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

IN THE MATTER OF THE CONSOLIDATED
PROTESTS OF **TECO INVESTMENTS, INC.**,
ID. NO. 02-121553-00 7, PROTEST TO
ASSESSMENT NO. 1914991; AND NO. 96-27
CHINO MINES COMPANY, ID. NO.
02-067168-00 7, PROTEST TO DENIAL
OF CLAIM FOR REFUND.

DECISION AND ORDER

This matter comes on for determination before Gerald B. Richardson, Hearing Officer, on the basis of stipulated facts and documentary evidence and briefs of the parties. Teco Investments, Inc., hereinafter, "Teco," was represented by Curtis W. Schwartz, Esq. Chino Mines Company, hereinafter, "Chino," was represented by Paul D. Barber, Esq. The Taxation and Revenue Department, hereinafter, "Department," was represented by Margaret B. Alcock, Special Assistant Attorney General. Because the protests of Teco and Chino are based upon the same transactions, and because these two taxpayers moved that these matters be consolidated for determination, these matters were consolidated for purposes of this administrative adjudication.

Based upon the stipulated facts, exhibits and the briefs of the parties, IT IS DECIDED AND ORDERED as follows:

FINDINGS OF FACT

1. Teco is a Florida corporation whose corporate headquarters and its principal place of business are located in Tampa, Florida. Florida is Teco's commercial domicile.

2. As its name suggests, Teco's principal business activity is investments.

3. Chino is a New Mexico general partnership between Phelps Dodge Chino, Inc. and Heisei Minerals.

4. Phelps Dodge Chino, Inc. is a wholly owned subsidiary of Phelps Dodge Corporation, a New York corporation with its principal place of business in Phoenix, Arizona.

5. Heisei Minerals is a wholly owned subsidiary of Mitsubishi Corporation.

6. Chino was formed in March, 1981 for the purpose of owning and operating a copper mine located in Hurley, New Mexico. Chino is a New Mexico general partnership whose original partners were Kennecott Santa Fe, a subsidiary of Kennecott Copper, and MC Minerals Corporation, a subsidiary of Mitsubishi Corporation. Kennecott Santa Fe owned a two-thirds interest in Chino. MC Minerals Corporation owned a one-third interest in Chino.

7. Chino has owned and operated a copper mine located in Hurley, New Mexico since 1981.

8. Effective January 1, 1987, Phelps Dodge Chino, Inc. purchased Kennecott Santa Fe's two-thirds interest in Chino. At approximately the same time, Mitsubishi restructured its ownership of Chino resulting in Heisei Minerals' ownership of Mitsubishi's one-third interest in Chino.

9. Phelps Dodge Chino, Inc. is the managing general partner of Chino.

10. In 1987, Chino desired to acquire certain tangible personal property, including haul trucks, loaders and pick-up trucks. Chino determined that leasing the equipment was preferable to outright purchase. On November 13, 1987 Chino entered into an agreement, called the Master Equipment Lease Agreement, (hereinafter the "equipment lease") with Teco for the equipment it desired. Under the terms of the lease, the total cost of the equipment to be leased was not to exceed $ 7,800,000.

11. In 1987, Teco determined that it wanted to develop a leveraged lease portfolio. A leveraged lease is a lease whereby Teco borrowed money to purchase equipment which it would, in turn lease to a third party, with the lease payments structured so that the payments over the life of the lease pay for Teco's debt service costs and provides a profit margin for Teco as well.

12. To develop a leveraged lease portfolio, Teco hired a specialist in leveraged leases. That person worked primarily through a broker or series of brokers to acquire leveraged leases. Teco's leveraged lease operation was essentially a one person operation.

13. One of the leveraged leases acquired by Teco with the assistance of a broker was the equipment lease with Chino.

14. Approximately two years after Teco had commenced its initiative to establish a leveraged lease portfolio, it had entered into only nine or ten leases for various types of equipment. Teco then altered its course and determined that it no longer wanted to expand into leveraged leases. As a result, the position of the person who conducted Teco's leveraged lease investment function was eliminated. Teco, however, maintained its investment in the leveraged leases in which it had already invested.

15. The Treasurer's office of Phelps Dodge Corporation arranged for the financing and equipment leasing on behalf of Chino. The actual financing and leasing was arranged through a broker.

16. Teco worked through the broker. Almost all of Teco's contact regarding the transaction was with the broker. There was little direct contact, if any, between Teco and Chino. Financing for the transaction was provided through Atlantic Leasing and Financial, Inc. The actual leasing was done by Teco.

17. Teco lease equipment to Chino pursuant to the equipment lease. All equipment leased pursuant to the equipment lease was tangible personal property. All such leased equipment was located in New Mexico at Chino's Hurley, New Mexico mine.

18. Teco has never had, nor does it now have, property in New Mexico other than the equipment leased pursuant to the equipment lease with Chino.

19. Teco has never had, not does it now have, any office, employees, sales people, or any business location in New Mexico.

20. Teco's only contact with New Mexico involves the use by Chino of equipment leased to it by Teco pursuant to the Equipment lease. Teco has no other property in New Mexico.

21. Paragraph 12 of the equipment lease sets out each party's obligations in connection

with taxes. In pertinent part, it provides that Chino agrees to pay and on demand to indemnify Teco for any taxes, together with any applicable penalty and interest which may be imposed upon the ownership, leasing renting, sale possession or use of the equipment leased, except for income taxes on Teco's net income. It further provides that Teco is to notify Chino of any claims made by any taxing authorities against Teco for any taxes which would be subject to indemnification and it allows for Chino to contest any such tax claims. It further provides that Teco shall file, at Chino's expense, any returns required with respect to New Mexico taxes on gross receipts and Chino shall cause, to the extent permitted by law, all billings of taxes to be made to Teco in care of Chino, and Chino is to make payment of such billings.

