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

IN THE MATTER OF THE PROTESTS OF
MORGAN BUILDINGS & SPAS, INC., No. 97-10
ID. NO. 01-870277-00 5,
PROTEST TO ASSESSMENT NO. 1870629

and

MORGAN BUILDINGS & SPAS MANUFACTURING CORP.
ID. NO. 01-822399-00 0, PROTEST
TO ASSESSMENT NO. 1885510

DECISION AND ORDER

This matter came on for formal hearing on October 10, 1996, before Gerald B. Richardson, Hearing Officer. Morgan Buildings & Spas, Inc. and Morgan Buildings & Spas Manufacturing Corporation were represented by Curtis W. Schwartz, Esq. and Jennifer A. Noya, Esq. The Taxation and Revenue Department, hereinafter, "Department", was represented by Bridget A. Jacober, Esq. Following the hearing the parties submitted briefs in support of their respective positions. The last brief was submitted on February 18, 1997, and the matter was considered submitted for decision at that time.

Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Morgan Buildings & Spas Manufacturing Corporation, hereinafter, "Manufacturing" manufactures portable and relocatable buildings, hot tubs and redwood related products that are sold with hot tubs, such as gazebos.

2. Manufacturing operates four plants where its products are manufactured. They are located in Macon, Mississippi, Hallettsville, Texas, Walnut Ridge, Arkansas and Raton, New Mexico. The Raton plant does not manufacture hot tubs or related products. It only

manufactures portable buildings.

3. Morgan Buildings & Spas, Inc., hereinafter, "Buildings & Spas" markets the portable buildings, spas and redwood related products produced by Manufacturing. It operates 24 company owned retail stores in 11 states, including a store in Albuquerque, New Mexico. It also sells Morgan products through a dealer network of approximately 40 independent dealers throughout the United States, including 12 or 13 independent dealers in New Mexico.

4. Buildings & Spas also has a commercial and industrial business division which employs salesmen who concentrate on marketing the portable building complexes or multiple modular relocatable buildings which are sold primarily to the government and other large concerns.

5. Manufacturing and Building & Spas are part of a family owned group of corporations collectively referred to as "the Morgan Companies".

6. Manufacturing places portable buildings on consignment to be sold by Building & Spas. When the portable buildings are sold, Manufacturing is paid an agreed upon "list price" for the building. The list price comes from a schedule of prices for "stock" or standard sized buildings built by Manufacturing.

7. Manufacturing sometimes sells construction materials from its Raton plant to local individuals and contractors, but its primary business is fabricating portable buildings which it sells through Buildings & Spas and its dealer network.

8. A third Morgan company, Morgan Building Transport Corporation exclusively hauls Morgan products both for Buildings & Spas and for Manufacturing, and delivers those products to customers.

9. Stock buildings are wood frame construction with a plywood floor. They are

mounted on skids, which allow the building to be moved by sliding the building on its skids. The buildings may have wooden or steel siding and the roofs are always of steel. Stock buildings are stocked at Building & Spas retail outlets and at the independent dealers. They come in standard sizes and colors. The buildings are displayed on a sales lot so that customers can inspect them when contemplating a purchase.

10. Custom buildings are buildings which are built to order to suit a customer's needs. For instance, a customer may specify a finished interior, that the building be insulated and that the building be pre-wired for electricity.

11. The most common use for Morgan buildings is for storage. They are not generally used for housing because they are not built to housing codes. Other uses are as portable classrooms, as construction field offices, guard shacks, portable offices, etc. 12. An important reason for many customers to buy a Morgan building is its relocatability. Morgan buildings are built so that they can be moved many times without damaging the building. This is advantageous for people who don't want to build a permanent improvement to the land where they wish to locate the building, either because the customer does not own the land or because the customer only contemplates a short term use for the building.

13. Some of the larger Morgan buildings are assembled by putting a number of building modules together. Perhaps the biggest Morgan building sold was 40,000 square feet and consisted of 50 to 60 modules.

14. The employees who build Morgan portable buildings are paid on a piece work and not an hourly basis.

15. When Morgan buildings leave the plant, they are 100% complete.

16. In the prefabricated and portable building industry, the terms prefabricated

building and portable building are understood to be different. "Prefabricated buildings" are generally understood to refer to pre-engineered steel buildings in which the components are pre-engineered and are shipped to a site for erection. They are erected on a foundation and cement slab and are permanently affixed to the land. Portable buildings are constructed off-site and are built to be portable and relocatable. They often are not permanently affixed to the land.

17. Building & Spas customers are responsible for site preparation of the site where the building is to be delivered. The ground of the site should be compacted or hard and should be relatively level, with differentials of no more than six inches.

