

**THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO**

**IN THE MATTER OF THE PROTEST OF
DUKE ENGINEERING & SERVICES, INC.
ID. NO. 02-130115-00 8, PROTEST TO
DENIAL OF CLAIM FOR REFUND**

NO. 01-11

DECISION AND ORDER

This matter came on for formal hearing on June 18, 2001 before Gerald B. Richardson, Hearing Officer. Duke Engineering & Services, Inc., hereinafter, "Taxpayer", was represented by Mr. Cooper Monroe, its Tax Manager. The Taxation & Revenue Department, hereinafter, "Department, was represented by Mónica M. Ontiveros, Special Assistant Attorney General. Based upon the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is in the business of providing nuclear engineering services in New Mexico and elsewhere.
2. Commencing in 1997, the Taxpayer contracted to provide engineering services to Johnson Controls Worldwide Services, which later became Johnson Controls Northern New Mexico, hereinafter, "Johnson Controls".
3. Johnson Controls contracts with the University of California, which operates Los Alamos National Laboratory, to provide various services.
4. Johnson Controls resold the services provided to it by the Taxpayer to Los Alamos National Laboratory.

5. Between October 21-29, 1999, the Department audited the Taxpayer at its headquarters in Charlotte, North Carolina.

6. As part of its standard audit procedures, on October 28, 1999, the Department's auditor provided the Taxpayer with what is known as a "sixty day letter", which provides notice to taxpayers that within sixty days of the notice, they must possess any New Mexico non-taxable transaction certificates ("NTTCS") to support deductions requiring such NTTCs which were claimed during the periods under audit. The letter further informs taxpayers that if they are not in possession of the NTTCs, that deductions previously claimed in reliance on such NTTCs will be disallowed.

7. During the audit and within the sixty day period for providing NTTCs, the Taxpayer provided the Department with the NTTC which Johnson Controls had provided to the Taxpayer and upon which the Taxpayer based a claim for deduction for its receipts from Johnson Controls when the Taxpayer reported and filed its monthly gross receipts taxes with the Department.

8. The Department's auditors orally informed the Taxpayer that they would not accept the NTTC presented from Johnson Controls because it had been altered, and the auditors informed the Taxpayer that it needed to obtain a proper NTTC from Johnson Controls to support the deductions which had previously been claimed.

9. The NTTC which was disallowed by the Department's auditors was issued by Johnson Controls to the Taxpayer on January 27, 1998. It is a Type 15 NTTC, which can be issued by taxpayers who contract with the Federal government under certain limited conditions. The NTTC was issued by the Department to Johnson Controls on April 7, 1992 and is a Department form NTTC. The NTTC was signed by David M. Williams, an employee of Johnson Controls, who was authorized to sign and issue NTTCs on behalf of Johnson Controls.

Johnson Controls altered this NTTC by typing in an additional line, “05-SERVICE FOR RESALE”, above the line indicating, “15 FEDERAL CONTRACTORS”.

10. On the same day that the Department auditors informed the Taxpayer that it would not accept the NTTC from Johnson Controls, the Taxpayer contacted Johnson Controls and informed them of the Department’s refusal to accept the NTTC and requested an unaltered Type 5 NTTC.

11. Johnson Controls provided the Taxpayer with a Type 5 NTTC on January 19, 2000, but this was after the 60 days for presenting such NTTCs to the Department had expired.

12. As a result of the Department’s audit and the Department’s disallowance of the deductions which the Taxpayer had claimed for its gross receipts from Johnson Controls, the Department assessed the Taxpayer \$97,184.05 in gross receipts tax, plus applicable penalty and interest.

13. The Taxpayer paid the assessment during the time that the Department was administering a legislatively authorized tax amnesty program which allowed the Department to abate the penalty and interest assessed upon payment of the tax principal.

14. On February 2, 2000, the Taxpayer submitted a claim for refund to the Department, requesting a refund of the \$97,184.05 in gross receipts taxes paid on the audit assessment issued by the Department and claiming that it had accepted the altered NTTC from Johnson Controls in good faith and that its claim of deduction for its receipts from Johnson Controls should not have been disallowed by the Department’s auditors.

15. On March 23, 2000, the Department denied the Taxpayer’s claim for refund on the basis that the Taxpayer could not have accepted the NTTC from Johnson Controls “in good faith”.