22. Teco understood that Chino had undertaken to remit whatever transaction taxes were due with respect to the leasing of the mining equipment in New Mexico.

23. Teco relied on Chino Mines for compliance with any and all New Mexico transaction tax obligations under the equipment lease. Teco did not consult a tax advisor or contact the Department to determine whether Teco was in compliance with the Department's views of Teco's obligations under New Mexico tax laws.

24. Teco did not report and pay gross receipts tax with respect to amounts paid to it by Chino for the lease of the equipment pursuant to the equipment lease.

25. Because Teco does not have a place of business in New Mexico, if Teco is subject to the gross receipts tax, it is not subject to "local option gross receipts tax" as defined in Section 7-9-3(Q) NMSA 1978. Rather, it would be subject to tax at the state tax rate. Assessment no. 1914991 imposes gross receipts tax at the state tax rate only.

26. The state tax rate and the compensating tax rate are identical.

27. The Department will allow one person to pay taxes on behalf of another person, upon filing a Form TS-22 , Agreement to Collect and Pay Over Taxes. No one has filed a Form TS-22 with the Department to pay gross receipts taxes on behalf of Teco with regard to receipts from the

equipment lease.

28. In late 1994, the Department conducted an audit of Teco. On March 30, 1995 the Department mailed Assessment no. 1914991 ("the Assessment") to Teco. The reporting periods with respect to which the Assessment was issued covered a seven year period commencing on January 1, 1988 and ending on December 31, 1994.

29. Because Teco had not filed any CRS-1 reports (the reports used for reporting gross receipts tax) with the Department, the Department invoked the extended statute of limitations for assessment of taxes contained in Section 7-1-18(C) NMSA 1978 which provides that in the case of the failure of a taxpayer to complete and file any return, the Department may assess tax at any time within seven years from the end of the calendar year in which the tax was due.

30. The Assessment asserted that the following amounts of gross receipts tax, penalty and interest were due and owing by Teco:

gross receipts tax	$ 374,777.47	
penalty	$ 37,473.13	
interest	$ 212,487.92	
Total		$ 624,738.52

31. The audit determined that Teco had not reported and paid gross receipts tax with respect to its receipts derived from leasing tangible personal property located in New Mexico to Chino. The amount of the tax assessed with respect to this issue is approximately $364,587.

32. The audit also determined that Teco had not reported and paid gross receipts tax with respect to its receipts derived from the sale of tangible personal property in New Mexico. In December, 1992, after the lease with Chino of specific equipment had expired, Teco sold that equipment. The sale took place in New Mexico. The total amount of gross receipts tax assessed with respect to the equipment sale issue was approximately $10,190.47.

33. On April 11, 1995, Teco timely filed a request for additional time to file a written protest to the Assessment. Responding to this request, the Department granted Teco until June 28, 1995 to file its protest. Teco filed its written protest to the Assessment on June 2, 1995. Teco's

protest was limited to the amounts of tax, penalty and interest assessed pursuant to the Assessment relating to receipts derived from leasing tangible property located in New Mexico to Chino. Teco did not protest the portion of the Assessment imposing tax on receipts derived from the sale of equipment in New Mexico.

34. Since its formation in 1981, Chino has on a monthly basis filed CRS-1 Reports with the Department.

35. Each monthly report filed by Chino included a report of Chino's compensating tax liability, if any, and such reports were accompanied by full payment of any compensating tax liability.

36. Chino reported and paid compensating tax to the Department at the applicable compensating tax rate with respect to all amounts paid by it to Teco for lease of equipment pursuant to the equipment lease.

37. Commencing in late 1987, each CRS-1 Report filed by Chino included a compensating tax liability respect to the lease payments made by Chino to Teco for equipment leased by Chino from Teco pursuant to the equipment lease. All leased equipment was used by Chino in New Mexico.

38. Chino did not contact the Department to determine whether Chino's reporting was in compliance with the Department's views of Chino's obligations under the equipment lease.

39. Chino paid compensating tax on the amounts paid by it to Teco for the lease of the equipment because it was Chino's understanding that it was required to do so under its contractual obligations pursuant to paragraph 12 of the equipment lease.

40. In 1995, it was brought to the attention of Chino that the Department had assessed Teco for gross receipts tax, penalty and interest with respect to receipts derived by Teco from the lease of equipment to Chino pursuant to the equipment lease.

41. Chino believes that, pursuant to paragraph 12 of the equipment lease, that it is also contractually obligated to indemnify and hold Teco harmless of any and all taxes, penalty and interest

imposed upon Teco with respect to the lease of the equipment leased pursuant to the equipment lease.

42. On December 28, 1995, Chino filed with the Department a claim for refund in the amount of $ 393,168.57 for compensating taxes paid by it with respect to its lease payments to Teco pursuant to the equipment lease for the reporting periods of February, 1988 through December, 1994.

43. The Department granted Chino's refund claims for the reporting periods occurring during calendar years 1992, 1993 and 1994, and refunded Chino the sum of $ 178,281.38.

44. Chino did not request, nor did the Department refund any interest with respect to the amount which it refunded to Chino.

45. On January 16, 1996, the Department denied Chino's refund claims for the reporting periods occurring during calendar years 1988, 1989, 1990 and 1991 on the basis that the statute of limitations for claiming refunds of tax for those reporting periods had expired.