18. Morgan buildings are moved by winching them up onto a trailer which is equipped with rollers at the end of the trailer over which the skids on the building are rolled. 19. When Morgan buildings are delivered to a site, they are unloaded from the trailer and if need be, dragged to their site. The building is jacked up and blocks are placed under the corners and at other places such as under the access door. The blocks are shimmed to get the building level. Depending upon how big the building is and how many units must be joined together, this can take less than an hour or several hours.

20. Morgan custom buildings can be pre-wired or plumbed at the customer's request. The pre-wiring includes placing a junction box on the outside of the building. The customer is responsible for bringing electricity to the site and hooking up electricity to the building, or for bringing water and sewer or septic service to the site and for making those hook-ups after the building has been delivered and set up on the site.

21. The cost of delivering the building and placing it on blocks is included in the price Building & Spas charges its customers. The cost of this service is approximately 1% to 2% of the sales price of the building.

22. There is a resale market for Morgan portable buildings. Buildings & Spas will take in used buildings as trade-ins for new buildings. It sometimes purchases used buildings at auctions and it takes back buildings it has leased at the end of the lease term. If the building was composed of many modular units, the units can be remodelled and reconfigured and resold. It resells used buildings at a discount from the price of new buildings.

23. Following an audit, the Department issued Assessment No. 1885510 to Manufacturing. The assessment assessed $9,649.91 in gross receipts tax, $1,138.14 in compensating tax, $1,078.85 in penalty and $5,252.29 in interest for a total of $17,119.19. The assessment was mailed to Manufacturing on December 30, 1994.

24. The audit period covered by Assessment No. 1885510 was January, 1988, through June, 1992.

25. Following an audit, the Department issued Assessment No. 1870629 to Buildings & Spas. The assessment assessed $60,520.30 in gross receipts tax, $508.60 in compensating tax, $6,103.09 in penalty and $36,330.33 in interest for a total of $103,546.32. The assessment was mailed to Buildings & Spas on November 18, 1994.

26. The audit period covered by Assessment No. 1870629 was January, 1989, through June, 1992.

27. On December 30, 1994, Manufacturing filed a timely, written protest to Assessment No. 1885510.

28. On November 28, 1994, Buildings & Spas requested an extension of time to protest Assessment No. 1870629. The Department granted the request and gave Buildings & Spas until February 16, 1995, to file its protest.

29. On February 16, 1995, Buildings & Spas filed a timely, written protest to

Assessment No. 1870629.

30. Buildings & Spas had issued Manufacturing a type 2 nontaxable transaction certificate for the purchase of tangible personal property for resale. The Department's auditors honored the certificate and did not assess Manufacturing for its gross receipts from sales to Buildings and Spas except for the period of January 1, 1992, through June 30, 1992, which was a time period for which the type 2 certificate was no longer valid. Manufacturing did not have a new 1992 series NTTC from Buildings & Spas to support a claim for deduction for sales after January 1, 1992, and it failed to obtain one within the time frame of the Department's 60 day notice referenced in the paragraph below. For that period, Manufacturing was assessed gross receipts tax and the tax assessed upon its sales to Buildings & Spas represents the vast majority of the gross receipts tax assessed to Manufacturing.

31. As part of the Department's standard audit procedures, it issued a 60 day letter to Buildings & Spas and to Manufacturing, on September 22, 1992. The 60 day letter gave Building & Spas and Manufacturing 60 days from the date of the notice to demonstrate possession of all NTTCs it relied upon when claiming deductions from tax. The letter further informed Buildings & Spas and Manufacturing that if any required NTTCs were not in its possession within the 60 days, that deductions previously claimed relating to those NTTCs would be disallowed.

32. On November 7, 1991, Buildings & Spas entered into a custom building purchase agreement with Sandia National Laboratories to purchase a double wide building, 24'x60', to be delivered within 120 days. As a custom building, it would need to be built to the custom specifications. The purchase price was $123,776.00. The two parts of the building were delivered to Sandia on March 10 and March 13, 1992, and were invoiced to Sandia on March 18 and March 27, 1992, respectively. Buildings & Spas is an accrual basis taxpayer and it reported

its receipts from this sale to the Department on its March, 1992, return. Buildings & Spas had NTTCs from Sandia on file at the time of the audit, but they were pre-1992 NTTCs which became void as of January 1, 1992. Buildings & Spas did not obtain a 1992 series NTTC from Sandia within 60 days of receiving notice from the Department of its need to have all NTTCs in its possession to support any claimed deductions.

33. During the audit period of January 1, 1989, through June 30, 1992, Buildings & Spas had four sales in excess of $60,000.00. They were as follows:

Sandia National Laboratories	$123,776.00
Lincoln County Medical Center	$ 64,995.00
N.M. Department of Corrections	$300,382.00
Miner's Colfax Regional Hospital	$ 65,000.00

All but the Miner's Colfax Regional Hospital sale were picked up as audit exceptions and used in calculating a percentage of error.

