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

IN THE MATTER OF THE PROTEST OF
BRIAN BLOUNT No. 00-29
ID NO. 02-134195-00-8
ASSESSMENT NO. 2261120

DECISION AND ORDER

A formal hearing on the above-referenced protest was held September 20, 2000, before Margaret B. Alcock, Hearing Officer. Brian Blount ("Taxpayer") was represented by Bryan P. Biedscheid with the law firm Catron, Catron & Sawtell, P.A. The Taxation and Revenue Department ("Department") was represented by Bridget Jacober, Special Assistant Attorney General. On October 13, 2000, the hearing officer solicited additional comments from the parties concerning a pending regulatory change that could affect the outcome of the protest. The Department's comments were received October 16, 2000; the Taxpayer did not respond Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is an artist residing in Santa Fe, New Mexico.

2. During 1994, the Taxpayer sold his art work through consignment agreements with Mill Street Gallery in Aspen, Colorado; Umbrello, Inc. in Santa Fe, New Mexico, and The Elaine Horwitch Gallery, which had locations in Santa Fe, New Mexico; Scottsdale, Arizona; Sedona, Arizona; and Palm Springs, California.

3. Pursuant to the consignment agreements, the Taxpayer retained title to the art work until it was sold. The proceeds of each sale was split 50/50 with the gallery.

4. The Taxpayer did not obtain nontaxable transactions certificates from any of the galleries with which he had consignment agreements.

5. Sales of the Taxpayer's art work by Mill Street Gallery were made from the gallery's location in Colorado.

6. Sales of the Taxpayer's art work by Umbrello, Inc. were made from the gallery's location in New Mexico.

7. Sales of the Taxpayer's art work by The Elaine Horwitch Gallery ("Horwitch") were made from one or more of the gallery's locations in New Mexico, Arizona and California. The Taxpayer delivered his art work to Horwitch's Santa Fe gallery and it was then distributed among the other galleries. The decision as to where a piece of art work would be shown was made by Horwitch.

8. When a piece of art work was sold by Horwitch, the Taxpayer received a check for his share of the sale proceeds from Horwitch's business office in Scottsdale. He was not told the name of the person who purchased the item, nor was he told the location of the gallery from which it was sold.

9. It is common for a gallery to withhold the identity of its buyers from the artists the gallery represents. Client lists are kept confidential in order to prevent the artist from terminating his relationship with the gallery and dealing directly with those clients known to be interested in the artist's work.

10. In May 1994, the Taxpayer sold a piece of his art work to Peter Nosler, who the Taxpayer met during a visit to San Francisco.

11. The Taxpayer carried photographs of his art work, which he showed to Mr. Nosler. Based on the photographs, Mr. Nosler decided to purchase a piece that was then being shown at the Horwitch gallery in Scottsdale, Arizona.

12. The Taxpayer called Horwitch and arranged to have the piece shipped directly from Scottsdale to Mr. Nosler in San Francisco.

13. In 1994, the Taxpayer owned a 5,000 square-foot warehouse in Santa Fe, New Mexico, which he used as a studio.

14. The Taxpayer occasionally rented the studio to film companies to use as sets for movies and commercials. The studio was rented on a daily and, in some cases, an hourly basis.

15. The Taxpayer gave up all control over the premises during the periods it was rented. Because the film companies did not want details of their movies or commercials to become known prior to screening, the Taxpayer was prohibited from entering the premises while it was occupied by a renter.

16. The Taxpayer allowed the film companies to tear down walls and make other alterations to the building, provided they repaired the damage by the end of the rental period. The Taxpayer required each company to obtain commercial general liability insurance for the period it occupied the building, including coverage for any damage to the building.

17. In 1998, the Department received information from the Internal Revenue Service concerning the business income reported on the Taxpayer's 1994 federal income tax return. When the Department investigated, it found the Taxpayer was not registered with the Department and had not reported or paid gross receipts tax on this income.

18. On May 31, 1998, the Department issued Assessment No. 2261120 to the Taxpayer in the total amount of $2,289.30, representing gross receipts tax, penalty and interest on his business receipts for tax periods January through December 1994.