46. On February 14, 1996, Chino timely filed a protest to the Department's denial of its claims for refund for 1988, 1989, 1990 and 1991.

47. Chino is willing to withdraw its protest to the Department's denial of its refund claims to the extent that it is allowed to equitably recoup against any liability of Teco pursuant to the Assessment.

DISCUSSION

This case is an unusual case in many respects. It is procedurally unusual in that the protests of two separate taxpayers, Chino and Teco have been consolidated for resolution because their determination hinges on a common set of facts, and resolution of this case, because of the contractual relationship between the taxpayers, necessarily implicates both taxpayers.[1] It is also unusual in that it calls for a determination of whether the doctrine of equitable recoupment should be applied to take into account compensating taxes paid by Chino on its lease of equipment from Teco in determining

[1] The consolidation of these separate protests was requested by the two taxpayers and each has agreed that the administrative record may be made open to the other, thereby removing any concerns about the confidentiality of these proceedings between the two taxpayers pursuant to Section 7-1-8 NMSA 1978.

Teco's gross receipts tax liability for leasing the same equipment to Chino. The doctrine of equitable recoupment has only recently been incorporated into New Mexico tax jurisprudence and the extent of its application is at the core of the dispute between these Taxpayers and the Department.

The essential facts are undisputed. In late 1987, Teco entered into a lease agreement with Chino whereby it agreed to lease several millions of dollars of equipment to Chino for use at its copper mine in Hurley, New Mexico. Teco did not report and pay gross receipts taxes upon its receipts from renting the equipment, but Chino erroneously paid compensating tax on its lease payments to Teco. These actions were taken on the basis of the parties' understanding of their obligations under the lease agreement, although the obligations imposed by the lease agreement are disputed between the Department and the Taxpayers and will be discussed at more length later in this decision. The gross receipts tax rates applied to Teco and the compensating tax rates paid by Chino were identical due to the fact that Teco is entitled to report at a rate, due to its out-of-state location, that includes no local option gross receipts taxes.

In 1995 the Department assessed Teco over $500,000 in gross receipts taxes, penalty and interest for failing to report and pay gross receipts taxes upon its lease receipts. In issuing the assessment, the Department was able to assess back to 1988 due to the seven year statute of limitations[2] which applies when there has been a failure to file returns reporting and paying taxes. Upon learning that Teco had been assessed gross receipts tax upon its equipment lease receipts by the Department, Chino filed a claim for refund, seeking to recover the compensating taxes it had paid on the same lease transactions, from 1988 forward. The Department allowed the claim for the 1992, 1993 and 1994 tax years as those fell within the three year statute of limitations for claiming refund of tax, pursuant to Section 7-1-26(B)(1) NMSA 1978, but it denied the claim for prior years on the basis that Chino's claim was barred by the statute of limitations. Chino has protested the denial of its refund claims on the basis that their claim is not barred by the statute of limitations, but it has agreed

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[2] Section 7-1-18(C) NMSA 1978.

that if equitable recoupment is applied, which it argues it should be, that it will withdraw its protest.

Teco has protested the assessment of tax on its lease receipts on the basis that equitable recoupment should be applied to allow Teco credit against the assessment for the compensating taxes paid by Chino. Alternatively, Teco alleges that any imposition of gross receipts taxes would violate the Commerce Clause of the United States Constitution because there exists insufficient nexus with New Mexico for the Department to be allowed to impose its taxes.

THE CLAIM OF EQUITABLE RECOUPMENT

Because the issue of equitable recoupment is common to both protests and, if applied, would resolve these protests without the need to address the other issues raised, it will be addressed first. The doctrine of equitable recoupment in the context of tax administration has been developed in the federal courts. The doctrine was first applied by the Supreme Court in ***Bull v. United States***, 295 U.S. 247, 55 S.Ct. 695, 79 L.Ed. 1421 (1935). In that case, the Internal Revenue Service, "IRS", required an estate to include in its value and to pay estate tax upon a decedent's share of partnership income. The IRS subsequently determined that the partnership income should be included as income to the estate, upon which income tax was due, and sought to collect the income tax. Thus, the same transaction was subjected to both estate and income tax. The estate filed suit and sought either a refund of the estate tax paid or to recoup the estate tax paid against any income tax deficiency. The lower court ruled that the matter taxed was properly taxed as income to the estate and although it had been improperly classified as an asset of the estate for estate tax purposes, that the statute of limitations for refund of the estate tax had expired, preventing any refund or credit against income taxes for that erroneously collected tax. The Supreme Court agreed that the estate's action for refund of the estate taxes was barred by the statute of limitations, but it reversed the lower court and applied the doctrine of equitable recoupment to allow the estate to claim a credit against its income taxes for the erroneously paid estate taxes.[3] In applying equitable recoupment, the Court noted:

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[3] There was no statute of limitations problem with respect to the litigation over the imposition of income tax upon the estate. Thus, there was no jurisdictional bar to the court acting upon the IRS' claim to income taxes

> While here the money was taken [by the federal government] through mistake without any element of fraud, the unjust detention is immoral and amounts in law to a fraud on the taxpayer's rights.

Id., 295 U.S. at 261.

