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

IN THE MATTER OF THE PROTEST OF
DAIRY CONSTRUCTION, INC. , NO. 97-44
ID. NO. 02-111944-00 9, PROTEST TO
ASSESSMENT NOS. 1982481 & 2004322

DECISION AND ORDER

THIS MATTER came on for formal hearing on November 13, 1997 before Gerald B. Richardson, Hearing Officer. Dairy Construction, Inc., hereinafter, "Taxpayer", was represented by Phil Brewer, Esq. The Taxation and Revenue Department, hereinafter, "Department", was represented by Bruce J. Fort, Esq. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer is a New Mexico corporation based in Dexter, New Mexico which does construction contracting work. Although the Taxpayer occasionally performs other types of construction work, the vast majority of the Taxpayer's work involves the construction of facilities for conducting dairy farming.

2. The buildings and elements of a dairy farm operation are the milking barn, commodities barn(s), hay barn(s), silage pit(s), corrals for the cows with shade structures, a scale and a scale house, and often, a residence for the owner or manager of the dairy farm operation. All of these buildings are permanently affixed to the real estate upon which they are built.

3. The milking barn has three main areas. It has a sprinkler room with floor mounted sprinklers which wash the cows prior to milking, a drip room where the cows dry after being washed, and a milking area where the cows are milked. The barn also houses the milking equipment, milk handling equipment which is a system for transporting the milk to a storage area and the milk storage equipment. Many milking barns also have a feed delivery system which measures and distributes feed to each cow while it is being milked.

4. Commodities barns are three sided buildings with a roof which contain bays which hold separate types of feed in each bay. They bays and floors of the bays are constructed of concrete. Each bay holds approximately 75 tons of feed. The bays are designed so that feed can be removed by a front end loader and dropped into trucks used to haul and distribute the feed to the cattle.

5. Hay barns are large roofed structures with open sides which are used to store large volumes of hay for feeding to the cattle.

6. A silage pit is a large structure, set into the ground with concrete sides and floor which is used for storage of ensilage to be fed to the cattle. It is also designed so that a front end loader can be used to load the ensilage into feed trucks which distribute the feed to the cattle.

7. Corrals are built to hold 200 cattle each. They contain water troughs built of concrete with stainless steel liners which have piped water for a continuous supply. They also contain shade structures consisting of a roof supported by corners of steel pipe to provide shade to the cattle. They also contain a concrete “feed lane” which consists of a concrete slab upon which the feed is put and along which a tractor or truck with a blade

can run to push the feed back to the center of the feed lane on a regular basis. Finally, each corral is equipped with 200 stanchions or enclosures, in which the cattle are individually locked so that they can be inspected, vaccinated, bred, etc.

8. Sometime in 1991 the Taxpayer learned that there is a deduction in the Gross Receipts and Compensating Tax Act which provides for a deduction of 50% of a taxpayer's gross receipts from the sale of agricultural implements. Prior to learning of this deduction, the Taxpayer had been reporting and paying gross receipts tax upon 100% of its gross receipts from performing construction services.

9. After learning of the deduction, the Taxpayer's office manager, who prepared the Taxpayer's monthly gross receipts tax returns, contacted an office of the Department by telephone to inquire about how this deduction applied to the Taxpayer. The Department employee informed the Taxpayer that they could estimate their taxable receipts by a formula by which the ten percent of the Taxpayer's receipts which were attributable to profit were first deducted from the Taxpayer's gross receipts. Of the remaining amount, the Taxpayer estimated that half was attributable to the cost of labor and half was attributable to the cost of materials. The Taxpayer was informed that the 50% deduction could be claimed against the portion of the Taxpayer's receipts which represented the cost of materials used in building dairy facilities.

10. The Taxpayer began using this formula to calculate its gross receipts taxes when it filed its monthly reports with the Department. Under the formula, the Taxpayer paid gross receipts tax on all of its receipts attributable to profit and the costs of labor and paid gross receipts tax on 50% of its receipts attributable to the cost of materials.

11. The Taxpayer was also informed that it could file a claim for refund for prior periods within the statute of limitations to claim the deduction which it had not previously claimed. The Taxpayer prepared amended returns using the formula provided by the Department and filed a claim for refund. The Taxpayer's refund claim was granted in the approximate amount of $100,000.

12. The Taxpayer was audited by the Department, which resulted in the issuance of two assessments. Assessment No. 1982481 was issued on December 7, 1995 and covered the reporting periods of January, 1992 through December, 1992. The assessment assessed $15,424.83 in gross receipts tax, $233.85 in withholding tax, $1,573.88 in penalty and $8,034.00 in interest for a total of $25,266.56. Assessment No. 2004322 was issued on February 22, 1996 and covered the reporting periods of January, 1993 through May, 1995. This assessment assessed $135,379.34 in gross receipts tax, $13,952.60 in penalty, and $38,360.99 in interest for a total of $187,692.93.