19. On June 28, 1998, the Taxpayer filed a written protest to the Department's assessment.

20. On July 27, 2000, the Department held a public hearing to consider an amendment to Regulation 3 NMAC 2.47.12, which required consignors claiming a deduction of receipts from sales of tangible personal property on consignment to have possession of a Type 2 NTTC.

21. During the July hearing, the Department's representative said the Department had concluded there was no statutory authority to require a consignor to have possession of an NTTC. For this reason, the Department proposed to amend its regulation to allow consignors to deduct receipts from sales of tangible personal property based on either an NTTC or other proof acceptable to the department that the property was sold by consignment.

22. The amended regulation, renumbered as 3.2.205.12 NMAC, became effective on October 31, 2000, the date it was published in the New Mexico Register.

DISCUSSION

There are three issues to be decided in this protest: (1) whether the Taxpayer submitted sufficient evidence to establish that certain sales of his art work occurred outside New Mexico and are not subject to New Mexico gross receipts tax; (2) whether the Taxpayer was required to provide NTTCs to support his deduction of receipts from art work sold on consignment; and (3) whether the Taxpayer's rental of studio space qualified as a lease of real property, the receipts from which are deductible.

Section 7-1-17(C) NMSA 1978 states that any assessment of taxes made by the Department is presumed to be correct, and it is the taxpayer's burden to overcome this presumption. *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer. *Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991). Accordingly, it is the Taxpayer's burden to come forward with evidence and legal arguments to show that he is entitled to the deductions and exemptions claimed and that the Department's assessment is incorrect.

Out-of-State Sales. The Taxpayer contends the Department erroneously included receipts from out-of-state sales when calculating the Taxpayer's gross receipts tax liability. While there is no dispute that out-of-state sales are not subject to gross receipts tax, it is the Department's position that the Taxpayer failed to provide sufficient evidence to clearly establish the nature of the sales in dispute. The issue presented for decision is whether the Taxpayer has met his burden of proof concerning these transactions.

Sales by Mill Street Gallery. In early 1994, the Taxpayer made sales of art work through a consignment agreement with Mill Street Gallery in Aspen, Colorado. At the hearing, the Taxpayer introduced a printed invitation that Mill Street Gallery mailed to its clients advertising a show of recent works by the Taxpayer. The invitation indicates the show was held at the Colorado gallery from February 21-March 6, 1994. The Taxpayer also provided a copy of a March 8, 1994 bank deposit slip with his handwritten notation: "Mill St." for "art sales". This evidence, together with the Taxpayer's testimony, is sufficient to establish that his March 1994 receipts from Mill Street

Gallery related to sales made outside New Mexico. The portion of the assessment attributable to these receipts should be abated.

Sale to Peter Nosler. The Taxpayer testified that he met Peter Nosler during a visit to San Francisco in the spring of 1994. The Taxpayer carried photographs of his art work, which he showed to Mr. Nosler. Based on the photographs, Mr. Nosler decided to purchase a piece that was then being shown at The Elaine Horwitch Gallery in Scottsdale, Arizona. The Taxpayer called the gallery and arranged to have the piece shipped directly from Scottsdale to Mr. Nosler in San Francisco. In May 1994, the Taxpayer received payment from Mr. Nosler, which is reflected on the Taxpayer's May 6, 1994 bank deposit slip. Although the only documentation of the sale is the handwritten notation on the deposit slip, the Taxpayer's testimony is sufficient to establish the sale to Mr. Nosler as an out-of-state sale. The Taxpayer was a credible witness and there was nothing inconsistent or inherently unbelievable in his testimony. Because the volume of the Taxpayer's art sales was low, while his sales prices were fairly substantial, it is reasonable to expect that the Taxpayer would remember the details of most transactions. The Taxpayer has met his burden of establishing that the Nosler sale occurred outside New Mexico, and the portion of the assessment attributable to these receipts should be abated.

Sales by The Elaine Horwitch Gallery. Throughout the 1980s and early 1990s, The Elaine Horwitch Gallery handled sales of the Taxpayer's art work on a consignment basis. Horwitch had galleries located in Santa Fe, New Mexico; Sedona, Arizona; Scottsdale, Arizona; and Palm Springs, California. Under the parties' business arrangement, the Taxpayer delivered his art work to Horwitch's Santa Fe gallery. From there, various pieces were distributed among the other galleries. The decision as to where a piece of art work would be shown was made by Horwitch.