The doctrine of equitable recoupment has only recently been adopted into the jurisprudence of New Mexico. It was first addressed in ***Vivigen, Inc. v. Minzner***, 117 N.M. 224, 870 P.2d 1382 (Ct. App. 1994). In its discussion of the doctrine, the Court of Appeals emphasized the limited application of the doctrine as it has been applied in federal tax cases because of the inherent tension between the government's need for certainty and finality with respect to its tax revenues, which statutes of limitation provide, and the need to assure that the government is not treating taxpayers unfairly by taxing them twice on the same transaction under inconsistent theories. Vivigen, Inc. sought to have equitable recoupment applied to receive a credit against its compensating tax liability for an investment tax credit which it had failed to apply for within the statute of limitations. The court denied equitable recoupment because the state had not sought to tax the same transaction on inconsistent theories. Additionally, the court found that the equities did not favor Vivigen's claim, because there had been, "[N]o conduct by the State--in particular, no conduct inconsistent with the State's present contentions--[which] prevented Vivigen from timely claiming an investment credit if one was available." *Id*. at 231, 870 P.2d at 1389.

Although the Court of Appeals declined to apply equitable recoupment in ***Vivigen***, it held that New Mexico would follow the weight of authority from other states and would adopt the standard set forth by the federal courts for application of the doctrine of equitable recoupment to tax collections. Specifically, the court stated:

> In particular, we hold that a taxpayer is not entitled to seek a credit after the statute-of-limitations period has expired unless the state is imposing a tax on the same taxable event on a ground that is inconsistent with the original payment by the taxpayer.

Id. at 231, 870 P.2d at 1389.

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and applying equitable recoupment to resolve the issue of liability for those taxes.

The issue of equitable recoupment of taxes was visited once again by the Court of Appeals in ***Siemens Energy and Automation, Inc v. Taxation and Revenue Department***, 119 N.M. 316, 889 P.2d 1238 (Ct. App. 1994). In that case, the taxpayer sought to have equitable recoupment applied to relieve it of gross receipts tax assessed upon some of its sales of equipment in New Mexico on the basis that the purchasers of the equipment had paid compensating tax upon their purchase of the equipment. This case provided the court with the opportunity to apply the other requirement of equitable recoupment developed in the federal case law, which is when equitable recoupment is claimed where multiple taxpayers are involved in the same transaction there must be a strict identity of interest between those taxpayers. In ***Siemens***, the court denied equitable recoupment because such identity of interest did not exist. As stated by the court:

> While the compensating use tax and gross receipts tax would both tax the same event, Siemens' sale of equipment, there is not an identity of interest between the purchasers and sellers. Siemens and the purchasers are totally distinct entities that do not have an identity of interest. A savings to Siemens under equitable recoupment would not necessarily redound to the benefit of the purchasers. This lack of congruity between Siemens and the purchasers is emphasized by the fact that, by paying compensating tax rather than gross receipts tax, the purchasers did not pay the additional amount local governments are entitled to under the gross receipts tax. NMSA 1978, § 7-9-3(Q) (Supp. 1994).

Id. at 323, 889 P.2d at 1245.

Thus, the requisites which must be established in this case before equitable recoupment can be applied are (1) that there is one taxable event, (2) that taxes have been assessed on that same transaction on an inconsistent basis, and (3) that there is a strict identity of interest between Chino and Teco with respect to the taxed transaction.

There can be no doubt that the first requisite has been met, because the taxable event was Teco's lease of equipment to Chino. It is that event upon which the Department's seeks to assess gross receipts tax and it is that taxable event upon which Chino reported and paid compensating tax.

The second requisite has also been met. Although there is no language in the statute which imposes compensating tax, NMSA 1978, Section 7-9-7, to support a conclusion that compensating tax

could have been imposed upon a lease of property in the circumstances of this case,[4] the gross receipts tax and the compensating tax are designed to be complementary and mutually exclusive. Compensating tax is only assessed when gross receipts tax was not paid on the transaction. With there being no statutory basis for imposing compensating tax upon Chino's lease of the equipment, and there being no dispute between the parties that Teco's lease receipts are subject to gross receipts tax, I have little difficulty in concluding that an inconsistency exists between the imposition of the two taxes on the lease transaction.

With respect to the third requisite, a strict identity of interest when multiple taxpayers are involved, ***Siemens*** makes it clear that it is not enough to establish that both compensating tax and gross receipts tax have been paid or imposed on the same transaction. *Id.*, 119 N.M. 316, 889 P.2d at 1245. To paraphrase the Court of Appeals, there must be an identity of interest such that a savings to the taxpayer claiming equitable recoupment would necessarily redound to the benefit of the other taxpayer. That requirement is met in this case because of the indemnification agreement with respect to taxes which existed between TECO and Chino. Specifically, paragraph 12(a) of the lease agreement provided:

> Lessee [Chino] agrees *to pay and on demand to indemnify and hold lessor* [Teco] *harmless from all* license fees, registration fees, *assessments, charges and taxes, together with any penalties or interest applicable thereto, which may now or hereafter be imposed upon* the ownership, *leasing*, renting, sales possession or use of the Equipment, excluding however, all taxes on or measured by Lessor's net income. (emphasis added)

[4] The only circumstances where compensating tax may apply where the leasing of property in New Mexico is involved would be where a deduction from gross receipts tax was claimed pursuant to Section 7-9-49, where tangible personal property was bought tax free by the delivery of a non-taxable transaction certificate by the purchaser who purported that the property was being purchased for leasing or resale, and the purchaser does not use the property for those purposes, or where a deduction was claimed under section 7-9-50 because the lessee of property delivered a non-taxable transaction certificate to a lessor of property to lease property free of gross receipts tax on the grounds that the property would be released by the lessee. In both of these circumstances, because the issuer of the non-taxable transaction certificates subsequently uses the property in a way that does not conform to the requirements for the issuance of a non-taxable transaction certificate, the issuer would be subject to compensating tax on the use of the property pursuant to Section 7-9-7(A)(3).

