telephonic Scheduling Hearing which set another scheduling hearing to occur on August 9, 2019. [Administrative File]

8. On August 9, 2019, the Administrative Hearings Office conducted a scheduling hearing and entered a Scheduling Order and Notice of Administrative Hearing that set a hearing on the merits of Taxpayer's protest for January 22, 2020. [Administrative File]

9. On September 24, 2019, Taxpayer filed a Certificate of Service of Taxpayer's First Set of Request for Admission, Interrogatories, and Requests for Production. [Administrative File]

10. On November 6, 2019, Taxpayer filed a Motion to Compel and for Sanctions. [Administrative File]

11. On November 6, 2019, the Department filed a Certificate of Service indicating that it had served the Department's Responses to Protestant's First Set of Requests for

Admissions, Interrogatories and Requests for Production of Documents. [Administrative File]

12. On November 25, 2019, Taxpayer filed a Motion to Vacate Hearing and for Sanctions. [Administrative File]

13. On November 27, 2019, Taxpayer filed a Stipulated Motion to Vacate Hearing. [Administrative File]

14. On November 27, 2019, Taxpayer filed Taxpayer's Withdrawal of its Motion to Compel and for Sanctions and Motion to Vacate Hearing and for Sanctions. [Administrative File]

15. On December 10, 2019, the Administrative Hearings Office entered an Order Vacating Hearing on Merits and Notice of Telephonic Scheduling Hearing that set a scheduling hearing for January 3, 2020. [Administrative File]

16. A scheduling hearing occurred on January 3, 2020, and on January 10, 2020, the Administrative Hearings Office entered a Scheduling Order and Notice of Administrative Hearing that set a hearing on the merits of Taxpayer's protest for May 6, 2020. [Administrative File]

17. On February 14, 2020, the Chief Hearing Officer of the Administrative Hearings Office entered a Notice of Reassignment of Presiding Hearing Officer. [Administrative File]

18. On February 14, 2020, the Department filed an Exercise of Peremptory Right to Challenge the reassignment of the presiding hearing officer. [Administrative File]

19. On February 20, 2020, the Chief Hearing Officer of the Administrative

Hearings Office entered a Notice of Reinstatement of Presiding Hearing Officer which reassigned the protest to back to Chris Romero, the undersigned Hearing Officer. [Administrative File]

20. On April 13, 2020, Taxpayer filed a Motion to Vacate Hearing and for Sanctions.[2] [Administrative File]

21. On April 16, 2020, the Administrative Hearings Office entered and Order Vacating Hearing on Merits and Notice of Telephonic Scheduling Hearing that set a scheduling hearing to occur on May 6, 2020. [Administrative File]

22. On May 14, 2020, the Administrative Hearings Office entered a Notice of Administrative Hearing which set a hearing on the merits of Taxpayer's protest for June 23, 2020. [Administrative File]

23. On June 2, 2020, Taxpayer filed Taxpayer's Prehearing Statement and the Department filed Department's Prehearing Statement. [Administrative File]

24. On June 23, 2020, the parties appeared for a hearing on the merits of Taxpayer's protest, but as a preliminary matter, the Department asserted that Taxpayer had not made a timely disclosure of its exhibits. Taxpayer responded that its ability to disclose exhibits was impaired by the unique circumstances presented by the COVID-19 pandemic. The Hearing Officer determined that the best method of minimizing potential prejudice to the parties arising from circumstances presented by the pandemic was to continue the hearing. The parties did not object to a continuance and agreed to proceed on July 10, 2020, at 9 a.m. [Record of Hearing (6/23/2020)]

25. On June 23, 2020, the Administrative Hearings Office entered a Continuance and

[2] Although the title of the motion referred to a request for sanctions, the reference to sanctions appeared to be a scrivener error since the body of the motion made no reference to sanctions.

Notice of Administrative Hearing continuing the hearing on the merits of Taxpayer's protest to July 10, 2020. [Administrative File]

Merits of Taxpayer's Protest

26. Mr. Jeff Reagan is the president of Taxpayer, ITSQuest, Inc. He has served Taxpayer in that capacity since 1994. [Direct Examination of Mr. Reagan]

27. Taxpayer is a staffing agency and under normal circumstances, has more than 300 employees placed per week with its clients. As of the date of the hearing, however, that figure had significantly declined as a potential result of the pandemic. [Direct Examination of Mr. Reagan]

28. Taxpayer operates primarily in New Mexico. [Direct Examination of Mr. Reagan]

29. Mr. Reagan's functions for Taxpayer vary and include developing agreements with clients, training staff with regard for marketing strategies, and overseeing financial aspects of the Taxpayer's operations. [Direct Examination of Mr. Reagan]

30. Mr. Reagan is a graduate of Texas Tech University with a degree in finance with an emphasis in accounting. He has experience in public accountancy and practiced as a certified public accountant from 1988 until approximately 1997 when he sold his CPA practice to devote his full efforts to Taxpayer's business. [Direct Examination of Mr. Reagan]

31. Taxpayer provides employees for a variety of clients, both public and private entities. [Direct Examination of Mr. Reagan]

Relationship with Employees

32. Clients utilizing Taxpayer's staffing services supervise and control the daily activities of Taxpayer's employees who are placed in their service, but employees are exclusively employed and compensated by Taxpayer. [Direct Examination of Mr. Reagan]

33. Taxpayer employs its employees "at will" and provides express notification to them that, "once hired, an employee serves at the pleasure of [Taxpayer], and dismissal from employment may occur at any time, with or without cause, at the discretion of either [Taxpayer] or his/her designee (employee)." [Taxpayer Ex. 8 (At-Will Employment)]

34. Taxpayer employees are also informed that "it is important that you understand you are a direct employee of … [Taxpayer][.]" [Taxpayer Ex. 8 (Temp-To-Hire Program)]

35. Both the employee information pamphlet (Taxpayer Ex. 8) and Taxpayer's time sheets (Taxpayer Ex. 11) state identically, as follows:

> Employees are aware of our relationship with our clients as a principal-agent relationship. All taxes and insurance are properly remitted by [Taxpayer] to the correct agencies, but a failure to do so would still insure all employees have the correct amounts credited to their accounts based on our client's principal-agent relationship.
>
> [Direct Examination of Mr. Reagan]

General Business Operations and GRT Reporting History

36. Taxpayer possesses an employee leasing license and has done so since at least 2008. [Direct Examination of Mr. Reagan]

37. Public and private sector clients utilizing Taxpayer's staffing services compensate Taxpayer for salary, wages, and benefits in addition to Taxpayer's service fees. [Direct Examination of Mr. Reagan]

38. Mr. Reagan had understood for several years that Taxpayer's gross receipts liability should be computed based on its profits (income less expenses) instead of its gross

receipts (income only). [Direct Examination of Mr. Reagan]