When a piece of art work was sold, the Taxpayer received a check for his share of the sale proceeds from Horwitch's business office in Scottsdale. He was not told the name of the person who purchased the item, nor was he told the location of the gallery from which it was sold. The Taxpayer said this is a common practice within the art world: client lists are generally kept confidential in order to prevent the artist from terminating his relationship with a gallery and dealing directly with those clients known to be interested in the artist's work. Unfortunately, this practice also prevented the Taxpayer from being able to identify which art sales were made from Horwitch's Santa Fe gallery and which were made from its Arizona and California galleries. Although there is little doubt that at least some sales of the Taxpayer's art work occurred outside New Mexico, the Taxpayer has not met his burden of identifying those sales. Consequently, all sales made by The Elaine Horwitch Gallery must be treated as New Mexico sales subject to gross receipts tax.

New Mexico Sales Made on Consignment. In 1994, the Taxpayer had consignment agreements with two New Mexico galleries: The Elaine Horwitch Gallery and Umbrello, Inc. The Department disallowed a deduction of receipts from sales made under the agreements because the Taxpayer did not have possession of a Type 2 nontaxable transaction certificate (NTTC) from each consignee. The Department maintains that possession of an NTTC is required by the following version of Regulation 3 NMAC 2.47.12 in effect during 1994:

> 3 NMAC 2.47.12 CONSIGNMENT SALES
>
> Receipts of a consignor from the sale of tangible personal property handled on consignment, when the sale is made by the consignee, may be deducted from gross receipts if the consignee delivers a nontaxable transaction certificate to the consignor pursuant to Section 7-9-47.

Section 7-9-47 NMSA 1978 provides a deduction for receipts from selling tangible personal property for resale. As Department counsel conceded at the September 20, 2000 protest hearing, the transactions at issue in this case were not sales for resale because the Taxpayer retained title to the

art work until it was sold to the final customer. The Taxpayer's arrangement with the various galleries was more in the nature of a joint venture than a sale for resale. This characterization of a consignment agreement finds support in the Department's recent amendment to 3 NMAC 2.47.12, which was published in the New Mexico Register on October 31, 2000. The amended version of the regulation, renumbered as 3.2.205.12 NMAC, reads as follows:

> 3.2.205.12 CONSIGNMENT SALES
>
> Receipts of a consignor from the sale of tangible personal property handled on consignment, when the sale is made by the consignee, may be deducted from gross receipts if the consignee delivers either a nontaxable transaction certificate to the consignor pursuant to Section 7-9-47 NMSA 1978 or other proof acceptable to the department that the consignor's tangible personal property was sold by consignment.

At the public hearing held on July 27, 2000 to consider the above amendment, the Department's representative acknowledged there was no statutory authority to require a consignor to have possession of an NTTC. For this reason, the Department amended its regulation to allow consignors to deduct receipts from sales of tangible personal property based on either an NTTC or other proof acceptable to the department that the property was sold by consignment.

Given the fact that there has been no change in the underlying law concerning consignment sales or in Section 7-9-47, the version of Regulation 3.2.205.12 NMAC published in the New Mexico Register on October 31, 2000 should apply to the Taxpayer's 1994 sales of art work by consignment. The Department is entitled to change its construction of the law; it cannot change the law itself. If the Department now maintains that a consignor is entitled to deduct receipts from consignment sales without having possession of an NTTC, this deduction should be available for all transactions during the period the law has remained unchanged. In this case, the Department has not disputed that the 1994 sales of the Taxpayer's art work by The Elaine Horwitch Gallery and

Umbrello, Inc. were made by consignment. Accordingly, the Taxpayer is entitled to deduct his receipts from these sales.