This provision requires Chino to indemnify Teco for any taxes, and applicable penalties or interest imposed upon the leasing of the equipment. Thus, to the extent that Teco is found liable for gross receipts tax on the lease of the equipment, Chino is bound to indemnify Teco. If Teco's claim of equitable recoupment is granted, Chino will be directly benefitted in the identical amount which Teco equitably recoups. Additionally, since Chino has stipulated to the withdrawal of its protest to the denial of its refund claim if Teco's claim for equitable recoupment is granted, there would be no double or disproportionate tax benefit to Chino. The other matter the Court of Appeals relied upon in ***Siemens*** as demonstrating a lack of identity of interest, the incongruity in the tax rates between the gross receipts tax and the compensating tax, does not exist in this case. That is because as an out-of-state taxpayer with no business location in New Mexico, Teco would report gross receipts tax at the state rate only. Without local option gross receipts taxes, the state gross receipts tax rate and the compensating tax rate are the same.

Thus, Teco has met the three conditions necessary for making a claim for equitable recoupment. The Department has argued that Teco's claim for equitable recoupment would be barred in any event because Chino's payment of compensating tax was voluntary. In making this argument, the Department relies upon the language in ***Siemens*** where the Court of Appeals, in first addressing Siemens' claim for a credit against gross receipts taxes due from it for compensating taxes paid by its purchasers stated:

> However, voluntary payment of compensating tax by the purchaser does not relieve the seller of liability for gross receipts tax otherwise collectible. ***Proficient Food Co. v. New Mexico Taxation & Revenue Dept.***, 107 N.M. 392, 397-398, 758 P.2d 806, 811-812 (Ct. App.), *cert. denied*, 107 N.M. 308, 756 P.2d 1203 (1988).

Teco and Chino have responded to the Department's argument by arguing that the payment of compensating taxes was not voluntary by Chino because such payment was required by the terms of the lease agreement between the parties. I disagree that there is anything in the contractual agreement which made the payment of compensating taxes involuntary on Chino's part. In the first place, the contract makes no reference to payment of compensating taxes by Chino, but rather,

specifically requires Teco to file gross receipts tax returns. Paragraph 12(C) of the contract provides as follows:

> Lessee [Chino] shall timely prepare and file all reports and returns which are required to be made with respect to any obligation of Lessee under, or arising out of, Section 12(a) [the paragraph providing for indemnification of taxes] hereof, *except that Lessor [Teco] shall file, at Lessee's expense, any returns required with respect to New Mexico taxes on gross receipts.* (Emphasis added.)

Even if the contract did require Chino to pay compensating taxes, I would still not consider the payment to be involuntary, since the contractual terms were negotiated and freely entered into between the parties.

Regardless of whether the payments were voluntary or involuntary, however, I believe that the Department's reading of the language from ***Siemens*** as a complete bar to the application of equitable recoupment when compensating tax was voluntarily paid misreads the Court's meaning when it used the language in issue. While there can be no disagreement with the court's statement of law that the voluntary payment of compensating tax does not relieve a seller of its liability for gross receipts tax, the court's citation to the *Proficient Foods* case is instructive, because the doctrine of equitable recoupment was not raised in that case. Even more instructive is the court's treatment of the equitable recoupment issue in the remainder of its decision in ***Siemens***. Following the citation to *Proficient Foods*, the court goes on to state that, "[S]iemens seeks to avoid this rule by reliance upon the doctrine of equitable recoupment." The court then went on to analyze whether the application of equitable recoupment was appropriate under the facts of the case and under the law of equitable recoupment. If application of equitable recoupment was barred in circumstances where compensating tax had been paid voluntarily by a purchaser rather than gross receipts tax being paid by a seller, there would have been no reason for the court to make any analysis about equitable recoupment and its applicability. Thus, I read the court's decision as recognizing that equitable recoupment can be applied even when compensating tax has been voluntarily paid, if application of equitable recoupment is appropriate.

Even though the voluntariness of a tax payment is not a bar to the application of equitable recoupment, consideration of the voluntariness of tax payment may be appropriate when determining whether equitable recoupment should be applied. This is because I read the case law applying equitable recoupment to also require an analysis of whether equitable considerations render the application of equitable recoupment appropriate even though the bottom line requisites for applying the doctrine have been met. From the genesis of the doctrine in tax cases, ***Bull v. U.S.***, *supra,* equitable considerations weighed heavily in whether the doctrine would be applied. In addition to the fact that the IRS had taken inconsistent positions with regard to which tax should be applied, a significant factor in the Supreme Court's decision to allow the equitable recoupment of the estate taxes which the IRS had erroneously assessed was the coercive nature of the government's tax collection procedures themselves. Not only had the IRS taken action initially to impose (erroneously) and collect estate taxes, but it initiated a subsequent action to collect income taxes on the same transaction, and because a claim for refund of the estate taxes was barred by the statute of limitations, the only avenue of recourse for the taxpayer was to pay the income taxes and seek refund of them as a means to challenge the IRS' action. *See, Id.* 295 U.S. at 259-263.