39. Mr. Reagan's understanding stemmed from his recollection of previous guidance from the Department in or prior to 2008, when Taxpayer was granted a refund after Taxpayer asserted that it overpaid gross receipts tax as a result of computing its tax liability as a percentage of its total gross receipts instead of its profits, meaning total gross receipts less expenses. [Direct Examination of Mr. Reagan]

40. The Department granted the refund, assertedly agreeing that Taxpayer overpaid gross receipts tax as a result of computing its tax liability as a percentage of its total gross receipts instead of its profits, meaning total gross receipts less expenses. [Direct Examination of Mr. Reagan]

41. The Department subsequently audited taxpayer to determine whether the methods used to compute the amount of the refund were accurate. [Direct Examination of Mr. Reagan]

42. Because the Department assertedly found there were no improprieties with Taxpayer's methods of computation, or records relied upon for computing its tax due, Mr. Reagan believed Taxpayer's method of computing its taxable gross receipts was approved and would continue to be accepted by the Department. [Direct Examination of Mr. Reagan]

43. Nevertheless, the Department provided Taxpayer with a notice that the Department intended to reclaim a portion of the previously granted refund because Taxpayer did not possess a leasing license. Taxpayer responded in part by obtaining appropriate licensure, and as previously indicated, has maintained licensure since. [Direct Examination of Mr. Reagan]

44. Since approximately 2008 until commencement of the audit underlying the current protest, the Taxpayer computed its gross receipts tax as a percentage of the difference between its total income and its expenses, otherwise referred to a its gross profit. [Direct Examination of Mr. Reagan]

45. Because the Department raised no concerns with Taxpayer's computation method, Taxpayer continued to utilize the method until approximately 2018. [Direct Examination of Mr. Reagan]

46. Concurrent with, or subsequent to the initiation of the audit underlying the protest, an auditor for the Department informed Mr. Reagan that Taxpayer needed to remit gross receipts tax based on a percentage of its total gross receipts, not based on its profit alone. [Direct Examination of Mr. Reagan]

47. In response to communications that Taxpayer needed to remit gross receipts tax based on a percentage of its total gross receipts instead of its profit, Taxpayer changed its business model and billing practices. [Direct Examination of Mr. Reagan]

48. Taxpayer's adjustments to its billing practices contributed to an increase in cost to Taxpayer's clients, which may have contributed to a loss of business and corresponding business income. [Direct Examination of Mr. Reagan]

Private Sector Contracts

49. Since at least 2014, Taxpayer's contracts with its private sector clients have included terms and conditions which Taxpayer asserts established, or demonstrated, the existence of a disclosed agency relationship. [Direct Examination of Mr. Reagan; Taxpayer Ex. 6]

50. Section 25 of Taxpayer Ex. 6, which exemplifies Taxpayer's standard private

sector agreement, states as follows:

> SCOPE OF AGREEMENT: If any provision of the scope of any provision of this Agreement is unenforceable or too broad in any respect whatsoever to permit enforcement to its full extent, such provisions shall then be enforced to the maximum extent permitted by law, and the parties consent and agree that such provisions shall be curtailed only to the extent necessary to conform to law. In the event of any conflict or inconsistency between any provision of this Agreement and any Schedule, purchase order, order acknowledgment or similar document issued by either party in connection herewith to this Agreement, the provision(s) of this Agreement shall control. *Both parties to this agreement are aware of the principal-agent relationship. Although [Taxpayer] remits all taxes and insurance, the employees will still have the correct amounts credited to their accounts if [Taxpayer] fails to remit based on the principal-agent relationship.*
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> [Emphasis Added]
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> [Taxpayer Ex. 6 (Section 25); *See also* Department Ex. G (Section 25); Department Ex. H (Section 25)]

51. The language contained in Taxpayer's standard private sector template compliments disclosures contained in Taxpayer's employee publications, such as Taxpayer's previously-mentioned employee information pamphlet and time sheet. [Direct Examination of Mr. Reagan; Taxpayer Ex. 8; Taxpayer Ex. 11]

52. Department Exhibits G, H, and Taxpayer Ex. 6, Page 4, Para. 15, on each exhibit (original pagination), states:

> INDEPENDENT CONTRACTOR STATUS: [Taxpayer] agrees that its status is solely that of an independent contractor and not an employee or agent of Customer. In furtherance of such understanding, and notwithstanding any other provision of this agreement to the contrary, the parties agree that [Taxpayer] shall be responsible for payment of all remuneration payable to said Assigned Employees and all taxes imposed on an employer with respect to such employees, including those imposed under federal and state withholding laws and [Taxpayer] shall also be responsible for payment of taxes under the Federal Insurance Contributions Act ("FICA") with respect to said employees. Except as required by Section 414 (n) of the Internal Revenue

> Code, all employees shall be considered and shall be treated as common law employees of [Taxpayer] and not as employees of Customer for purposes of Section 401 (a) of the Internal Revenue Code.

53. Despite the statement that "[Taxpayer] agrees that its status is solely that of an independent contractor and not an employee or agent of Customer[,]" Mr. Reagan believed that Taxpayer was agent of Taxpayer's clients. [Department Ex. G (Page 4, Para. 15); Department Ex. H (Page 4, Para. 15); Taxpayer Ex. 6 (Page 4, Para. 15); Cross Examination of Mr. Reagan]

54. Taxpayer's time sheets (Taxpayer 11) also state in reference to indemnification:

> [Taxpayer] agrees to indemnify and defend customer from any and all losses, liability, expenses (including legal) and claims from damage of any nature, whatsoever, which customer may incur, suffer, become liable for, or which may be asserted or claimed against contractor, on the basis that [Taxpayer] failed to comply with any federal, state, or local laws in its capacity as employer of the employees assigned to customer.
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> [Taxpayer Ex. 11]

Treatment of Public Sector Contracts

55. Public sector clients, such as state and local government and other public bodies, generally require use of their own contract template. Samples of those contracts were contained in Taxpayer Exhibits 12 – 16. [Direct Examination of Mr. Reagan; Taxpayer Ex. 12; Taxpayer Ex. 13; Taxpayer Ex. 14; Taxpayer Ex. 15; Taxpayer Ex. 16]

56. Taxpayer's Statewide Pricing Agreement with the State of New Mexico provides as follows in Article VII:

> It is specifically agreed between the parties executing this agreement that it is not intended by any of the provisions of any part of the agreement to create in the public or any member thereof a third party beneficiary or to authorize anyone not a party to the agreement to maintain a suit(s) for wrongful death(s), bodily and/ or personal injury(s) to person(s), damage(s) to property(ies) and/or any other claim(s) whatsoever pursuant to the provisions of this agreement.

