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

IN THE MATTER OF THE PROTEST OF
D & H PUMP SERVICE, INC. **No. 02-23**
ID NO. 01-798794-00-6
ASSESSMENT NO. 2747196

DECISION AND ORDER

A formal hearing on the above-referenced protest was held September 24, 2002, before Margaret B. Alcock, Hearing Officer. D & H Pump Service, Inc. ("Taxpayer") was represented by its attorney, Clinton W. Marrs, Vogel, Campbell, Bluener & Castle, P.C. The Taxation and Revenue Department ("Department") was represented by Bridget A. Jacober, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is a corporation organized under the laws of Texas with its principal place of business is El Paso, Texas. The Taxpayer has additional business locations in Odessa, Texas, and Albuquerque and Farmington, New Mexico.

2. The Taxpayer is engaged in the business of selling tangible personal property (*e.g.*, petroleum liquids dispensing equipment) and services (*e.g.*, installation, construction, and repair services).

3. From January 1995 through March 2001 ("the audit period"), approximately 70 percent of the Taxpayer's business was in Texas and approximately 25 percent of its business was in New Mexico. The Taxpayer engaged in a total of 500 to 600 business transactions each month.

4. During the audit period, the Taxpayer used a generic accounting software program that assigned various codes to the Taxpayer's sales of goods and services to indicate whether a

particular transaction was taxable or nontaxable. The accounting program did not differentiate between sales that occurred in Texas and sales that occurred in New Mexico. For example, all sales of services to governmental and nonprofit entities were coded as nontaxable, without regard to the location where the services were performed.

5. From 1988 to mid-2000, Paul Bidwell was the Taxpayer's controller. Mr. Bidwell was not a certified public accountant, but had a B.B.A. in accounting from the University of Texas at El Paso. Prior to becoming the Taxpayer's controller, Mr. Bidwell spent four years with an accounting firm in El Paso and ten years as controller of an industrial supply company in Texas.

6. During the twelve years that he served as the Taxpayer's controller, Mr. Bidwell was responsible for the Taxpayer's accounting system. Mr. Bidwell's duties included filing the Taxpayer's monthly gross receipts, compensating and withholding tax returns under New Mexico's combined reporting system ("CRS").

7. The Taxpayer retained the services of a certified public accountant in El Paso to assist the Taxpayer's controller. The CPA was not involved with the Taxpayer's reporting of New Mexico CRS taxes. The CPA prepared the Taxpayer's corporate income tax returns based on an annual summary taken from the Taxpayer's sales tax ledgers.

8. From time to time over the years, Mr. Bidwell and the CPA attended New Mexico gross receipts tax seminars. On occasion, something he learned at a seminar would cause Mr. Bidwell to makes changes in the Taxpayer's business methods to better comply with its tax obligations.

9. Before he retired in mid-2000, Mr. Bidwell trained his assistant to take over his duties as controller.

10. In May 2001, the Department conducted a field audit at the Taxpayer's offices in El Paso, Texas. The audit uncovered several errors in the Taxpayer's reporting of New Mexico gross receipts tax, compensating tax, and corporate income tax. The audit did not find any errors in the Taxpayer's reporting of New Mexico withholding tax.

11. On May 31, 2001, the Department's auditor met with the Taxpayer's president and its controller. During this initial meeting, the auditor discovered that the Taxpayer was not aware that New Mexico had a compensating tax. The auditor subsequently determined that the Taxpayer owed compensating tax on the value of tangible personal property the Taxpayer purchased from out-of-state vendors for use in New Mexico or on purchases of property where the Taxpayer improperly tendered New Mexico nontaxable transaction certificates ("NTTCs") to the vendor.

12. Other New Mexico reporting errors made by the Taxpayer during the audit period included the following:

(a) The Taxpayer erroneously deducted receipts from construction projects and other services performed in New Mexico for nonprofit and governmental entities. The Taxpayer's controller told the auditor that no gross receipts tax was paid on these transactions because the Taxpayer's accounting software coded all such transactions as nontaxable.

(b) The Taxpayer erroneously deducted receipts from sales of tangible personal property and services that were not purchased for resale but were purchased for use by the Taxpayer's customer. In some cases, the Taxpayer accepted NTTCs not applicable to the transaction at issue. In other cases, the Taxpayer took deductions without having received any NTTC from its customer.

(c) The Taxpayer erroneously deducted receipts from transactions where the Taxpayer failed to obtain required NTTCs within the time limits set by New Mexico law.

(d) The Taxpayer misallocated receipts from certain construction projects by reporting the receipts to its business location rather than to the location of the construction project as required by New Mexico law.