The Court of Appeals in its ***Vivigen*** decision also looked beyond the bare requisites of equitable recoupment in determining whether equitable recoupment was warranted. After determining that Vivigen did not qualify for equitable recoupment of an investment tax credit against its compensating tax liability because there had been no taxation by the state on an inconsistent basis, the court went further in its analysis and evaluated the equities of Vivigen's claim as well. In that case, Vivigen's claim for an investment credit was barred by the statute of limitations but Vivigen sought to have the investment credit claim applied, on the basis of equitable recoupment, to the Department's claim for compensating taxes. In examining the equities the Court found it significant that:

> No conduct by the State--in particular, no conduct inconsistent with the State's present contentions--prevented Vivigen from timely claiming an investment credit if one was available. Any equity favoring Vivigen here is not of sufficient magnitude to justify

> overriding the limitations period of Section 7-9-8(A). We therefore reject Vivigen's claim of equitable recoupment.

Id., 117 N.M. at 231.

Thus, the Court of Appeals found it significant to examine the conduct of the state taxing authorities in weighing the equities before determining whether equitable recoupment was appropriate in a given case.

An examination of the equities in this matter reveals a significant equity in favor of the taxpayers, the fact that if equitable recoupment is not allowed, the effect will be to allow the imposition of both gross receipts tax, and compensating tax on the same lease receipts, as well as the imposition of interest and possibly penalty on the same transaction. It should be the goal of the taxing authorities to only collect the correct tax, and to collect it only once from a taxable transaction.[5] An examination of the equities surrounding the circumstances which caused the erroneous payment of compensating tax by Chino and Teco's failure to report and pay gross receipts taxes is not so favorable to the taxpayer's however. Teco made no effort to determine its tax liability under the lease agreement. Although the agreement required Teco to file gross receipts tax returns, Teco made no attempt to do so, and it made no inquiry of a tax professional or the Department concerning its tax obligations under the lease agreement. Additionally, there was also no evidence that Teco made a written request under the terms of the lease agreement (or any other less formal request) to confirm that Chino had acted to satisfy Teco's tax obligations. Teco apparently just presumed that, somehow, its tax obligations were being taken care of.

The equities are no more favorable for Chino. As noted earlier in this decision, there was no basis under the compensating tax statutes or regulations for Chino to conclude that compensating tax was payable on its lease of equipment in New Mexico. Nor did Chino follow the terms of its own lease agreement, which required Teco to file, at Chino's expense, gross receipts tax returns. Chino

[5] In this regard, it is should be noted that the Department promptly refunded all of the compensating tax which Chino sought to have refunded which was allowable under the statute of limitations, upon being put on notice that compensating tax had been erroneously paid by Chino.

made no inquiry of the Department or of a tax professional to determine the tax consequences of the lease transaction. Chino has never offered an explanation as to how it concluded to report and pay compensating taxes.[6] It is noteworthy, that in this regard, the Department does have a procedure whereby one taxpayer may pay gross receipts taxes on behalf of another taxpayer. By filing a Form TS-22, Agreement to Collect and Pay Over Taxes, Chino could have properly reported and paid gross receipts tax on behalf of Teco and received all notices and assessments issued in connection with Teco's liability for New Mexico gross receipts tax. If Chino had made inquiry of the Department, it could have learned of this procedure and avoided its present dilemma.

Thus, even though an erroneous tax was paid, the two taxpayers have only themselves to blame for this situation. Unlike the situation in ***Bull v. United States***, there was no action, coercive or otherwise, by the taxing authority, which in any way caused the erroneous payment of the compensating taxes which the taxpayers seek to equitably recoup. As noted above, the Department was never consulted concerning the proper way to handle the taxes on the lease transaction. When Chino filed its monthly tax returns reporting compensating taxes, the Department had no way of knowing that compensating tax was being reported erroneously, since the return merely reports an amount of compensating tax being self-assessed and provides no detail of the transactions involved. The Department did not assess the compensating taxes, it only accepted Chino's own declaration of its tax liability. It is also significant that the Department took no action which would have prevented Chino from making a timely refund claim for the erroneously paid compensating tax. Finally, it promptly refunded the erroneously paid taxes which it was authorized to refund within the statute of limitations upon being informed that the taxes were erroneously paid by the filing of Chino's refund claim. In short, to paraphrase the language quoted just above from ***Vivigen***, there has been no

[6] Although the record is completely silent as to the basis for Chino's decision to report compensating taxes, and in this case, because Teco has no business location in New Mexico, the tax rates are the same, it is conceivable that Chino, as a large and significant taxpayer with lots of taxable activities in New Mexico, was aware that, as noted in the ***Siemens*** decision, in most cases, the amount of compensating tax is less than the amount of gross receipts tax imposed on a transaction because compensating tax does not include the local option gross receipts taxes imposed by counties and municipalities.

conduct by the state--in particular, no conduct inconsistent with the State's present contentions--which prevented Chino from timely claiming a refund of the compensating taxes which it erroneously paid and reported. Given the Court of Appeals' emphasis on the narrow scope of equitable recoupment because of the tension application of the doctrine creates with statutes of limitation, and given the Court of Appeals' emphasis on whether conduct by the taxing authority caused the problem resulting in the imposition of two taxes on inconsistent bases, it must be concluded that the circumstances of this case do not warrant the application of equitable recoupment of the erroneously paid compensating taxes for which the claim for refund is barred.

NEXUS

Teco argued, in the alternative that equitable recoupment was denied, that because Teco has no employees, office, sales people or business location in New Mexico and since its only activity with respect to New Mexico was the leasing of the equipment to Chino under the lease agreement, that it lacks "substantial" nexus with New Mexico and as such, it would violate the Commerce Clause to allow the imposition of the tax at issue.