34. The Department's auditor used an audit sampling method when it audited Buildings & Spas. The method used was the auditor selected the high sales month, the low sales month and the average sales month for each year audited. The auditor did a detailed audit for each of the sample months, determining which deductions claimed were, in the Department's opinion, not deductible. These are called audit exceptions. The audit exceptions for each year were totalled and compared with the total deductions claimed for each year by the taxpayer to arrive at a percentage of error. The percentage of error was then applied to all months of each tax year except for the actual months audited to arrive at an amount of disallowed deductions. For the months actually audited, the actual amount of disallowed deductions was used. The gross receipts tax was then calculated on the disallowed deductions and assessed.

35. In March of 1992, Buildings & Spas sold another portable building to Sandia National Laboratories for $7,992.00. The building was delivered that same month and Buildings & Spas reported the sale and claimed a deduction for that month. Buildings & Spas did not present a 1992 series NTTC to the Department's auditors to support its claim of deduction on that transaction.

36. In May of 1989, Buildings & Spas entered into an agreement with Inhalation Toxicology and Research Institute to move a Morgan portable building from Albuquerque to Brooks Air Force Base in Texas for $3,661.99, for which Buildings & Spas had claimed a deduction from gross receipts tax as a transaction in interstate commerce. The Department's auditor denied the deduction because the invoice did not reflect where the building was being moved to or from.

37. On October 30, 1991, Buildings & Spas sold a stock building to Albuquerque Development for $797.00. Buildings & Spas had claimed a deduction, but upon audit, was unable to produce a NTTC to support its claim for deduction within 60 days of the Department's notice requiring that it demonstrate possession of the NTTC. The Department's audit disallowed the deduction. At the formal hearing, Buildings & Spas produced a NTTC from Albuquerque Development dated October 30, 1991.

38. In March of 1992, Buildings & Spas sold a stock portable building to the Northeastern Regional Hospital in Las Vegas, New Mexico for $9,930.00. Although the purchase agreement reflects a number for some sort of NTTC, upon audit, and through the close of evidence at the hearing, Buildings & Spas has been unable to produce the NTTC. The Department's audit disallowed the deduction.

39. In April of 1992, Buildings & Spas sold a stock portable building to the Canoncito

Senior Center in Canoncito, New Mexico for $1341.00. The purchase agreement makes no reference to a tax exemption certificate. Buildings & Spas has produced a copy of a NTTC which is completely illegible in support of its claimed deduction. The Department's audit disallowed the deduction.

40. Sun Country Housing was an independent dealer for Morgan portable buildings during portions of the audit period. The Department's audit disallowed the deductions claimed by Buildings & Spas for sales to Sun Country Housing because a NTTC to support the deductions was never presented by Buildings & Spas. Although Morgan claims that it would have had such an NTTC, it has never presented one to the Department.

DISCUSSION

The primary issue to be determined herein is the nature of what Buildings & Spas sells when it sells portable buildings. Buildings & Spas contends that when it sells portable buildings, it is selling tangible personal property. The Department, in reliance on Regulation GR 3(C):6 contends that a construction service is being sold. This distinction is critical to this case because the majority of the audit exceptions picked up by the Department's auditor are for sales of portable buildings to governmental agencies or to organizations granted 501(C)(3) tax exempt status by the Internal Revenue Service. NMSA 1978, § 7-9-54 allows a deduction for sales of tangible personal property to governmental agencies and NMSA § 7-9-60 allows a deduction for sales of tangible personal property to 501(C)(3) organizations. Both statutes, however, deny the deduction where the tangible personal property will become an ingredient or component part of a construction project.

Construction is defined at NMSA 1978 § 7-9-3 in pertinent part as follows:

"construction" means building, altering, repairing or demolishing in the ordinary course of business any:
***

(2) building, stadium or other structure;

The Gross Receipts and Compensating Tax Act, Chapter 7, Article 9 NMSA 1978, also defines construction to be a service. Specifically, NMSA 1978, §7-9-3(K) defines service as follows:

"service" means all activities engaged in for other persons for a consideration which activities involve predominantly the performance of a service as distinguished from selling or leasing property. "Service" includes activities performed by a person for its members or shareholders. In determining what is a service, the intended use, principal objective or ultimate objective of the contracting parties shall not be controlling.