[Direct Examination of Mr. Reagan; Taxpayer Ex. 12.71 (Article VII)]

57. Mr. Reagan acknowledges that Article VII provides no right to bind the state in contract and that it is not an agent of the state under the agreement, but that Taxpayer also had no part in drafting the agreement. [Direct Examination of Mr. Reagan; Taxpayer Ex. 12.71 (Article VII)]

58. Taxpayer's contract with the City of Las Cruces provides as follows in Para. 15:

> Nothing contained in this Agreement shall create any partnership, association, joint venture, fiduciary or agency relationship between CONTRACTOR and CITY. Except as otherwise specifically set forth herein, neither CONTRACTOR nor CITY, shall be authorized or empowered to make any representation or commitment or to perform any act which shall be binding on the other unless expressly authorized or empowered in writing.

[Direct Examination of Mr. Reagan; Taxpayer Ex. 13.4 (Para. 15)]

59. Mr. Reagan acknowledges that Para. 15 in Taxpayer's contract with the City of Las Cruces provides no right to bind the city in contract and that it is not an agent of the city under the contract, but that Taxpayer also had no part in drafting the contract. [Direct Examination of Mr. Reagan; Taxpayer Ex. 13.4 (Para. 15)]

60. Taxpayer's contract with the New Mexico Department of Corrections provides as follows in Section 6:

> The Contractor and its agents and employees are independent contractors performing professional services for the Agency and are not employees of the State of New Mexico. The Contractor and its agents and employees shall not accrue leave, retirement, insurance, bonding, use of state vehicles, or any other benefits afforded to employees of the State of New Mexico as a result of this Agreement. The Contractor acknowledges that all sums received hereunder are reportable by the Contractor for tax purposes, including without limitation, self-employment and business income tax. The Contractor agrees not to purport to bind

> the State of New Mexico unless the Contractor has express written authority to do so, and then only within the strict limits of that authority.
>
> [Direct Examination of Mr. Reagan; Taxpayer Ex. 14.4 (Section 6)]

61. Mr. Reagan acknowledges that Taxpayer's agreement with the New Mexico Department of Corrections provides no right to bind the state in contract and that it is not an agent of the state under the contract, but that Taxpayer also had no part in drafting the contract. [Direct Examination of Mr. Reagan; Taxpayer Ex. 14.4 (Section 6)]

62. Taxpayer's contract with the Albuquerque Public Schools is silent in regard to the issue of agency or the authority to bind it in contract. Consequently, Mr. Reagan acknowledges that Taxpayer acquired no explicit right to bind the district in contract and that it is not an agent of the district under the contract, but that Taxpayer also had no part in drafting the contract. [Direct Examination of Mr. Reagan; Taxpayer Ex. 15]

63. Taxpayer's contract with the Village of Ruidoso provides as follows in Section 7:

> It is specifically agreed between the parties executing this Agreement that it is not intended by any of the provisions or any part of the Agreement to create in the public or any member thereof a third party beneficiary or to authorize anyone not a party to the Agreement to maintain any suit for wrongful death, bodily or personal injury, damage to property or any other matter whatsoever pursuant to the provisions of this Agreement.
>
> [Direct Examination of Mr. Reagan; Taxpayer Ex. 16.3 (Section 7)]

64. Taxpayer's contract with the Village of Ruidoso also provides as follows in Section 8:

> The Contractor is an independent contractor by performing those services for the Village and is not an employee of any federal, state or local government body and is not an agent of the Village.
>
> [Direct Examination of Mr. Reagan; Taxpayer Ex. 16.3 – 16.4

(Section 8)]

65. Mr. Reagan acknowledges that Taxpayer's contract with the Village of Ruidoso provides no right to bind the village in contract and that it is not an agent of the village under the contract, but that Taxpayer also had no part in drafting the contract. [Direct Examination of Mr. Reagan; Taxpayer Ex. 16]

66. With regard for receipts derived under public sector clients, in the years under audit, the Taxpayer remitted taxes based on profits, meaning income less expenses, rather than total gross receipts. [Direct Examination of Mr. Reagan]

Protest Review of Audit and Assessment

67. Ms. Angelica Rodriguez is a tax protest auditor for the Department. She reviewed the circumstances underlying the protest and various records. [Direct Examination of Ms. Rodriguez]

68. Records reviewed by Ms. Rodriguez include the audit workpapers and the records identified in Department Ex. A. [Direct Examination of Ms. Rodriguez]

69. Ms. Rodriguez did not identify any errors in the underlying audit and concurred with the initial conclusions that certain deductions should not have been allowed. [Direct Examination of Ms. Rodriguez]

70. Ms. Rodriguez reviewed the list of customers identified in Column J (Department Exhibit A beginning at C7.1 (original pagination)) and the auditor's explanation for denying deductions, exemptions, or exclusions in Column L. [Department Ex. A; Direct Examination of Ms. Rodriguez]

71. Ms. Rodriquez contacted the auditor to inquire whether she had reviewed the contracts that served as the basis for her determination of taxability of certain receipts. The auditor's response was that she had only reviewed contracts that were

actually provided. [Department Ex. A; Direct Examination of Ms. Rodriguez]

72. Any contracts that were not specifically identified as being provided to the auditor were not reviewed. All contracts that were provided for review were identified in the audit narrative. [Department Ex. A; Cross Examination of Ms. Rodriguez]

73. Taxpayer's private sector contract template (Department Exhibits G, H, and Taxpayer Ex. 6) were particularly relevant to Ms. Rodriguez. She perceived Page 4, Para. 15 of the template as Taxpayer's recognition that it was an independent contractor to its clients instead of a disclosed agent. [Department Ex. G; Direct Examination of Ms. Rodriguez]

74. Ms. Rodriguez would not conclude under any circumstances that Taxpayer maintained an agency relationship with its clients without authority to bind the client. An agency relationship would need to be supported by an express authority to bind. [Cross Examination of Ms. Rodriguez]

75. The audit exit interview did not contain any indication to Ms. Rodriguez that Taxpayer contested any of the audit's conclusions. [Direct Examination of Ms. Rodriguez]

Penalty

76. In approximately 2014, Mr. Reagan personally inquired from the Department cabinet secretary, Ms. Demesia Padilla, during a meet-and-greet at a local dining establishment, about the Department's position on this issue, at which time the cabinet secretary indicated that the Department's position on the issue had not changed. Accordingly, Mr. Reagan believed there should be no concerns with the methods it continued to employ for computing its gross receipts tax liability. [Direct Examination of Mr. Reagan; Department Ex. E]

77. Ms. Rodriguez was unable to verify the accuracy of any communications between Demesia Padilla and Mr. Reagan by reviewing various Department records where notations of

communications would have been documented. [Department Ex. E; Department Ex. F; Direct Examination of Ms. Rodriguez]