(e) The Taxpayer made mathematical errors on the spreadsheets used to prepare its monthly CRS returns, resulting in errors in its New Mexico gross receipts tax and corporate income tax reporting.

13. On February 12, 2002, the Department issued Assessment No. 2747196 to the Taxpayer in the total amount of $116,072.61, representing $74,093.49 gross receipts tax, $1,904.91 compensating tax, $7,599.89 penalty, and $32,474.32 interest for reporting periods January 1995 through March 2001.

14. On March 13, 2002, the Taxpayer filed a written protest to the assessment.

15. The Taxpayer's protest challenged the Department's assessment of: (a) gross receipts tax and interest on the Taxpayer's receipts from Mevatech, a company from which the Taxpayer asserted it had a timely NTTC; (b) gross receipts tax and interest on the Taxpayer's receipts from sales of tangible personal property and services ordered by non-New Mexico companies and delivered to third parties located in New Mexico; and (c) penalty in the amount of $7,599.89.

16. At the September 24, 2002 administrative hearing, the Department stipulated that the Taxpayer is not liable for the gross receipts tax, penalty and interest assessed on its receipts from Mevatech. The Department's attorney stated that the portion of the assessment relating to these receipts will be abated.

17. At the September 24, 2002 administrative hearing, the Taxpayer withdrew its protest to all but the following amounts: (a) the tax, penalty and interest assessed on its receipts from

Mevatech, which the Department stipulated was not due; and (b) the $1,915.80 penalty assessed in connection with $348,663.50 of receipts from the 14 transactions listed in Taxpayer Exhibit B.

18. In each of the transactions listed in Taxpayer Exhibit B, the Taxpayer received an order for goods and services from a non-New Mexico company. The company directed the Taxpayer to deliver the goods and services to a third party located in New Mexico. With the exception of one sale made COD, the Taxpayer billed and received payment from the company placing the order, rather than from the business to which the goods and services were delivered.[1]

DISCUSSION

The sole issue to be determined is whether the Taxpayer is liable for the $1,915.80 penalty assessed in connection with its receipts from selling goods and services ordered by out-of-state companies and delivered to third parties located in New Mexico. The Taxpayer originally argued that these were out-of-state sales. It now concedes that its delivery of the goods and services in New Mexico created a liability for New Mexico gross receipts tax. The Taxpayer maintains, however, that its failure to pay tax on these transactions was not negligent or in disregard of rules and regulations. On this basis, the Taxpayer challenges the Department's assessment of the ten percent negligence penalty.

Section 7-1-17 NMSA 1978 provides that any assessment of taxes made by the Department is presumed to be correct. Section 7-1-3 NMSA 1978 defines tax to include not only the amount of tax principal imposed but also, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." Accordingly, the presumption of correctness applies to the assessment

[1] At the administrative hearing, the parties disagreed on the exact nature of these transactions. The Taxpayer maintained that it was selling equipment to out-of-state companies for subsequent lease in New Mexico. The Department took the position that the out-of-state companies were acting as financing agents for customers located in New Mexico. Neither party presented sufficient evidence to establish which characterization is correct. Such a determination is not necessary, however, since the parties now agree that the Taxpayer's sales of goods and services were sales made in New Mexico and were subject to New Mexico gross receipts tax.

of penalty at issue in this case, and it is the Taxpayer's burden to present evidence and legal arguments to justify an abatement. *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 779 P.2d 982 (Ct. App. 1989).

The Taxpayer's March 13, 2002 protest letter questioned application of the presumption of correctness in this case, arguing that the Department was required to give the Taxpayer a separate explanation for the assessment of penalty before the presumption could arise. There is no such requirement in New Mexico law. To the contrary, Section 7-1-30 NMSA 1978 states that "[a]ny amount of civil penalty and interest may be collected in the same manner as, and concurrently with, the amount of tax to which it relates, *without assessment or separate proceedings of any kind*." (Emphasis added). This statute relieves the Department from the burden of having to issue multiple assessments to reflect the continuing accrual of penalty and interest on outstanding tax liabilities. It also indicates that penalty and interest are such an integral part of a taxpayer's liability for unpaid tax that a separate assessment is unnecessary, much less a written explanation of the reasons for their imposition.