"Service" includes construction activities and all tangible personal property that will become an ingredient or component part of a construction project. Such tangible personal property retains its character as tangible personal property until it is installed as an ingredient or component part of a construction project in New Mexico. However, sales of tangible personal property that will become an ingredient or component part of a construction project to persons in the construction business are sales of tangible personal property. (emphasis added)

Under the definition of service, tangible personal property which becomes incorporated into a construction project becomes a part of the construction service, but it retains its character as tangible personal property until it is installed as an ingredient or component part of a construction project.[1] Thus, in order for the sales at issue to be taxable, the sale of the portable buildings on an

[1] The purpose of the language which provides that tangible personal property retains its character as tangible personal property until it is incorporated into a construction project and that it is tangible personal property when sold to persons engaged in the construction business is to allow construction contractors to issue suppliers of materials a type 6 nontaxable transaction certificate when purchasing construction materials. This enables the materials suppliers to claim the deduction provided at NMSA 1978 § 7-9-51 and the construction contractor to purchase the materials free of gross receipts tax. The construction contractor will be subject to gross receipts tax upon his receipts from performing construction services, which includes the materials incorporated into the construction project, but it prevents the pyramiding or stacking of the gross receipts tax on the construction project.

installed basis must either qualify as construction, or the buildings must, when installed, become an ingredient or component part of a construction project.

Building & Spas presented substantial evidence to support its contention that when it sold portable buildings, it was selling tangible personal property and not construction services. In the first place, it does not build the portable buildings itself, since receives them, in a 100% complete condition, on a consignment basis from Manufacturing. All it does is sell them, deliver them, set them on blocks and level them. This falls far short of the types of activities described in the definition of construction, so the only basis to deny the deduction is on the basis that the buildings become ingredient or component parts of a construction project. Buildings & Spas presented evidence that its buildings are constructed on skids so as to be moveable and that they are merely set upon blocks, rather than permanently affixed to property. It presented evidence that relocatability is a significant factor in many customer's decisions to purchase a Morgan building. The buildings are built so that they can be moved many times without damage to the building. It presented evidence that in the industry, prefabricated and portable buildings are different. Prefabricated buildings are pre-engineered and erected on site and are permanently affixed to the land on which they sit, while portable buildings are built off-site and are complete when they leave the plant where they are built. They are delivered to a site and are not permanently affixed to the land. It also presented evidence that the cost of delivering the buildings and setting them on blocks and leveling them is incidental to the cost of the building itself. Finally, it presented evidence that there is a re-sale market for its portable buildings.

Morgan also presented substantial authority from other jurisdictions which indicates that portable buildings are tangible personal property, both for Uniform Commercial Code purposes and for federal tax purposes. *See,* Morgan's Brief in Chief, pp. 10-11. Morgan could even point

to a decision of the United States Court of Appeals for the 7th Circuit, ***Cates v. Morgan Portable Building Corp***., 591 F.2d 17 (7th Cir. 1979), which affirmed the lower court ruling that Morgan portable buildings were "goods" for purposes of Article 2 of the Uniform Commercial Code. The decision cited to the UCC definition of goods mean, "all things (including specially manufactured goods) *which are moveable at the time of identification to the contract for sale*..." (emphasis added). This is the same definition adopted by New Mexico. *See*, NMSA 1978, § 55-2-105(1).

Although there is a presumption of correctness which attaches to an assessment of taxes by the Department pursuant to NMSA 1978, § 7-1-16, this evidence was sufficient to rebut the presumption of correctness with respect to the deductions claimed for sale of tangible personal property and shifts the burden to the Department to prove that the buildings were not tangible personal property or were incorporated into a construction project. This, the Department did not do, instead relying upon Regulation GR 3(C):6, which provides as follows:

> The sale of prefabricated buildings, whether constructed from metal or other material, is the sale of construction services irrespective of whether the building is permanently affixed to land.
>
> If a structure is a building, in the ordinary sense of that word, and is designed to serve the function of housing or sheltering persons or property, the manner in which that structure comes into existence has no significance. Sale of mobile homes or trailers, which are defined as vehicles by Section 66-1-4(B), are not within the scope of this regulation.

While normally, a reviewing authority will accord substantial weight to the interpretation given a statute by the body charged with administering the statute, ***State ex rel. Battershell v. City of Albuquerque***, 108 N.M. 658, 777 P.2d 386 (Ct. App. 1989), an administrative agency has no

power to create a rule or regulation that is not in harmony with its statutory authority. ***Rivas v. Board of Cosmetologists***, 101 N.M. 522, 686 P.2d 934 (1984). My review of the entire definition of "construction" and of some of the Department's other regulations with respect to ingredient or component parts of a construction project has convinced me that, to the extent that Regulation GR 3(C):6 defines prefabricated buildings to be construction, without regard to whether the building becomes a permanent fixture, the regulation is overbroad and exceeds the Department's authority to interpret statutes.