78. Although Mr. Reagan asserted that its methods of computation, reporting and payment of gross receipts taxes during the relevant periods of time were approved by the Department, the evidentiary record does not contain any written communication or other instructions that may be relied upon to corroborate Mr. Reagan's recollections. In fact, Taxpayer, through Mr. Reagan, admitted that "[Taxpayer], at one time did have written correspondence from the Department but is unable to locate it after these many years." [Department Ex. E]

DISCUSSION

The primary issue in dispute is whether the Department erroneously assessed gross receipts tax on revenue allegedly received solely on behalf of another in a disclosed agency capacity under Section 7-9-3.5 (A) (3) (f). In evaluating Taxpayer's position, the Hearing Officer is asked to review the propriety or scope of Regulation 3.2.1.19 (C) (1) NMAC and determine whether it unlawfully abridges Section 7-9-3.5 (A) (3) (f). The secondary issue is whether penalty should be abated based on Taxpayer's asserted reliance on prior advice of the Department as well as subsequent comments by its former cabinet secretary.

The Department asserts that its assessment is correct because there was no evidence to establish the existence of an agency relationship consistent with the requirements of Section 7-9-3.5 (A) (3) (f), as implemented by Regulation 3.2.1.19 (C) (1) NMAC, and that there is no basis for the abatement of penalty based on comments made by the former cabinet secretary or any other Department personnel.

Prior to addressing Taxpayer's claims, it is necessary to discuss the burden Taxpayer must

overcome in order to prevail.

Presumption of Correctness

Pursuant to NMSA 1978, Section 7-1-17 (C) (2007), the Assessment of tax issued in this case is presumed correct and unless otherwise specified, for the purposes of the Tax Administration Act, "tax" includes interest and civil penalty. *See* NMSA 1978, Section 7-1-3 (X) (2013). Therefore, under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) also extends to the Department's assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-050, ¶16, 139 N.M. 498, 134 P.3d 785 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight).

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

In circumstances where a taxpayer's claim for relief relies on the application of an exemption or deduction, "the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer." *See Wing Pawn Shop v.*

Taxation and Revenue Department, 1991-NMCA-024, ¶16, 111 N.M. 735, 809 P.2d 649 (internal citation omitted); *See also TPL, Inc. v. N.M. Taxation & Revenue Dep't*, 2003-NMSC-007, ¶9, 133 N.M. 447, 64 P.3d 474.

Computing Taxable Gross Receipts

As a practical matter, one of the initial steps in any audit is to compute or verify the amount of gross receipts. A subsequent step is to subtract from the taxpayer's total gross receipts those amounts which are deductible or exempt or even excludable from the definition of gross receipts, assuming excludable receipts were erroneously included in the computation. The difference between total gross receipts and any applicable deductions or exemptions, or less any amounts that should be excluded, is the amount of taxable gross receipts.

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

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

Accordingly, under the Gross Receipts and Compensating Tax Act, all gross receipts of a person engaged in business are presumed taxable. *See* NMSA 1978, Section 7-9-5 (2002).

But, as previously stated, a taxpayer's actual obligation may be affected by any number of applicable deductions or exemptions, or by presenting evidence that its receipts are excludable from taxation under NMSA 1978, Section 7-9-3.5 (*e.g.* amounts received solely on behalf of another in a disclosed agency capacity pursuant to Section 7-9-3.5 (A) (3) (f)).

Statutory Exclusions from Gross Receipts pursuant to Section 7-9-3.5 (A) (3) (f)

NMSA 1978, Section 7-9-3.5(A) (3) (f) explicitly states that the term "gross receipts" excludes "amounts received solely on behalf of another in a disclosed agency capacity." Regulation 3.2.1.19 (C) (1) NMAC goes on to provide that, "[a]n agency relationship exists if a person has the power to bind a principal in a contract with a third party so that the third party can enforce the contractual obligation against the principal."

New Mexico courts have addressed on several occasions, in the context of gross receipts tax, whether an agency relationship exists and what effect that relationship has on the taxability of receipts derived from that relationship. As early as 1971, the Court of Appeals in *Westland Corporation v. Commission of Revenue*, 1971-NMCA-083, ¶38, 83 N.M. 29, observed that there was no justification under the facts of that case to impose gross receipts tax on the receipts of a person who served as a "friendly agent" for the limited purpose of "receiving and paying out sums for debts or obligations owing" from another company.

More than two decades later, the Court of Appeals in *Carlsberg Mgmt. Co. v. State*, 1993-NMCA-121, 116 N.M. 247 once again considered the issue of agency in the area of New Mexico's gross receipts tax. *Carlsberg* concerned a property management group that operated an apartment complex on behalf of the property owner. The rent at the apartment complex was subsidized by a federal agency. The taxpayer claimed that the federal agency mandated the form of the agreement in place between that taxpayer and the owner. The agreement in *Carlsberg* referred to that taxpayer as "agent." Under an agency theory, the *Carlsberg* taxpayer argued that money it received from the owner's reimbursing of the payment of employee wages were not subject to gross receipts tax.

The Court of Appeals in *Carlsberg* explained "that a principal's control over the agent is the key characteristic of an agency relationship." *See Carlsberg*, 1993-NMCA-121, ¶12. It went on to explain that whether an agency relationship existed was a factual determination. *See Carlsberg*,

1993-NMCA-121, ¶16. It began its evaluation by reviewing the terms of the relevant agreement. In doing so, it emphasized the long-standing rule that when the contract is unambiguous, the language of the contract determines the intent of the parties without further interpretation. It went on in its analysis to conclude that the contract central to the issues in dispute created an unambiguous agent-principal relationship and rejected the Department's requirement that an agent be disclosed, and adopted the rule that "if a party only receives money… of [] another's employment-related obligations, then an agency relationship exists sufficient to avoid taxation of those funds as gross receipts." *See Carlsberg*, 1993-NMCA-121, ¶15. The Court concluded that the level of control the owner of the apartment complex wielded over that taxpayer regarding that taxpayer's employees left that taxpayer with no control over the payment of the employees, and thus that taxpayer never possessed any interest in the funds in question used to pay the employees. *See Carlsberg*, 1993-NMCA-121, ¶19. The *Carlsberg* decision also noted that an indemnification clause requiring the owner to pay that taxpayer for employment related expenses supported its holding. *See id*.

The Court of Appeals again had an opportunity to revisit the issue in 1995 when it considered *Brim Healthcare, Inc. vs. State*, 1995-NMCA-055, 119 N.M. 818. The question presented by *Brim* was whether an agency relationship excluded taxpayer's reimbursements from the gross receipts tax. In ultimately disagreeing with the taxpayer's position, the Court of Appeals identified several areas of distinction from the facts underlying *Carlsberg*. The most significant factor distinguishing *Brim* from *Carlsberg* was the absence of an indemnification clause in the agreement at issue in *Brim*. *See id*. But another distinction cited in *Brim* was that the contracts at issue expressly noted that the taxpayer was "not an agent… but rather [was] an independent contractor." Ultimately, the Court of Appeals agreed that the receipts central to the dispute were not received as "reimbursement of expenses as an agent." *See Brim*, 1995-NMCA-055, ¶18.