13. The Taxpayer filed timely, written protests to Assessment Nos. 1982481 and 2004322 on December 29, 1995 and March 11, 1996, respectively.

DISCUSSION

The primary issue to be determined herein is whether the Taxpayer was entitled to claim the deduction provided at Section 7-9-62 NMSA 1978 to deduct 50% of the value

of the materials it used in its construction work building dairy farm facilities.[1] Section 7-9-62 provides as follows:

> Fifty percent of the receipts from selling agricultural implements, farm tractors, aircraft or vehicles that are not required to be registered under the Motor Vehicle Code may be deducted from gross receipts. Any deduction allowed under section 7-9-17 must be taken before the deduction allowed by this section is computed.

The Taxpayer argues that it is entitled to the deduction on the basis that the materials it used in constructing dairies should be considered agricultural implements, because they are used in and are essential to the business of dairy farming. While the Department does not dispute that dairy farming is an agricultural activity, it disputes that because construction materials are used in building a dairy farm, that they can be considered to be agricultural implements.

There is no definition of agricultural implement in the statute or the gross receipts and compensating tax, nor have I found or been cited to a definition adopted by the courts of New Mexico. The Taxpayer has cited to a decision of the Court of Criminal Appeals of Texas, ***Reaves v. State***, 50 S.W.2d 286 (1931) in which an "implement of husbandry" was defined as "something necessary to the carrying on of the business of farming, etc., without which the work cannot be done" ***id***. at 287, and urges that such a broad definition be adopted herein. This definition would allow any "something" to be considered an agricultural implement, so long as it is necessary to the business of farming.

[1] The Taxpayer also performed construction services with respect to some non-dairy farm facilities, such as a sales barn for cows and some other small construction jobs, but because the majority of the Taxpayer's activities during the audit period related to the construction of dairy farm facilities and because that is the context in which the Taxpayer has focused its legal arguments, the applicability of the deduction will be first determined with respect to dairy construction.

Although there is not a definition of "agricultural implement" in the Gross Receipts and Compensating Tax Act, it is defined and illustrated in the Department's regulations which are presumed to be a correct implementation of the laws which the Department is charged with administering. Section 9-11-6.2(G) NMSA 1978. A review of these regulations indicates that the definition is not so broad as the Taxpayer would urge. Regulation 3 NMAC 2.62.7 (formerly GR Regulation 62:2) defines an agricultural implement as follows:

> An "agricultural implement" is an article of equipment, *such as a tool or instrument*, essential to the production of crops or livestock on a commercial farm or ranch. (emphasis added.)

This definition would also appear to be a proper interpretation of an agricultural implement based upon the generally accepted rule of statutory construction that words in statutes are presumed to be used in their common and ordinary sense. ***Bettini v. City of Las Cruces,*** 82 N.M. 633, 485 P.2d 967 (1971). An implement is defined to be, "a tool or utensil forming part of equipment for work." Webster's Third New International Dictionary.

In addition to defining an agricultural implement, the Department's regulations provide examples of what the Department considers to qualify or not qualify as agricultural implements. Thus, under the Department regulations, proportioning pumps used to distribute metered amounts of fertilizer, herbicides, pesticides, fumigants and the like to crop land by mixing those substances with irrigation water are agricultural implements. 3 NMAC 2.62.9. Fruit harvesting equipment such as picking sacks, field boxes, orchard machinery and ladders used for fruit picking are agricultural implements.

3 NMAC 2.62.10. Metal bins and similar devices designed to store feed on a farm or ranch, which, in addition to storing, measure and control the flow of feed to livestock are agricultural implements. 3 NMAC 2.62.11. Things not considered to be agricultural implements are fuel for irrigation pumps, 3 NMAC 2.62.12; baling wire, 3 NMAC 2.62.15; and irrigation pipe, 3 NMAC 2.62.13.

Of particular interest with respect to the facts of this case is the regulation concerning irrigation pipe. 3 NMAC 2.62.13.1 provides:

> The receipts from building irrigation pipelines for persons engaged in the business of farming or ranching are receipts from performing a construction service. The receipts from the sale of completed construction projects are subject to the gross receipts tax.

3 NMAC 2.62.13.2 provides:

> The deduction provided for by Section 7-9-62 does not apply to irrigation pipe which becomes an ingredient or component part of a completed construction project.

Thus, the Department takes the position that materials incorporated into a construction project, even if it is a construction project related to agriculture, become part of the construction service provided and are not considered to be agricultural implements. This position is supported by the definition of "service" as found at Section 7-9-3(K) NMSA 1978. "Service" is defined in pertinent part as follows:

> "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. (emphasis added.)

Thus, under this definition it is clear that because the Taxpayer was selling his customers construction services, which includes the materials incorporated in the buildings and structures it built for its customers, that it was not selling tangible personal property which could be considered to be agricultural implements.