The full definition of "construction", as defined at NMSA 1978, § 7-9-3(C) follows:

"construction" means building, altering, repairing or demolishing in the ordinary course of business any:
(1) road, highway, bridge, parking area or related project;
(2) building, stadium or other structure;
(3) airport, subway or similar facility;
(4) park, trail, athletic field, golf course or similar facility;
(5) dam, reservoir, canal, ditch or similar facility;
(6) sewerage or water treatment facility, power generating plant, pump station, natural gas compressing station, gas processing plant, coal gasification plant, refinery, distillery or similar facility;
(7) sewerage, water, gas or other pipeline;
(8) transmission line;
(9) radio, television or other tower;
(10) water, oil or other storage tank;
(11) shaft, tunnel or other mining apurtenance;
(12) microwave station or similar facility; or
(13) similar work;
"construction" also means:
(14) leveling or clearing land;
(15) excavating earth;
(16) drilling wells of any type, including seismograph shot holes or core drilling; or

(17) similar work;

A review of this definition reveals that construction means either some alteration of the

land itself, or it involves the building, altering, repairing or demolishing of some sort of structure, facility or building which, in our ordinary understanding, would be a permanent structure to the land itself. This understanding is further enforced by the ordinary meaning of a "building", as found in ***Webster's Third New International Dictionary***, which defines a building as follows:

> **1**: a thing built; **a**: a constructed edifice *designed to stand more or less permanently*, covering a space of land, usually covered by a roof and more or less completely enclosed by walls, and serving as a dwelling, storehouse, factory, shelter for animals, or other useful structure--distinguished from structures not designed for occupancy (as fences or monuments) *and from structures not intended for use in one place* (as boats or trailers) even though subject to occupancy.

The concept that "construction" involves more or less permanent improvement of real property draws further support from the Department's regulations promulgated under Section 7-9-51, which is the deduction for the sale of tangible personal property to persons engaged in the construction business when the tangible personal property will become an ingredient or component part of a "construction project". Regulation GR 51:16 provides as follows:

> In determining whether tangible personal property will become an ingredient or component part of a construction project, the department will use the following criteria, but not exclusively:
>
> (1) Did the tangible personal property become "fixtures" as defined under GR 3(C):9?
> (2) Was the person performing the work using tangible personal property required to be licensed under the Construction Industries Licensing Act, Section 60-13-1 to 60-13-59?
> (3) Did the work for which the tangible personal property was used required a permit from one or more of the trade boards established by the Construction Industries Licensing Act or from a municipal building or mechanical department?

As referenced by the above regulation, Regulation GR 3(C):9 provides the following guidance about "fixtures":

> Construction includes the sale and installation of "fixtures" such as kitchen

> equipment, library equipment, science equipment and other miscellaneous equipment *installed so that it becomes firmly attached to the realty*. Fixtures are considered to be items of tangible personal property which are necessary or essential to the intended use of a construction project *and which are so firmly attached to the realty as to constitute a part of the construction project".*
>
> *Receipts from the sale of furniture, kitchen equipment, library shelves and other furniture or equipment sold on an assembled basis that does not become a "fixture" is a sale of tangible personal property and not construction*. (emphasis added).

Although this regulation speaks of equipment, it makes it clear that the sale of tangible personal property that does not become a fixture which is permanently attached to real estate is tangible personal property and not a construction service.

In this case, the Department never presented evidence to establish that the portable buildings became permanently affixed to any real property. If that had been the case, the Department would have provided evidence that the portable buildings could be considered part of a construction service as ingredient or component parts of a construction project. In the absence of any such evidence, and because it is apparent that the Regulation GR 3(C):6 is overbroad to the extent that it declares prefabricated buildings to be construction without respect to whether the buildings become permanently affixed to real property, the Department's assessments are erroneous in that they deny deductions for the sale of tangible personal property to governmental agencies and 501(C)(3) organizations.

Resolution of the issue of the characterization of the sale of the portable buildings resolves a number of other issues presented. Thus, there is no need to discuss whether Buildings & Spas accepted nontaxable transaction certificates ("NTTC's") in good faith for the purchase of tangible personal property, or whether penalty was properly assessed upon its sales to governmental agencies, and 501(C)(3) organizations from whom it had proper nontaxable transaction

certificates. There remain a number of discrete transactions which still need to be discussed, however, to determine their taxability and proper treatment.