Although *Carlsberg* expressly rejected the Department's previous policy and regulation allowing for exemption of gross receipts only when there is a disclosed agency relationship, a subsequent legislative enactment has limited the *Carlsberg* holding. *See MPC*, 2003-NMCA-021, ¶14. At the time the Court of Appeals issued its decision in *Carlsberg*, the gross receipts tax definition contained no provision excluding from gross receipts tax receipts received solely on behalf of another in a disclosed agency capacity. Since that case, the Legislature has expressly enacted an exclusion for receipts received in a disclosed agency capacity at Section 7-9-3.5 (A) (3) (f).

In 2003, the Court of Appeals in *MPC* revisited the consequences of an agency relationship in the context of gross receipts tax, albeit for the first time under the subsequently enacted "disclosed agency" exception to the definition of "gross receipts." In so doing, the Court warned that *Carlsberg* and *Brim* were both decided before the enactment of the explicit exclusion for receipts derived in the capacity of a disclosed agent pursuant to Section 7-9-3.5(A) (3) (f), and for that reason, those cases had limited instructive value. *See MPC,* 2003-NMCA-021, ¶34.

Similar to Taxpayer's field of business, *MPC* concerned a taxpayer that provided temporary staffing services to clients in New Mexico. *MPC* mostly relied on unwritten agreements with its clients, but did have some written agreements in place that established the terms and conditions of its services. For example, and similar to the facts underlying the present protest, *MPC's* clients supervised the activities of the assigned employees, but the client did not pay the employees. Instead, clients paid the taxpayer, which in turn paid the employee's wages, benefits, and withholdings. The taxpayer in *MPC* then went on to claim the totality of its receipts should be excluded from gross receipts because it "received the amounts purely as a conduit between its clients and its employees." *See MPC,* 2003-NMCA-021, ¶8.

The taxpayer's argument in *MPC* required that the Court consider both a regulation addressing joint employers and the statutory and regulatory elements for establishing a disclosed agency relationship. Similar to the matter at hand, the Court was called upon to consider the application of Regulation 3.2.1.19 (C) (1) NMAC interpreting and implementing Section 7-9-3.5 (A) (3) (f). In doing so, *MPC* observed Regulation 3.2.1.19 (C) (1) NMAC to mean that:

> (1) the agent [taxpayer] has the authority to bind the principal (the client)… to an obligation (to the employee) created by the agent [taxpayer], and (2) the beneficiary of that obligation (the employee) is informed by contract that he or she has a right to proceed against the principal (the client) to enforce the obligation.

The Court in *MPC* went on to further explain:

> Section 7-9-3(F)(2)(f) requires a disclosure to the employee of an agency relationship. This breaks down into the requirements that there be a relationship by which the principal is liable (and knows he is liable) to the employee for payroll if the agent fails to pay, and that the agent disclose this relationship and obligation to the employee.

The Court further noted that Regulation 3.2.1.19 (C) demanded additional bookkeeping requirements that must be met in order to exclude receipts received as part of a disclosed agency capacity from gross receipts. *See MPC,* 2003-NMCA-021, ¶36.

Turning to the facts now under consideration, the Hearing Officer notes several similarities between the facts presented by Taxpayer and *MPC.* For example, the sampling of private sector contracts presented by Taxpayer clearly specified that the relationship between Taxpayer and its clients is that of independent contractor and explicitly disclaimed any agency relationship. *See* Department Exhibit G (Page 4, Para. 15); Department Ex. H (Page 4, Para. 15); Taxpayer Ex. 6 (Page 4, Para. 15).

Taxpayer's public sector contracts are even clearer in regard to Taxpayer's status, or lack thereof, as an agent. In fact, Mr. Reagan readily admitted that none of the public sector contracts established an agency relationship between Taxpayer and its public sector clients.

Similar to the facts in *MPC*, Taxpayer's clients also supervise the day-to-day activities of Taxpayer's employees who are not directly compensated by the client. As in *MPC*, clients pay Taxpayer a sum of money comprised of the employee's salary or wages, benefits, plus a fee for the services Taxpayer provided. There was no evidence to suggest that clients pre-pay payroll or contribute to any sort of payroll fund from which Taxpayer draws money for employee compensation.

Although Taxpayer points out conflicting language in Taxpayer's client agreements, the Hearing Officer is not persuaded that such language is sufficient to satisfy the requirements of the relevant statute, rule, and case law, recognizing of course that, "the majority rule is that the manner in which the parties designate a relationship is not controlling, and if an act done by one person on behalf of another is in its essential nature one of agency, the one is the agent of the other, notwithstanding he is not so called." *See Chevron Oil Co. v. Sutton*, 1973-NMSC-111, ¶ 4, 85 N.M. 679, 681, 515 P.2d 1283, 1285.

The provision upon which Taxpayer relies states, "[b]oth parties to this agreement are aware of the principal-agent relationship. Although [Taxpayer] remits all taxes and insurance, the employees will still have the correct amounts credited to their accounts if [Taxpayer] fails to remit based on the principal-agent relationship."

The precise meaning of this language is difficult to ascertain. It does not explicitly convey any right to employees to enforce any obligations against a client. In fact, the language makes no reference to Taxpayer's clients at all. It is vague and ambiguous. But assuming that Mr. Reagan's understanding of the provision is accurate, it does not actually establish or evidence any genuine principal-agent relationship, and even if it did, the terms and conditions of that relationship are entirely unknown. Conversely stated, to be "aware of the principal-agent relationship" is not

equivalent to explicitly establishing such relationship, especially when other provisions in the same agreement effectively disclaim the existence of an agency relationship. Section 15 of its private-sector contracts admitted as Taxpayer Ex. 6 and Department Exhibits G and H state in relevant part that, "[Taxpayer] agrees that its status is solely that of an independent contractor and not an employee or agent of Customer." It goes on to state that "[Taxpayer] shall be responsible for payment of all remuneration payable to said Assigned Employees and all taxes imposed on an employer with respect to such employees, including those imposed under federal and state withholding laws and [Taxpayer] shall also be responsible for payment of taxes under the Federal Insurance Contributions Act ("FICA") with respect to said employees."