Under the first prong of the four-part Commerce Clause test applied in ***Complete Auto Transit, Inc. v. Brady***, 430 U.S. 274, 279, 97 S.Ct. 1076 (1977), one of the requirements to sustain a tax against a Commerce Clause challenge is that the tax must be applied to an activity with a "substantial" nexus with the taxing state. More recently, in ***Quill Corporation v. North Dakota***, 504 U.S. 1904, 112 S.Ct. 1904 (1992), the Supreme Court distinguished between the "minimum contacts" nexus requirement for jurisdiction under the Due Process Clause from the "substantial" nexus requirement under the Commerce Clause. Under the minimum contacts Due Process Clause standard, a state can tax a non-domiciliary corporation, even if the corporation had no physical presence in the state, as long as the corporation has "purposefully directed" its activities at residents of the taxing state. The Commerce Clause, requires more, however. In ***Quill***, the Supreme Court reaffirmed its decision in ***National Bellas Hess, Inc. v. Department of Revenue of Illinois***, 386 U.S.

753, 87 S. Ct. 1389 (1967) that a vendor must have some physical presence in a state before the vendor can be required to collect a state use tax from the purchaser. Quill Corporations was an out-of-state mail order house with neither outlets nor sales representatives in North Dakota and which utilized the mails or common carriers to deliver its merchandise into the state. Its in-state presence was limited to owning tangible property in the form of a computer software program on floppy discs which it licensed to its customers and which enabled Quill's customers to check Quill's inventories and prices and to place orders directly with Quill. The Supreme Court held Quill's licensing of software in North Dakota, was too minimal or insignificant to meet the "substantial nexus" requirement of the Commerce Clause. *Id.* 504 U.S. at 315, n.8 112 S.Ct at 1914 n.8.

Teco relies upon ***Quill***, and ***Cally Curtis Co. v. Gruppo***, 572 A.2d 302, (Conn. 1990), *cert. denied,* 498 U.S. 824, 111 S.Ct 77 (1990) in support of its argument that New Mexico lacks substantial nexus to tax its lease transactions. In ***Cally Curtis***, the Connecticut Supreme Court ruled that a limited number of three day rental transactions by an out-of-state company that produced industrial films and video tapes for personnel training purposes did not create sufficient nexus to sustain Connecticut's effort to tax.

I find both ***Quill*** and ***Cally Curtis*** to be distinguishable from the facts of this case. During the years in question, Teco owned millions of dollars of equipment which it leased on an ongoing basis to Chino, generating approximately $ 7 million in lease revenues.[7] This far exceeds the ownership of a "few floppy discs" (***Quill***) or the limited number of short term film and video rentals which occurred in ***Cally Curtis***. In this regard it is noteworthy that the Connecticut Supreme Court distinguished the facts in ***Cally Curtis*** from ***Union Oil Co. of California v. Board of Equalization***, 34 Cal. Rptr. 872 (1963), *appeal dismissed,* 377 U.S. 404, 84 S.Ct. 1629 (1964), where nexus to tax was found on the basis of the long term leasing of oil tankers. Teco's case is far closer to ***Union Oil*** than

[7] Although the exact dollar value of the equipment was not disclosed, the Master Lease Agreement sets a total acquisition cost for the equipment "not to exceed $ 7,800,000. The Department's audit revealed that Teco had failed to report $7,438,149.28 in lease revenues from Chino. Exhibit S-1, p. C 6.

it is to the facts of ***Cally Curtis***. Teco's ownership of the equipment used by Chino and its receipt of substantial lease receipts over the years involved in this case are sufficient to create "substantial nexus" to tax in this case.

PENALTY

Teco also argues that it should not be assessed penalty for failure to report and pay gross receipts taxes on the basis that its understanding with Chino was that Chino would bear the economic burden of any taxes on the lease of the equipment and that in doing so, Teco exercised ordinary business care so as not to be subject to penalty.

The imposition of penalty is governed by the provisions of Section 7-1-69(A) NMSA 1978 (1995 Repl. Pamp.), which imposes a penalty of two percent per month, not to exceed ten percent:

> [I]n the case of failure, due to negligence or disregard of rules and regulations, but without intent to defraud, to pay when due any amount of tax required to be paid or to file by the date required a return regardless of whether any tax is due,....

This statute imposes penalty based upon negligence (as opposed to fraud) for failure to timely pay tax or for failure to file a return by its due date. Thus, the good faith of the Taxpayer in fairly reporting its taxes is not at issue. What is at issue is whether a taxpayer was negligent in failing to file a return or to pay its taxes when they were due. Taxpayer "negligence" for purposes of assessing penalty is defined in Regulation TA 69:3 as:

1) failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;

2) inaction by taxpayers where action is required;

3) inadvertence, indifference thoughtlessness, carelessness, erroneous belief or inattention.