The only remaining issue with respect to the assessment issued to Manufacturing is the Department's denial of the deduction claimed for sales to Buildings & Spas. The Department allowed those deductions from the beginning of the audit period through December 31, 1991, based upon Buildings & Spas issuance of a type 2 nontaxable transaction certificate ("NTTC") to Manufacturing. Deductions for sales by Manufacturing to Buildings & Spas were disallowed for the remainder of the audit period, January 1, 1992, through June 30, 1992, because Manufacturing did not have one of the new 1992 series NTTCs from Buildings and Spas and it failed to obtain one in the 60 day time frame allowed in the Department's 60 day notice letter. This disallowance of the deduction was based upon the 1991 amendments to Section 7-9-43. Laws 1991, Ch. 9 §29, effective July 1, 1991, enacted a new subsection D to Section 7-9-43 which provided that, "[A]fter January 1, 1992, any nontaxable transaction certificate issued prior to that date *shall be void*." (emphasis added). As a result, Manufacturing no longer had a valid NTTC to support its claim of deduction on its sales to Buildings & Spas. The Department properly denied the deduction for sales to Buildings & Spas after January 1, 1992. Manufacturing was claiming deduction pursuant to NMSA 1978, Section 7-9-47, which requires a NTTC to support a claim of deduction. NMSA 1978, §7-9-43(A), 1990 Supp., which applied to the sales at issue unequivocally provides:

> If the seller or lessor is not in possession of these nontaxable transaction certificates within sixty days from the date that the notice requiring possession of these nontaxable transaction certificates is given the seller or lessor by the department, deductions claimed by the seller or lessor that require delivery of these nontaxable transaction

certificates *shall be disallowed.* (emphasis added).

Apparently, the Department's assessment also disallowed deductions claimed with respect to some other sales by Manufacturing for which it failed to possess timely NTTCs. Manufacturing presented no evidence regarding those transactions and the Department's denial of those deductions is upheld.

Buildings & Spas made two sales to Sandia National Laboratories which were picked up as audit exceptions. The largest was a sale of a custom made double-wide portable building for $123,776.00. The purchase agreement for this building was entered into in November of 1991, but the building needed to be built. The delivery took place in two phases (each half of the building was delivered separately), on March 10, and March 13, 1992, and the two buildings were separately invoiced on March 18 and March 27, 1992. As an accrual basis taxpayer, Buildings & Spas recognized the receipts from the sale in the month it was invoiced and delivered and reported the receipts and claimed a deduction therefor on its March, 1992, return filed with the Department. Although Buildings & Spas had NTTCs from Sandia when it was audited, they were the earlier (pre-1992) NTTCs which became void as of January 1, 1992. Buildings & Spas did not obtain a 1992 series NTTC to support the deduction it claimed in March of 1992. The second sale to Sandia, in the amount of $7,992.00, was also in March of 1992, but the purchase order and the sale and delivery all occurred in March of 1992. As with the other sale to Sandia, Buildings & Spas had no 1992 series NTTC from Sandia to support its deduction.

With respect to the first sale, Buildings & Spas argues that since the purchase agreement was entered into in 1991, that the sale should be deductible because it has earlier series NTTCs to support its deduction. The Department argues that Buildings & Spas would have needed to demonstrate possession of the new 1992 series NTTCs to support its deduction. As noted above,

§ 7-9-43 governing the use and applicability of NTTCs was amended by Laws 1991, Ch. 9, §29, effective July 1, 1991, and found in NMSA 1978, § 7-9-43, 1991 Supp. In addition to enacting a new Subsection D which provided that after January 1, 1992, any NTTC issued prior to that date was void, Subsection A was amended to read, "Subject to the provisions of Subsection D of this section, all nontaxable transaction certificates executed by buyers or lessees should be in the possession of the seller or lessor for nontaxable transactions *at the time the nontaxable transactions occur*." (emphasis added). The statute then further provided a 60 day grace period for taxpayers to obtain such certificates, once the Department had issued its 60 day notice letter. In this case, deductibility turns on when the transaction for which the deduction was claimed occurred. If it occurred at the time the purchase order was made, the old series NTTCs would be valid to support the deduction. If it occurred when the buildings were delivered and invoiced and the sales were reported, then Buildings & Spas did not have a proper NTTC to support its claim of deduction. Buildings and Spas provided no authority on this issue to support its position that the transactions occurred when the purchase order was entered into. In making this determination, I am persuaded by the actions of Buildings and Spas in how it treated the transaction. Buildings & Spas did not recognize the sale itself for tax purposes until it invoiced and delivered the buildings, even though it reports taxes on an accrual basis. On this basis I conclude that the transaction occurred when it was recognized by Buildings & Spas, in March of 1992. With respect both this sale and to the second sale to Sandia in March of 1992, Buildings & Spas must be denied the deduction based upon its failure to demonstrate possession of a valid NTTC from Sandia.