Therefore, whatever grant of authority or relationship might be inferred from the acknowledgment appearing in Section 25, the language contained in Section 15 negates it in clear and unambiguous terms. To the extent there could be reliance on another agreement, not made part of the contract or proffered for consideration in this matter that explicitly establishes a principal-agent relationship, Section 26 in the same exhibit proclaims that "[t]his agreement contains the entire agreement between the parties with respect to the matters covered herein[.]"

Moreover, there is no indication that any Taxpayer employee enjoys the right to proceed directly against any client to enforce any contractual obligations. Section 15 clearly obligates Taxpayer for compensating its employees and there is no explicit right to proceed against a client if Taxpayer should fail to do so. The fleeting recognition of a principal-agent relationship in Section 25, when read in light of the remaining sections of the agreement, does not confer any rights on Taxpayer's employees to pursue contractual claims against anyone except Taxpayer.

Although the Hearing Officer found Mr. Reagan to be an affable and credible witness, the Hearing Officer was unpersuaded based on his testimony and the cited agreements that Taxpayer

maintained a genuine principal-agent relationship with any of its clients in the manner prescribed by the Department and upheld in *MPC.* "The question of agency must be determined from all of the facts and circumstances in each case, along with the conduct and communications of the parties." *See Trans Union Leasing Corp. v. Hamilton*, 1979-NMSC-058, ¶ 10, 93 N.M. 310, 312, 600 P.2d 256, 258. In this case, the only evidence in support of a disclosed agency relationship is straightforwardly refuted by contradictory evidence on the record. In fact, the opposing evidence so heavily weighs against the existence of a disclosed agency relationship that the Hearing Officer perceives the language contained in Section 25 as an afterthought suggesting the desire to have one's cake and eat it, too; to enjoy the fruits of the exclusion provided by the disclosed agency relationship without incurring its potential liabilities or assuming its responsibilities. This, however, would thwart the intentions of the Legislature, which intended the exclusion to apply to a genuine agency-relationship, not one created with the mere purpose of sidestepping taxation. *See e.g. MPC Ltd.*, 2003-NMCA-021, ¶ 25, 133 N.M. 217, 223, 62 P.3d 308, 314 (Legislature required agency relationship and disclosure, not merely one or the other).

With concern for disclosure, the evidence established that Taxpayer distributes a pamphlet to employees which states, "[e]mployees are aware of our relationship with our clients as a principal-agent relationship. All taxes and insurance are properly remitted by [Taxpayer] to the correct agencies, but a failure to do so would still insure all employees have the correct amounts credited to their accounts based on our client's principal-agent relationship." *See* Taxpayer Ex. 8. The same language appears in fine print on Taxpayer's time sheets. *See* Taxpayer 11.

However, making employees aware in the manner provided by Taxpayer is not enough. The Hearing Officer's observation in this protest is similar to the observation made in *MPC* in

which the Court explained, Taxpayer "nowhere specifically sets out whether employees were told they could enforce a payroll obligation against the client." Furthermore, Taxpayer does not show, "any understanding, oral, or written, with any of its clients that the client would be or could be obligated to the employee for payroll." *See MPC*, 2003-NMCA-021, ¶ 39. Even if Taxpayer has a good faith belief that those were the intentions underlying the asserted disclosures provided in Taxpayer Exs. 8 and 11, the language utilized is inadequate for providing any meaningful disclosure of any actual rights employees could assert against Taxpayer's clients, and there is no evidence that any client could be directly indebted to any of Taxpayer's employees for payroll obligations.

Taxpayer argued that the guidance provided by Ruling 401-09-3 (Effective June 17, 2009) should apply to the facts of this protest. At first blush, the facts considered in that ruling appeared somewhat analogous to the facts underlying Taxpayer's protest. The taxpayer in that ruling contracts with film and television producers to perform administrative functions relating to the employment of the production's cast and crew. The taxpayer handled various tasks, including payroll, withholdings, and other administrative tasks. In exchange for services, the production company separately paid a fee for services and a reimbursement for employee payroll, taxes, benefits, and other payroll expenditures.

After considering the application of the relevant statute, regulation, and cases, including *Carlsberg*, *Brim*, and *MPC*, the Department concluded that the taxpayer's receipts from producers for payroll, benefits, taxes, workers compensation insurance, and similar employee related reimbursements were not gross receipts for purposes of the gross receipts tax act. However, the hearing officer does not find Ruling 401-09-3 to be binding or persuasive under the facts of this protest. The taxpayer subject of the ruling contracted with producers to perform

administrative functions relating to the employment of production cast and crew. The taxpayer subject of the ruling was not a staffing agency nor employer of the employees at issue.

In the present matter, Taxpayer is not retained by the employer to merely assist with performance of administrative functions. Taxpayer's objective is to employ staff which it can lease to clients in exchange for compensation. The circumstances between Ruling 401-09-3 and the present issue are clearly distinguishable on their facts.

The distinction is further exemplified by comparing and contrasting the examples contained in Regulation 3.2.1.19 (C) (7) and (8) NMAC. The example in Regulation 3.2.1.19 (C) (7) bears a resemblance to the facts in Ruling 401-09-3. But in the subsequent example, the Department considers a scenario having more facts in common with the facts of Taxpayer's protest. That example provides:

> A enters into an agreement with its client B to provide temporary workers to B. The agreement provides that A retains the right to select and hire employees, to control when the employees are paid, and the right to replace employees. A issues the payroll checks to employees with A as payor. The employees are unaware of any principal-agent relationship between A and B. All receipts A receives from B for payroll and A's commission or fee for its services to B are subject to gross receipts tax.
>
> *See* Regulation 3.2.1.19 (C) (8) NMAC.

In conclusion and for the reasons discussed, Taxpayer did not satisfy the requirements of Section 7-9-3.5(A) (3) (f) and Regulation 3.2.1.19 (C) (1) NMAC, as supported by *MPC.* Taxpayer failed to prove by a preponderance of evidence that it derived receipts "solely on behalf of another in a disclosed agency capacity." There was insufficient evidence to establish a genuine principal-agent relationship or the sorts of meaningful disclosures required by Regulation 3.2.1.19 (C) (1) and subsequently endorsed by *MPC.*

Incidentally, although the Hearing Officer need not address the issue having found that

Taxpayer failed to satisfy the requirements of Regulation 3.2.1.19 (C) (1), the Hearing Officer observed that Taxpayer did not address the bookkeeping requirements contained in Regulation 3.2.1.19 (C) (2) NMAC. That regulation provides, "[r]eceipts from the reimbursement of expenses incurred as agent on behalf of a principal while acting in a disclosed agency capacity are not included in the agent's gross receipts *if the expenses are separately stated on the agent's billing to the client and are identified in the agent's books and records as reimbursements of expenses incurred on behalf of the principal party*." (Emphasis Added)

Accordingly, even had the Hearing Officer found that Taxpayer had satisfied the requirements of Regulation 3.2.1.19 (C) (1), there is nothing apparent from the evidentiary record on which the Hearing Officer could evaluate whether the Taxpayer also satisfied Regulation 3.2.1.19 (C) (2) NMAC. *See MPC,* 2003-NMCA-021, ¶36.