In this case we have both failure to pay tax when due by Teco as well as a failure to file timely returns reporting gross receipts tax. While Teco may have relied upon Chino to take care of any tax consequences resulting from its lease of equipment, I don't find this reliance to be such as to negate a conclusion that Teco was negligent in failing to report and pay taxes. In the first place, Teco

failed to follow the terms of the lease itself, which required that it file the gross receipts tax reports, even though the filing was to be at Chino's expense. Secondly, Teco's reliance on Chino for tax law compliance does not vitiate against the imposition of penalty under well established New Mexico authority. It is well settled that every person is charged with the reasonable duty to ascertain the possible tax consequences of his actions, and the failure to do so has been held to amount to negligence for purposes of the imposition of penalty pursuant to Section 7-1-69 NMSA 1978. ***Tiffany Construction Co. v. Bureau of Revenue***, 90 N.M. 16, 558 P.2d 1155 (Ct. App. 1976), *cert. denied*, 90 N.M. 255, 561 P.2d 1348 (1977). Teco did nothing itself to determine the tax consequences of its leasing activities. It neither consulted with the Department or with a professional tax advisor. Nor was its reliance on Chino a defense to the imposition of penalty. In ***El Centro Villa Nursing Center v. Taxation and Revenue Department***, 108 N.M. 795, 799, 779 P.2d 982, 986 (Ct. App. 1989), the court ruled that a taxpayer may not abdicate its responsibility to properly report and pay taxes in reliance on the taxpayer's accountant.[8] If reliance on one's agent, one's accountant, to properly report and pay taxes is not sufficient to avoid the imposition of penalty for negligence, then Teco's reliance on an independent third party to properly report and pay taxes would be insufficient to avoid the conclusion that Teco was negligent in failing to properly report and pay its gross receipts taxes. Teco was negligent both by failing to determine for itself the tax consequences of its activities and in failing to determine how its reporting responsibilities for gross receipts taxes were being fulfilled.

THE STATUTE OF LIMITATIONS ON CHINO'S REFUND CLAIM

The final issue to be determined is whether the Department's denial of a portion of Chino's refund claim as being beyond the statute of limitations was proper.

The Department denied a portion of Chino's claim for refund based upon NMSA 1978,

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[8] The case is distinguishable from a case where a taxpayer inquires of a tax professional for advice as to the taxability of something. The Department's regulation TA 69:3 recognizes this as a basis for abating penalty. In ***El Centro Villa***, the taxpayer did not seek such advice, but merely relied upon its accountant to handle its tax reporting in general, properly.

Section 7-1-26(B)(1)(a), which states:

> (B) ...no credit or refund of any amount may be allowed or made to any person unless as a result of a claim made by that person as provided in this section:
> (1) within three years of the end of the calendar year in which:
> (a) the payment was originally due or the overpayment resulted from an assessment by the department pursuant to Section 7-1-17 NMSA 1978, whichever is later;

Subsection (B)(1) thus requires that to be timely, a taxpayer must make a claim for refund within three years of the end of the calendar year when the tax was due, or if the taxpayer paid a tax as a result of an assessment issued by the Department, the taxpayer has three years from the end of the calendar year in which the alleged overpayment was made.

Chino contends that its claim for refund is timely under Section 7-1-26 (B)(3) on the basis that the statute of limitations for Chino's refund was extended by the Department's assessment of gross receipts against Teco. Subsection (B)(3) provides:

> (3) For assessments made on or after July 1, 1993, within one year of the date of an assessment of tax made under Subsection B, C or D of Section 7-1-18 NMSA 1978 when the assessment applies to a period extending at least three years prior to the beginning of the year in which the assessment was made, but the claim for refund shall not be made with respect to any period not covered by the assessment.

This subsection extends the limitation on refunds and allows a claim to be made within one year of assessment for assessments made under the extended periods of limitation on assessment of taxes, such as the seven year limitation period applied to Teco pursuant to Section 7-1-18(C) because of its failure to file returns reporting gross receipts taxes. Chino argues that Subsection (B)(3) does not require that the taxpayer making the claim for refund be identical to the taxpayer for which the assessment is made. This argument disregards the language of Subsection (B) which speaks of refunds being allowed or made as a result of a claim "made by *that* person" (emphasis added). In the context of Subsection (B)(3) "that person" claiming the refund refers to the person who was assessed a tax under the extended statute of limitations provisions of Section 7-1-18 (B),(C) or (D). In this case, there has been no assessment of tax against Chino under any subsection of Section 7-1-18 and so Chino cannot claim to fall under Subsection (B)(3).

The absurdity of Chino's contention is patent. To construe Subsection (B)(3) otherwise would completely eviscerate the statute of limitations on tax refunds. If identity of taxpayers is not required and any taxpayer could claim a refund if any other taxpayer in the universe of taxpayers has been assessed under the extended periods of Section 7-1-18 (B),(C) or (D), the only relevant statute of limitations on refund claims would be the longest one, the ten year limitation on assessments in the case of taxpayer fraud under Section 7-1-18(B). This would render meaningless the other statutory provisions of Section 7-1-26 (B) (1) or (2). Chino simply does not qualify as a taxpayer who is entitled to claim a refund under Section 7-1-26(B)(3) because it has not been assessed under the extended limitation periods of Section 7-1-18.

CONCLUSIONS OF LAW

1. Teco filed a timely, written protest to Assessment No. 1914991 and jurisdiction lies over the parties and the subject matter of its protest.

2. Chino filed a timely, written protest to the Department's partial denial of its claim for refund, and jurisdiction lies over both the parties and the subject matter of its protest.

3. Under the facts of this case, Teco may not equitably recoup the compensating taxes paid by Chino with respect to the lease of equipment from Teco against Teco's liability for gross receipts taxes upon the lease payments it received from Chino.

4. Teco was negligent in failing to properly report and pay gross receipts taxes on its lease receipts from Chino and penalty was properly imposed.

5. Chino's claim for refund of compensating taxes paid for tax periods occurring in 1988, 1989, 1990 and 1991 were properly denied by the Department as barred by the provisions of Section 7-1-26 NMSA 1978.

For the foregoing reasons, the protests of Teco and Chino ARE HEREBY DENIED.

DONE, this 16th day of December, 1996.