New Mexico's tax statutes and regulations provide taxpayers with ample notice of the legal basis for imposing penalty and interest, as well as the methods used to calculate them. Section 7-1-69 NMSA 1978 governs penalty. Subsection A imposes a penalty of two percent per month or any fraction of a month, up to a maximum of ten percent, that a taxpayer fails "due to negligence or disregard of rules and regulations" to pay taxes or file required tax reports in a timely manner. Taxpayer negligence for purposes of assessing penalty is defined in Regulation 3.1.11.10 NMAC as:

> A. failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
>
> B. inaction by taxpayers where action is required;

C. inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

New Mexico case law confirms that penalties may be assessed when a taxpayer's failure to pay tax is based on inadvertent error, erroneous belief, or a lack of knowledge of state tax law. *See, Arco Materials, Inc. v. Taxation & Revenue Department*, 118 N.M. 12, 16, 878 P.2d 330, 334 (Ct. App. 1994) *rev'd on other grounds* by *Blaze Construction Co. v. Taxation & Revenue Department*, 118 N.M. 647, 884 P.2d 803 (1994); *Vivigen, Inc. v. Minzner*, 117 N.M. 224, 231-232, 870 P.2d 1382, 1389-1390 (Ct. App. 1994); *El Centro Villa Nursing Center v. Taxation & Revenue Department*, 108 N.M. 795, 797-798, 779 P.2d 982, 984-985 (Ct. App. 1989).

In this case, the Department's audit established that the Taxpayer was in disregard of New Mexico's tax statutes and regulations. The audit report includes a detailed explanation of the ways in which the Taxpayer's reporting failed to comply with New Mexico law. The Department's audit also established that the Taxpayer's underpayment of tax was due to inadvertent error (mathematical errors), inaction where action was required (failing to review the tax codes used by its off-the-shelf accounting program to insure compliance with both Texas and New Mexico law); and a general inattention to and lack of knowledge of New Mexico's tax laws (failing to realize that New Mexico imposes a compensating tax, giving and accepting incorrect NTTCs, failing to obtain required NTTCs, reporting receipts to the wrong location, and believing that taxable transactions were not subject to tax).

The Taxpayer focuses its argument that it was not negligent on the 14 transactions listed on Taxpayer Exhibit B. These transactions involved the sale of tangible personal property and services ordered by out-of-state companies and delivered to third parties located in New Mexico. In each case (except for one sale made COD), the Taxpayer billed and received payment from the company placing the order. Although the Taxpayer now concedes that its delivery of goods and services in

New Mexico created a liability for the gross receipts tax, it argues that the transactions were so complex that the Taxpayer was justified in its belief that the sales were out-of-state sales not subject to tax by New Mexico. The Taxpayer argues that there "are no specific regulations or other clear guidance on this issue." (Taxpayer Exhibit A, p.7).

The Taxpayer's argument overlooks at least two decisions of the New Mexico Court of Appeals holding that a sale occurs in New Mexico when title and risk of loss pass to the purchaser in New Mexico and that tax may be imposed on those sales. *Pittsburgh & Midway Coal Mining Co. v. Revenue Division, Taxation & Revenue Department*, 99 N.M. 545, 554, 660 P.2d 1027, 1036 (Ct. App.1983); *See also*, *Proficient Food Co. v. New Mexico Taxation & Revenue Department*, 107 N.M. 392, 395, 758 P.2d 806, 809 (Ct. App. 1988), *cert. denied*, 107 N.M. 308, 756 P.2d 1203(1988) (upholding Department's determination that products delivered to restaurants in New Mexico were sold in New Mexico and subject to gross receipts tax, notwithstanding the fact that invoices were handled at the out-of-state corporate offices of the buyers and the taxpayer-seller). The New Mexico Supreme Court has also held that the term "sale" means "the passing of title and possession of property for money which the buyer pays, or promises to pay." *Bennett v. Western Surety Co*., 95 N.M. 13, 14, 618 P.2d 357, 358 (1980); *Raton Wholesale Liquor Co. v. Besre*, 49 N.M. 121, 125, 158 P.2d 295, 297 (1945).

The fact that an out-of-state company with business locations in New Mexico is subject to tax in New Mexico when it performs services or delivers goods into the state is not a new or particularly complex legal concept. There is no merit to the Taxpayer's argument that it was not negligent in failing to recognize that the 14 transactions at issue were subject to New Mexico gross receipts tax. Nor is there any merit to its argument that out-of-state companies should be held to a different standard of negligence than in-state companies. The gross receipts tax is imposed on the

privilege of engaging in business in New Mexico. Section 7-9-4 NMSA 1978. The Taxpayer has not provided any authority to support the proposition that in determining its New Mexico tax liability, an out-of-state company that has purposefully availed itself of the privilege of conducting business in this state, and derived economic benefit from doing so, should be held to a lower standard of care than in-state companies.