Buildings & Spas has raised a secondary issue with respect to the first sale to Sandia. It argues that the sale is an unusually large sale, and that during the three and one-half year audit period, it only had four sales in excess of $60,000.00. It argues that to include this sale in the

percentage of error and apply it to all other months other than those actually audited would skew the percentage of error and assess an improper amount of tax.[2] Although the Taxpayer never explained how it arrived at the $60,000.00 figure, my own review of the audit exceptions for the test months audited reveals that the $123,000.00 sale to Sandia is highly unusual, with most sales ranging in the $4,000.00 to $15,000.00 range and a rare sale in the $20,000.00 to $30,000.00 range. Buildings & Spas argument is well taken. The proper way to handle transactions which are so out of scale with a taxpayer's normal operations is to exclude them from the calculation of error and to assess them separately if they should have been taxable.

In May of 1989, Buildings & Spas entered into a contract to move a Morgan Portable Building for Inhalation Toxicology Research Institute from Albuquerque, New Mexico to Brooks Air Force Base in Texas for $3,661.99. Buildings & Spas had claimed a deduction from gross receipts tax for its receipts from this contract on the basis of the deduction at NMSA 1978, §7-9-55, which provides a deduction for transactions in interstate commerce. The Department's auditor had denied the deduction because the contract did not show on its face where the building was being either moved from or to. At the hearing, Building & Spas provided testimony about the building move to support its claim for deduction. While there was a basis for the Department's auditor to assess this item, this is the sort of factual issue which the parties should be able to sufficiently document on an informal basis so that the Hearing Officer's time is not wasted addressing such issues. There is no legal issue in dispute here. Buildings & Spas has demonstrated its entitlement to the deduction taken.

On October 30, 1991, Buildings & Spas sold a stock building to Albuquerque

[2] The percentage of error will already need to be recalculated as a result of this decision. The two other sales in excess of $60,000 which were included in the audit exceptions will need to be deleted as those sales, as well as many others would be deductible as sales of tangible personal property.

Development for $797.00. Buildings & Spas had claimed a deduction, but upon audit, was unable to produce a NTTC to support its claim for deduction within 60 days of the Department's notice requiring that it demonstrate possession of the NTTC. The Department's audit disallowed the deduction. At the formal hearing, Buildings & Spas produced a NTTC from Albuquerque Development dated October 30, 1991. Under the applicable provisions of Section 7-9-43 at the time of this transaction, deductions are disallowed of the seller was not in possession of the NTTC within the 60 day notice period. At the hearing, Mr. Morgan testified that Buildings & Spas acquired the NTTC at the time of the sales transaction. The date on the certificate confirms this. Based upon this evidence, Buildings & Spas has demonstrated that it possessed the certificate in a timely manner and the deduction will be allowed. Once again, this is the type of factual matter which counsel for both the taxpayers and the department should have resolved well in advance of the hearing date.

Buildings & Spas also claimed a deduction for the sale of a stock portable building to the Northeastern Regional Hospital in March of 1992. The invoice reflects a tax exemption certificate number but Buildings & Spas has never been able to produce the certificate. This is insufficient to demonstrate possession of a proper NTTC. In the first place, a certificate number is not proof that the type of certificate is one which would support a deduction for the sale of tangible personal property. Nor does it demonstrate the certificate to be a 1992 series certificate, as it would need to be to validly support a deduction. Buildings & Spas has failed to carry its burden of proving entitlement to this deduction. Similarly, Buildings & Spas has produced an absolutely illegible certificate in support of a claimed deduction for a sale to the Canoncito Senior Center. This does not carry Buildings & Spas burden of proof with respect to this deduction is denied.

Finally, Sun Country Housing was an independent dealer for Morgan portable buildings during portions of the audit period. The Department's audit disallowed the deductions claimed by Buildings & Spas for sales to Sun Country Housing because a NTTC to support the deductions was never presented by Buildings & Spas. Although Morgan claims that it would have had such an NTTC, it has never presented one to the Department. The deduction claimed for these sales was the deduction provided at §7-9-47 for sales of tangible personal property for resale. The statute requires that the seller possess a NTTC in order to claim the deduction. By failing to present a copy of the certificate, Buildings & Spas has failed to demonstrate its entitlement to the deductions claimed and the deduction must be denied. Section 7-9-43(A). The last issue to be addressed is whether penalty is properly imposed with respect to those transactions which will not be adjusted as a result of the rulings in this decision. Those transactions fall into two categories, transactions where deduction was denied due to the failure to possess a NTTC to support the claim of deduction and transactions where the deduction was denied due to the failure to possess a proper form of NTTC due to the change in law which rendered the old NTTCs void.