Propriety of Regulation 3.2.1.19 NMAC

As seen in the preceding section, the Hearing Officer's evaluation of the issues presented concentrates in part on Regulation 3.2.1.19 (C) (1) NMAC. Taxpayer asserts, however, that the rule as applied in this case abridges Section 7-9-3.5 (A) (3) (f) and should be disregarded as invalid. It has long been recognized that, "[i]t is, of course, a fundamental principle of administrative law that the authority of the agency is not limited to those powers expressly granted by statute, but includes, also, all powers that may fairly be implied therefrom." *See Wimberly v. N.M. State Police Bd.*, 1972-NMSC-034, ¶6, 83 N.M. 757, 758, 497 P.2d 968, 969.

The Department is empowered under NMSA 1978, Section 9-11-6.2 (A) to issue regulations to administer the tax laws of this state. Its authority, however, is not without limitation. The Department may only promulgate regulations that interpret and exemplify the statutes to which they relate. *See* NMSA 1978, Section 9-11-6.2 (B) (1).

In deciding whether a regulation interprets or exemplifies a statute, a regulation may not abridge or otherwise limit the scope of the related statutory enactment. *See Rainbo Baking Co. of El Paso, Tex. v. Comm'r of Revenue*, 1972-NMCA-139, ¶¶ 10-12, 84 N.M. 303, 305-306. In *Rainbo Baking Co.*, the court held that the Commissioner of Revenue may not promulgate a regulation that would nullify a deduction authorized by the Legislature. In *Rainbo*, the Commissioner promulgated a regulation that required a nontaxable transaction certificate to be in the possession of the buyer at the time of an audit, which contradicted the statute that only required the buyer to have in its possession a nontaxable transaction certificate. Consequently, the Court ruled that a regulation may not add a requirement that the Legislature has not also authorized or imposed which limits or abridges a statute.

Similarly, in *Gonzales v. Educ. Retirement Bd.*, 1990-NMSC-024, 109 N.M. 592, 788 P.2d 348, the Court held that the Educational Retirement Board could not enact a regulation that was "unreasonable or irrelevant." In *Gonzales*, the Board, by regulation, required a member who was requesting an award of disability benefits to hold no property interest in a bus contract. The Court said that there was nothing within the statutory grant of authority to award disability benefits that authorized the Board to refuse to accept an application for disability if the applicant continued to have a property interest in a bus contract. The Court held that the Board did not have the "statutory power to create unreasonable or irrelevant requirements within the application process before it considers the application." *See Gonzales,* 109 N.M. at 594, 788 P.2d at 350. Thus, the Board's regulation was held to create an unreasonable or irrelevant requirement.

Taxpayer's perception that Regulation 3.2.1.19 (C) (1) NMAC limits or abridges the availability of the exclusion under Section 7-9-3.5 (A) (3) (f) is misplaced. Application of Regulation 3.2.1.19 (C) (1) NMAC has come before the New Mexico Court of Appeals on several

occasions. The first reported case was MPC more than 20 years ago when the guidance to which this decision adheres was first articulated. A handful of unreported, and albeit unprecedential decisions of the court have also followed. In each instance, the parties and the court had an opportunity to reconsider the application of *MPC* or the regulation on which it relied. At no time has any court disturbed the rule articulated by *MPC* or second-guessed the propriety of the regulation on which it relied in reaching its decision. *See Active Sols., Incorporated v. New Mexico Taxation & Revenue Dep't*, A-1-CA-37632, 2020 WL 4459109 (N.M. Ct. App. Aug. 3, 2020); *Del Corazon Hospice, LLC v. New Mexico Taxation & Revenue Dep't*, A-1-CA-37347, 2020 WL 4730709 (N.M. Ct. App. Aug. 10, 2020); *Matter of Protest of ATC Healthcare Services, Inc.*, A-1-CA-36081, 2019 WL 2092230 (N.M. Ct. App. May 7, 2019); *Bogle Mgmt. Co., Inc. v. New Mexico Taxation & Revenue Dep't*, A-1-CA-35641, 2017 WL 6997308 (N.M. Ct. App. Dec. 5, 2017).

That is not to say that an appellate court could not take a different view should it find it appropriate to do so. But the guidance it has provided in both precedential and non-precedential decisions has been consistent and reliable and the Hearing Officer does not perceive any facts in the present case which should cause a change in direction.

Moreover, the Hearing Officer observed that Regulation 3.2.1.19 NMAC was most recently amended in 2010 but the specific section at issue in this protest has remained consistent since it was discussed in *MPC* in 2002. The Hearing Officer finds significance in this observation because, "[i]n construing statutes and regulations, courts will 'give persuasive weight to long-standing administrative constructions of statutes by the agency charged with administering them.'" *See Pub. Serv. Co. of N.M. v. N.M. Taxation & Revenue Dept.*, 2007-NMCA-050, ¶ 41, 141 N.M. 520, 532, 157 P.3d 85, 97 (*citing High Ridge Hinkle Joint Venture v. City of Albuquerque*, 1998-NMSC-050, ¶ 5, 126 N.M. 413, 414, 970 P.2d 599, 600).

Regulation 3.2.1.19 (C) is a proper implementation of the law and the Hearing Officer perceives no conflict with the statute which authorizes it.

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.
>
> [Emphasis Added]

The statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meet the legal definition of "negligence." *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24, 32 (use of the word "shall" in a statute indicates that a 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 fall under the definition of civil negligence subject to penalty, Section 7-1-69 (B) provides an exception in that "[n]o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds."

In this case, Taxpayer is negligent for failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances or inadvertence, erroneous belief, or inattention.

In this protest, Taxpayer claims that no penalty should be assessed because the Department previously expressed agreement with Taxpayer's methods of computing its gross receipts tax liability, and a subsequent interaction with Ms. Demesia Padilla, the Department's cabinet secretary at the time. The interaction occurred at a local restaurant in close proximity to the New Mexico State Capitol during the legislative session. Mr. Reagan said that the cabinet secretary "came to visit friends who were working with him" on his efforts to procure state business.

During their interactions, Mr. Reagan "mentioned to her [he] had an employee leasing license and used it for years as a mechanism to deduct direct labor costs from the billing amounts and taxed the remaining portion for remittance to the state. She seemed knowledgeable about the laws pertaining to employee leasing and talked about consistency and utilization of direct costs for deductions." Mr. Reagan went on to explain that "[he] left the conversation without any red flags and believed she understood [his] business model." *See* Department Ex. E.