16. On June 20, 2000, the Taxpayer submitted a written protest to the Department's denial of its claim for refund.

DISCUSSION

The sole issue to be determined herein is whether the Department properly denied the Taxpayer's claim for refund which was based upon the Department's prior denial of the Taxpayer's claimed deduction for its receipts from Johnson Controls, which had provided the Taxpayer with an altered NTTC. The Department did not argue or attempt to establish that the Taxpayer should have recognized or known that the NTTC was an improper or altered NTTC at the time it filed its original returns and claimed the deduction. Instead, the Department argued that the Taxpayer had the opportunity to obtain a proper NTTC prior to the expiration of the 60 day period and failed to present a proper Type 5 NTTC in support of its claim for deduction within the 60 day time frame allowed by statute. The Department agrees that a proper Type 5 NTTC would support the Taxpayer's claim of deduction, but in the absence of one, the Department argues that the Taxpayer could not properly deduct those receipts.

The Taxpayer argues that it accepted the altered NTTC in good faith, that it was not aware of the fact that the NTTC had been altered, that the NTTC was properly executed by Johnson Controls, that the NTTC was on a form prescribed by the Department, although it was subsequently altered, and the NTTC was in its possession within the time required by statute. Based upon these circumstances, the Taxpayer argues that the original, but altered NTTC, was valid insofar as the Taxpayer's claim of deduction for its receipts from Johnson Controls.

The ultimate issue to be determined, then, is whether the original, but altered, NTTC can support the Taxpayer's claim of deduction for its receipts from Johnson Controls. This case presents a unique set of facts, the legal consequences of which have not previously been determined under the Gross Receipts and Compensating Tax Act.

Section 7-9-43(A) NMSA 1978 (1998 Repl. Pamp.) is the statute which governs the determination of the issue at hand. It provides as follows:

All nontaxable transaction certificates of the appropriate series executed by buyers or lessees should be in the possession of the seller or lessor for nontaxable transactions at the time the return is due for receipts from the transactions. *If the seller or lessor is not in possession of the required nontaxable transaction certificates within sixty days from the date that the notice requiring possession of these nontaxable transaction certificates is given the seller or lessor by the department, deductions claimed by the seller or lessor that require delivery of these nontaxable transaction certificates shall be disallowed. The nontaxable transaction certificates shall contain the information and be in a form prescribed by the department.* The department by regulation may deem to be nontaxable transaction certificates documents issued by other states or the multistate tax commission to taxpayers not required to be registered in New Mexico. Only buyers or lessees who have a registration number or have applied for a registration number and have not been refused one under Subsection C of Section 7-1-12 NMSA 1978 shall execute nontaxable transaction certificates issued by the Department. If the seller or lessor has been given an identification number for tax purposes by the department, the seller or lessor shall disclose that identification number to the buyer or lessee prior to or upon acceptance of a nontaxable transaction certificate. *When 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.* (Emphasis added.)

The Department bases its denial of the Taxpayer's claimed deduction on the fact that it does not consider the altered NTTC to be a proper NTTC because it, being altered, is not "in a form prescribed by the Department". Section 7-9-43(A). Thus, the Department denied the Taxpayer's claim of deduction because it failed to demonstrate possession of a proper Type 5 NTTC within

the sixty days from the notice the Department gave the Taxpayer to be in possession of any NTTCs it needs to claim a deduction.¹

I disagree with the Department's application of Section 7-9-43(A). I believe that the altered NTTC was in "a form prescribed by the department". The NTTC was a form NTTC issued to Johnson Controls by the Department. It was altered by Johnson Controls, after the fact, to add language indicating that it applied to the transactions in which the purchaser will resell the services being sold to the purchaser, but there was no evidence or even the contention by the Department that the Taxpayer was aware of the alteration or was in any way on notice that the Department's certificate form was improper to cover the transaction at issue until the alteration was pointed out to the Taxpayer by the Department's auditors. This occurred long after the acceptance of the NTTC by the Taxpayer in support of the deductions at issue.

The Taxpayer argues that under the good faith acceptance language of Section 7-9-43(A), that the Department may not deny the deductibility of the receipts in question, citing *Leaco Rural Telephone Cooperative, Inc., v. Bureau of Revenue*, 86 N.M. 629, 526 P.2d 426 (Ct. App. 1974). In that decision, the court stated:

There are three requirements to be met before an NTTC becomes conclusive evidence that proceeds of a transaction are deductible. The requirements are timeliness of acceptance of the NTTC, good faith acceptance of the NTTC and a properly executed NTTC.