The imposition of penalty is governed by the provisions of NMSA 1978, Section 7-1-69(A) NMSA 1978 (1995 Repl. Pamp.), which imposes a penalty of two percent per month, up to a maximum of ten percent:

> In 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. Thus, there is no contention that the failure to report and pay taxes was based upon any conscious attempt by the Taxpayer to underreport taxes. What remains to be determined

is whether the Taxpayer was negligent in failing to report its taxes properly. 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 the failure of Buildings & Spas and Manufacturing to possess NTTCs to support their claim of deduction amounts to negligence in that it can be fairly characterized to be due to inadvertence, carelessness, inaction or inattention. With respect to their failure to possess the proper form of NTTC due to the change in the tax laws, in ***Arco Materials, Inc. v. State, Taxation and Revenue Department***, 118 N.M. 12, 15, 878 P.2d 330 (Ct. App. 1994), reversed on other grounds, ***Blaze Construction Co. v. Taxation and Revenue***, 118 N.M. 647, 884 P.2d 803 (1994), the Court of Appeals had this to say about a taxpayer's duty with respect to deductions claimed in reliance upon NTTCs:

> We are not persuaded by Taxpayer's argument that a taxpayer has no continuing duty to assess the validity of deductions made in reliance on NTTCs issued. We interpret Section 7-9-43(A) as protecting a taxpayer when the purchaser who provided the NTTC has failed to live up to the promise that the actual transaction was nontaxable. As Taxpayer notes, it would create a tremendous burden to require a taxpayer to monitor the purchaser's activities. However, we do not interpret the statute as protecting taxpayers from changes in the law that render formerly nontaxable transactions taxable.
>
> A taxpayer has an affirmative duty to keep informed about changes in the tax law that might affect its liability. (citations omitted).

In this case, both taxpayers had an affirmative duty to keep informed about the changes in the law affecting the validity of the NTTCs it had from its existing customers. In failing to obtain the new series NTTCs, whether it was due to erroneous belief or mere carelessness or

inattention,[3] the taxpayers were negligent and penalty was properly imposed.

CONCLUSIONS OF LAW

1. Both Buildings & Spas and Manufacturing filed timely, written protests to Assessment Nos. 1870629 and 1885510 and jurisdiction lies over both the parties and the subject matter of those protests.

2. "Construction" as defined in NMSA 1978, §7-9-3(C) contemplates some sort of permanent improvement to real property. Regulation GR 3(C):6, which determines that the sale of prefabricated buildings is the sale of construction services, regardless of whether the buildings become permanently affixed to the land is overbroad and exceeds the Department's authority to interpret the statutes it administers with respect to its statement that the buildings need not become permanently affixed to the land. To that extent, the regulation is void.

3. Buildings & Spas overcame the presumption of correctness which attached to the Department's assessment to the extent that it proved that the portable buildings it sells to governmental agencies and to 501(C)(3) organizations are tangible personal property which is not incorporated into a construction project. Thus, to the extent that the Department's assessment denied deductions for sales of tangible personal property to governmental agencies, the assessment is improper. The assessment is also improper to the extent that it denied deductions for sales of tangible personal property to 501(C)(3) organizations for sales in which Buildings & Spas has demonstrated timely possession of a proper NTTC.

4. To the extent that the Department's audit included in the calculation of a percentage of error disallowance of a deduction for a $123,776.00 for the sale of a portable

[3] Neither taxpayer presented any explanation as to why it didn't have the new NTTCs to support its claims of deduction.

building to Sandia National Laboratories, the Department's audit methodology was improper and resulted in a percentage of error which is not representative of all periods covered by the audit. Although this deduction was properly disallowed for the failure of Buildings & Sales to possess the proper form of NTTC, the proper way to handle the denial of this deduction is to simply calculate the tax on the denied deduction separately from the calculation of the percentage of error.

5. The Department properly denied the deductions claimed by Buildings & Spas for its $7992.00 sale to Sandia National Laboratories, and for Buildings & Spas sales to the Northeastern Regional Hospital and the Canoncito Senior Center.

6. Buildings & Spas proved its entitlement to its claims of deduction for its sales to Inhalation Toxicology and Research Institute and Albuquerque Development.

7. Manufacturing has failed to demonstrate its entitlement to a deduction for sales to Buildings & Spas for transactions occurring after January 1, 1992, and for any other transactions for which the Department denied deduction based upon Manufacturing's failure to demonstrate possession of proper and timely NTTCs.

8. With respect to all deductions claimed by Buildings & Spas or Manufacturing, the disallowance of which have been upheld by this decision for failure to demonstrate possession of proper and timely NTTCs, Buildings & Spas and Manufacturing were negligent and penalty was properly assessed.

For the foregoing reasons, the protests of Buildings & Spas and Manufacturing are granted in part and are denied in part.

DONE, this 20th day of March, 1997. The Department is hereby ordered to recalculate the percentage of error to allow the deductions allowed herein, to deny the deductions denied

herein, and to remove the $123,776.00 sale to Sandia National Laboratories from the calculation of the percentage of error and to assess tax on that transaction separately. The Department is hereby ordered to abate those portions of the assessments as herein provided.