In *Tiffany Construction Co. v. Bureau of Revenue*, 90 N.M. 16, 17, 558 P.2d 1155, 1156 (Ct. App. 1976), *cert. denied*, 90 N.M. 255, 561 P.2d 1348 (1977), the Court of Appeals stated that "every person is charged with the reasonable duty to ascertain the possible tax consequences of his action." The court noted that this duty may be discharged by consultation with a legal advisor. *See also,* Department Regulation 3.1.11.11(D) NMAC, which provides that a taxpayer's reasonable reliance on the advice of a qualified professional "as to the taxpayer's liability after full disclosure of all relevant facts" may negate a finding of negligence. In this case, the Taxpayer engaged a Texas CPA to prepare its corporate income tax returns. The Taxpayer relied on its controller, Paul Bidwell, to report and pay its sales and gross receipts taxes. Mr. Bidwell was not a CPA, and his education and accounting experience was limited to Texas. Although the Taxpayer's president testified that Mr. Bidwell attended various gross receipts tax seminars in New Mexico, there is no evidence to establish who conducted the seminars or what topics were covered. Given the fact that Mr. Bidwell did not know New Mexico had a compensating tax, did not know that receipts from services sold to nonprofit and governmental entities were subject to gross receipts tax, and did not understand the proper use of New Mexico NTTCs, it is apparent that the seminars were of limited application. Mr. Bidwell did not qualify as a "legal advisor" or "qualified professional" with regard to New Mexico tax law. Nor is there any indication that Mr. Bidwell ever discussed the Taxpayer's liability for

gross receipts tax on the 14 transactions at issue with the Taxpayer's CPA. In the absence of such evidence, the requirements for a finding of nonnegligence are not met.

As its final point, the Taxpayer raises a de minimis argument. During the audit period, the Taxpayer engaged in approximately 500 to 600 business transactions each month. Because the Taxpayer entered into only three or four of what it denominated as "leasing transactions" each year, the Taxpayer argues that its failure to properly report these transactions to New Mexico is insignificant and does not qualify as negligence. There are several problems with this argument.

First, the Taxpayer has not identified how many of its monthly transactions occured in New Mexico. The only basis for calculating an accurate percentage of error in reporting New Mexico gross receipts tax is to compare unreported New Mexico gross receipts tax to the total amount of New Mexico gross receipts tax due for the same period. Comparing unreported New Mexico tax (or transactions) to the total of tax (or transactions) everywhere renders the results meaningless. Assume, for example, that the Department audits a company that failed to report 10 out of 50 transactions occurring in New Mexico. This results in an error rate of 20 percent. Assume further that during the same period the company had 1,000 transactions nationwide. Comparing the 10 unreported New Mexico transactions to total transactions everywhere reduces the error rate to one percent, a clear distortion of the Taxpayer's New Mexico underreporting. Using the Taxpayer's approach, any company that transacts most of its business outside New Mexico would be deemed nonnegligent in failing to pay New Mexico tax because its New Mexico error rate would always be insignificant when compared to the company's total business volume.

The second problem with the Taxpayer's reasoning is its failure to acknowledge that the 14 transactions at issue represent only a small number of the errors made during the audit period. Due to the Taxpayer's lack of knowledge of New Mexico law, the Taxpayer failed to pay compensating

tax on property brought into New Mexico, failed to pay tax on sales of services to nonprofit and governmental entities, failed to obtain NTTCs required to support its deductions, and issued incorrect NTTCs to its customers. The Taxpayer's failure to pay tax on receipts from selling goods and services ordered by out-of-state companies and delivered to third parties located in New Mexico was also based on its lack of knowledge and its erroneous belief that such transactions were not subject to New Mexico gross receipts tax. There is no basis to find that this error was any less negligent than the other errors set out in the Department's audit report.

Finally—and most importantly—the Taxpayer's argument misinterprets New Mexico's penalty statute. Section 7-1-69(A) NMSA 1978 imposes a penalty of up to 10 percent "in the case of failure due to negligence or disregard of rules and regulations...to pay when due the amount of tax required to be paid...." The focus is on the amount of tax not paid. The statute does not provide a de minimis exception, and the fact that a taxpayer may have paid 99 percent of its tax correctly is irrelevant. If the failure to pay the remaining one percent of tax is due to the taxpayer's negligence as defined in New Mexico's regulations and case law, penalty is due on that one percent.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2747196, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer was negligent in failing to pay gross receipts tax due on the 14 transactions listed in Taxpayer Exhibit B, and the 10 percent negligence penalty was properly imposed pursuant to Section 7-1-69(A) NMSA 1978.

For the foregoing reasons, the Taxpayer's protest IS DENIED, except with respect to the tax, penalty, and interest related to the Taxpayer's receipts from Mevatech, which the Department is ordered to abate.

DATED October 2, 2002.