Former cabinet secretary Padilla, by signed and sworn affidavit responded that "[she] did not recall giving any tax advice to Jeff Reagan at any time." *See* Department Ex. F.

Although Mr. Reagan presents as very credible, the Hearing Officer is not persuaded that the conversation, as described in the testimony or in Mr. Reagan's written summary, justifies abatement of penalty based on mistake of law made in good faith and on reasonable grounds. Viewing Mr. Reagan's recollection of his conversation in the light most favorable to Taxpayer, simply leaving his conversation "without any red flags" assuming that Ms. Padilla "understood

[his] business model" is not equivalent to a mistake of law made in good faith and on reasonable grounds. Even if Ms. Padilla and Mr. Reagan shared similar views regarding tax policy, their agreement is not nor should it be equated with tax advice upon which Taxpayer should reasonably rely. Moreover, having similar views on tax policy cannot be construed as permission to deviate from the requirements of law if those requirements do not align with the favored policy.

The other grounds for abatement of civil negligence penalty are found under Regulation 3.1.11.11 NMAC. That regulation establishes eight indicators of non-negligence where penalty may be abated. Based on the evidence presented, the first factor under Regulation 3.1.11.11 NMAC that is potentially applicable in this proceeding is:

> D. the taxpayer proves that the failure to pay tax or to file a return was caused by reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts; failure to make a timely filing of a tax return, however, is not excused by the taxpayer's reliance on an agent;

Referring back to Mr. Reagan's interactions with Ms. Padilla, there was no evidence to suggest, much less establish by a preponderance, that Mr. Reagan provided a full disclosure of all relevant facts. In contrast, Mr. Reagan's description of his conversation indicates that their interactions may have been quite superficial and policy based, rather than fact specific. Accordingly, the communications that Mr. Reagan may have had with Ms. Padilla fail to satisfy the requirements of Regulation 3.1.11.11 (D) NMAC.

The other potentially applicable indicator of non-negligence at Regulation 3.1.11.11 (A) provides for abatement of penalty if "the taxpayer proves the taxpayer was affirmatively misled by a department employee[.]" For the same reasons, this indicator of non-negligence fails to afford relief from penalty because once again in the light most favorable to Taxpayer, leaving a

conversation "without any red flags" assuming that the cabinet secretary "understood [his] business model" is not equivalent to being affirmatively misled. In contrast, NMSA 1978, Section 9-11-6.2 and the rules implementing the law provide a formal mechanism for seeking a ruling from the secretary of the Department if Taxpayer desired "clarification of the consequences of a specified set of circumstances." *See* NMSA 1978, Section 9-11-6.2 (B) (2); *see also* Regulation 3.1.2.8 NMAC.

To the extent Taxpayer relies on other communications, such as those that may have occurred in or about 2008, the Hearing Officer finds that Mr. Reagan's testimony alone is not sufficient to establish entitlement to an abatement in the absence of the written communications he recalled having (as referenced in Department Ex. G), but was unable to produce as evidence. Although generally credible in all regards, Mr. Reagan's testimony on this issue lacked the sort of specificity necessary to evaluate whether Taxpayer's reliance was reasonable, whether the Department's positions had changed, or whether the Taxpayer was indeed misled.

It is Taxpayer's duty under *Tiffany Construction Co.*, 1976-NMCA-127, ¶5, to ascertain the tax consequences of its actions. The Department did not allege that Taxpayer's conduct in this regard was with the intent to evade or defeat a tax. In other words, Taxpayer did not act with bad intentions. Yet, *El Centro Villa Nursing Ctr. v. Taxation & Revenue Dept. of State of N.M.*, 1989-NMCA-070, 108 N.M. 795, 795, 779 P.2d 982, 982, established that the civil negligence penalty is appropriate under the circumstances of this protest and Regulation 3.1.11.11 NMAC does not provide grounds for abatement of the penalty.

For the reasons stated, Taxpayer did not overcome the presumption of correctness that attached to the Assessment, and the protest should be DENIED.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Assessment. Jurisdiction lies over the parties and the subject matter of this protest.

B. A hearing was timely set and held within 90 days of Taxpayer's protest as required by NMSA 1978, Section 7-1B-8.

C. All of Taxpayer's receipts were presumed subject to gross receipts tax under NMSA 1978, Section 7-9-5 (2002).

D. Taxpayer carries the burden to present countervailing evidence or legal argument to show that it is entitled to an abatement of an assessment. *See Casias Trucking*, 2014-NMCA-099, ¶8.

E. If a taxpayer presents sufficient evidence to rebut the presumption, then the burden shifts to the Department to re-establish the correctness of the assessment. *See MPC Ltd.*, 2003-NMCA-021, ¶13.

F. The contracts between Taxpayer and its private sector and public sector clients failed to establish the existence of a disclosed agency relationship in which Taxpayer had actual authority to bind its customers with third parties. Taxpayer was therefore not a disclosed agent under NMSA 1978, Section 7-9-3.5 (A) (3) (f) and Regulation 3.2.1.19 (C) (1) NMAC. *See MPC*, ¶36.

G. Since Taxpayer was not a disclosed agent under NMSA 1978, Section 7-9-3.5 (A) (3) (f) and Regulation 3.2.1.19 (C) (1) NMAC, Taxpayer's receipts from providing employment staffing services were taxable gross receipts.

H. Under NMSA 1978, Section 7-1-67 (2007), Taxpayer is liable for accrued interest under the assessment, which shall continue to accrue until the tax principal is satisfied.

I. Under NMSA 1978, Section 7-1-69 (2007), Taxpayers are liable for civil negligence penalty and there is no basis under the facts of the protest to permit an abatement.

J. Taxpayer did not rebut the statutory presumption of correctness that attached to the Assessment under NMSA 1978, Section 7-1-17 and the burden did not therefore shift to the Department to re-establish the correctness of its assessment.

For the foregoing reasons, Taxpayer's protest should be, and hereby is, DENIED.

DATED: June 17, 2021

Chris Romero
Hearing Officer
Administrative Hearings Office
P.O. Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), the parties have the right to appeal this decision by *filing a notice of appeal with the New Mexico Court of Appeals* within 30 days of the date shown above. If an appeal is not timely filed with the Court of Appeals within 30 days, this Decision and Order will become final. Rule of Appellate Procedure 12-601 NMRA articulates the requirements of perfecting an appeal of an administrative decision with the Court of Appeals. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may begin preparing the record proper. The parties will each be provided with a copy of the record proper at the time of the filing of the record proper with the Court of Appeals, which occurs within 14 days of the Administrative Hearings Office receipt of the docketing statement from the appealing party. *See* Rule 12-209 NMRA.

CERTIFICATE OF SERVICE

On June 17, 2021, a copy of the foregoing Decision and Order was submitted to the parties listed below in the following manner:

Email *Email*
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