Rental of Studio Space. In 1994, the Taxpayer owned a 5,000 square-foot warehouse in Santa Fe, New Mexico, which he used as a studio. The Taxpayer occasionally rented the studio to film companies to use as sets for movies and commercials. The studio was rented on a daily and, in some cases, an hourly basis. The Taxpayer gave up all control over the premises during the periods it was rented. Because the film companies did not want details of their movies or commercials to become known prior to screening, the Taxpayer was prohibited from entering the premises while it was occupied by a renter. The Taxpayer allowed the film companies to tear down walls and make other alterations to the building, provided they repaired the damage by the end of the rental period. The Taxpayer required each company to obtain commercial general liability insurance for the period it occupied the building, including coverage for any damage to the building.

The Taxpayer maintains he was leasing real property and is entitled to deduct his rental receipts under Section 7-9-53(A) NMSA 1978. The Department argues that the Taxpayer's short–term rentals do not meet the requirements of a lease. It is the Department's position that the Taxpayer's receipts were from granting a license to use real property and are subject to gross receipts tax.

The Gross Receipts and Compensating Tax Act defines leasing as "any arrangement whereby, for a consideration, property is employed for or by any person other than the owner of the property, except that the granting of a license to use property is the sale of a license and not a lease." Section 7-9-3(J) NMSA 1978. In *Cutter Flying Service, Inc. v. Property Tax Dep't*, 91 N.M. 215, 219, 572 P.2d 943, 947 (Ct. App. 1977), the court defined a lease as "an agreement under which the owner gives up the possession and use of his property for a valuable consideration and for a definite

term." Under a lease, the tenant must acquire some definite control and dominion of the premises. *Id*., 91 N.M. at 219-20, 572 P.2d at 947-48.

Although not included in the definition of lease set out in the statute or in *Cutter Flying Service*, the Department maintains that a rental of real property must continue for a period of at least 30 days in order to constitute a lease. The only authority the Department gives in support of its position is Regulation 3 NMAC 2.53.8.2, which states that receipts from renting space in a trailer park for a manufactured home or recreational vehicle for a period of under one month are subject to gross receipts tax while receipts from renting the space for a period of over one month are deductible. This regulation is based on the following provisions of Subsection (B) of Section 7-9-53:

> B. Receipts received by hotels, motels, rooming houses, campgrounds, guest ranches, trailer parks or similar facilities, *except receipts received by trailer parks from the rental of a space for a manufactured home or recreational vehicle for a period of at least one month*, from lodgers, guests, roomers or occupants are not receipts from leasing real property for purposes of this section (emphasis added).

The highlighted language, and the language the Department cites from 3 NMAC 2.53.8.2, relates only to trailer parks and has no application to the general deduction for receipts from the lease of real property provided in Subsection (A) of Section 7-9-53. While the short-term duration of the Taxpayer's rentals is atypical, this alone is not sufficient to find that his arrangement with the film companies did not constitute a lease. *See, Quantum Corp. v. State Taxation & Revenue Dep't*, 1998-NMCA-50, 125 N.M. 49, 956 P.2d 848.

Under the terms of the rental agreements, the Taxpayer gave up complete possession and control of his premises for a definite period of time in return for the film companies' payment of rent. The Taxpayer did not have the right to enter the premises or revoke the agreements during the admittedly short periods of time they were in effect. In addition, the Taxpayer required each

company to obtain commercial liability insurance for the period it occupied the premises. Despite the short-term nature of the Taxpayer's rental agreements, the weight of the evidence favors a lease over a license to use. The Taxpayer is entitled to deduct his rental receipts under Section 7-9-53(A) NMSA 1978.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2261120, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer's receipts from Mill Street Gallery and Peter Nosler are receipts from sales made outside New Mexico and are not subject to gross receipts tax.

3. Pursuant to Regulation 3.2.205.12 NMAC, the Taxpayer is entitled to deduct his receipts from New Mexico sales of tangible personal property made pursuant to the Taxpayer's consignment agreements with The Elaine Horwitch Gallery and Umbrello, Inc.

4. The Taxpayer's receipts from renting his Santa Fe studio are deductible under Section 7-9-53 NMSA 1978 as receipts from the lease of real property.

For the foregoing reasons, the Taxpayer's protest is granted, and the Department is ordered to abate Assessment No. 2261120 in full.

DATED November 3, 2000.