Id., 86 N.M. at 632. There is no issue of timeliness of the altered NTTC, since the Taxpayer demonstrated that it was in its possession during the audit when such certificates were requested as part of the Department's audit procedures and in responses to the Department's sixty day letter. Good faith acceptance under the language of Section 7-9-43(A) requires that the seller accept the certificate "in good faith that the buyer or lessee will employ the property or service

¹ Section 7-9-48 NMSA 1978 provides a deduction for receipts from selling a service for resale "if the sale is made to a person who delivers a nontaxable transaction certificate to the seller." Thus, a NTTC is required to support the

transferred in a nontaxable manner”. That requirement is met here because the Taxpayer was aware that Johnson Controls would be reselling the services pursuant to its relationship with the Los Alamos laboratories and the certificate, on its face, indicates that it covers the resale of services. Finally, the certificate was properly executed. The Court of Appeals, in *Leaco*, found that “properly executed”, in an earlier version of Section 7-9-43, is used “in the sense of completing—filling out and signing—the NTTCs.” *Id.*, 86 N.M. at 632. The certificate at issue was completed properly by the issuer and signed by its authorized representative. When these three requirements are met, the properly executed certificate “shall be conclusive evidence and the only material evidence that the proceeds from the transaction are deductible....” Section 7-9-43(A).

The Court of Appeals’ ruling in *Leaco* has been limited by two subsequent decisions. In *McKinley Ambulance Service v. Bureau of Revenue*, 92 N.M. 599, 592 P.2d 515 (Ct. App. 1979), the court held that when a party accepts a NTTC which, on its face, does not apply to the type of transaction being conducted, the good faith acceptance language in Section 7-9-43 does not cover the situation to provide a safe harbor for the person accepting the transaction. Good faith acceptance was further limited in *Arco Materials, Inc. v. State, Taxation and Revenue Department*, 118 N.M. 12, 878 P.2d 330 (Ct. App. 1994), which found that it did not protect taxpayers from the consequences of a change in law that renders formerly nontaxable transactions taxable. Neither of those exceptions to good faith acceptance have any applicability to the instant matter.

claim of deduction at issue herein.

The Taxpayer in this case has met its burden to establish its entitlement to the safe harbor provided by the “good faith acceptance” requirements of Section 7-9-43(A) NMSA 1978². Accordingly, the Taxpayer’s protest will be granted.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest, pursuant to Section 7-1-26(B) NMSA 1978, and jurisdiction lies over both the parties and the subject matter of this protest.
2. The altered NTTC was in a form prescribed by the Department.
3. The altered NTTC was properly executed by Johnson Controls.
4. The Taxpayer accepted the altered NTTC in good faith that the buyer would employ the service in nontaxable manner.
5. The Taxpayer is entitled to the deduction found at Section 7-9-48 for its receipts from selling services to Johnson Controls based upon its good faith acceptance of the altered NTTC provided to it by Johnson Controls.

² The good faith acceptance safe harbor is intended to protect Taxpayers who claim a deduction in reliance on the issuer’s representation, by issuing a NTTC, that the goods or services transferred will be used in a nontaxable manner, since sellers would usually have no way to actually know what a purchaser will do with the goods or services purchased. In such instances, the Department may usually go after the purchaser who misused the certificate by assessing compensating tax against the purchaser on the value of the transaction. See, Section 7-9-7(A)(3) (where tangibles were purchased with an NTTC, initially avoiding the imposition of tax), and Section 7-9-3(C) (where services were purchased with an NTTC, initially avoiding the imposition of tax). Section 7-9-44(A) further gives the Department the right to suspend a purchaser’s right to use NTTCs if they fail to pay the compensating tax on the subsequent use of property or services purchased through the use of an NTTC. The party in the wrong in this matter was Johnson Controls, who improperly altered the NTTC. Unfortunately, Section 7-9-44 does not cover the situation presented in this case, where the purchaser altered an NTTC to cover a transaction not otherwise covered by the NTTC because compensating tax is only imposed based upon the purchaser’s subsequent use of the property or service purchased, and not upon an improper alteration of a NTTC.

For the foregoing reasons, the Taxpayer's protest IS HEREBY GRANTED.

The Department IS HEREBY ORDERED TO GRANT THE TAXPAYER'S CLAIM FOR REFUND, TOGETHER WITH APPLICABLE PENALTY AND INTEREST UNTIL SUCH CLAIM IS PAID.

DONE this 18th day of July, 2001.