Lest there be even the smallest doubt that the construction materials supplied by the Taxpayer for incorporation into its dairy construction projects are not agricultural implements, the legislative history of Section 7-9-62 provides further support for this conclusion. The fundamental rule of statutory construction is to ascertain and give effect to the intention of the legislature. ***Reese v. Dempsey,*** 48 N.M. 417, 152 P.2d 157 (1944). Section 7-9-62 was enacted by Laws 1969, Ch. 144, §52. In addition to allowing a 50% deduction for agricultural implements and farm tractors, the statute also provides the same deduction for "vehicles that are not required to be registered under the Motor Vehicle Code." As recognized by the New Mexico Supreme Court in ***City of Alamogordo v. Walker Motor Co.,*** 94 N.M. 690, 616 P.2d 403 (1980), it is the demonstrated legislative policy in New Mexico to treat the taxation of motor vehicle sales differently from the taxation of most other business activities. As evidence of this, the Court cited to Section 66-6-27 NMSA 1978 (Cum. Supp. 1979) which imposed an excise tax of 2% of the sales price on the issuance of a certificate of title arising from the sale of a motor vehicle and to Section 7-9-22 NMSA 1978 which provided that the receipts from sales of motor vehicles on which a tax was imposed under Section 64-11-15 NMSA 1953 (predecessor to Section 66-6-27 NMSA 1978) were exempt from the gross receipts tax. As a review of these statutes demonstrates, it has been the legislative policy to exempt the sales of motor vehicles from the gross receipts tax and to subject them to an excise tax

under the Motor Vehicle Code. The exemption from gross receipts tax, Section 7-9-22 NMSA 1978 was enacted at the same time and in the same legislative act as the deduction at issue here, Section 7-9-62. Both were enacted by Laws 1969, ch. 144. It is also interesting to note that the gross receipts tax rate at that time was 4%. *See,* Laws 1969, ch. 144, § 2. In the same legislative session that the exemption from gross receipts tax for the sale of motor vehicles was enacted and the deduction at issue was enacted, the excise tax on the issuance of title for motor vehicles was raised to 2% of the sales price. Laws 1969, ch. 150, §1. Thus, it appears that what the legislature was doing when it enacted the 50% deduction at issue herein for agricultural implements, farm tractors and vehicles not subject to registration under the Motor Vehicle Code was to extend the same effective 2% tax rate to farm vehicles and other vehicles not subject to registration under the Motor Vehicle Code as was imposed on vehicles subject to registration under the Motor Vehicle Code. Given this legislative history, it would appear that the 50% deduction for agricultural implements was actually intended to cover the types of agricultural implements commonly thought of, such as disks, planters, etc. which are vehicles because they are pulled behind tractors, but are not the type of vehicles which must be registered under the Motor Vehicle Code. This interpretation is also supported by the canon of statutory construction, *ejusdem generis,* which applies where a statute enumerates certain classes of things and also uses general words. Under the canon, the general words are construed to refer to things of the same character as the enumerated items. Thus "farm implements" should be construed to be items of the same character,

(e.g. vehicles) as farm tractors, aircraft or vehicles that are not required to be registered under the Motor Code.[2]

In addition to the Taxpayer's receipts from the construction of dairy farm structures, the Taxpayer also claimed the 50% deduction for its receipts from building other buildings related to agriculture, such as cattle auction barns, residences for dairy farm owners, feed storage facilities, a large animal veterinary clinic, etc. Although related to agriculture, the materials used to construct these structures are not agricultural implements. They are neither tools or instruments essential to the production of crops or livestock, but rather, by definition, when sold as part of a construction project as they were by the Taxpayer in this case, they become part of the construction service and are subject to gross receipts tax at the full tax rate.

The final issue to be determined is whether penalty was properly imposed upon the Taxpayer under the facts and circumstances of this case. The imposition of penalty is governed by the provisions of NMSA 1978, Section 7-1-69(A)(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.

[2] While not deciding this issue as it is not necessary to determining the case at issue, it would appear that some of the Department's regulations under Section 7-9-62 go well beyond the legislative intent of what

Taxpayer "negligence" for purposes of assessing penalty is defined in Regulation 3 NMAC 1.11.10 (formerly 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 Taxpayer contends that it was not negligent because it relied upon information provided to it by a Department employee who led the Taxpayer to believe that it was eligible to claim the deduction for agricultural implements, and by the Department's own actions in honoring its claim for refund of taxes based upon its claim of the deduction for previous years.

Regulation 3 NMAC 1.11.10 contains examples of what the Department considers to be indications of non-negligence, justifying the abatement of penalty. One of those examples is where the taxpayer proves that it was affirmatively misled by a Department employee. I found the testimony of the Taxpayer's President, Mr. Owen Voss, to be honest and trustworthy. Although Mr. Voss was unable to testify to the content of the telephone conversation with the Department employee, the Department's actions in approving the Taxpayer's claim for refund in this case essentially affirmed to the Taxpayer that it was entitled to claim the deduction at issue herein upon a portion of its receipts from building structures used for or related to agricultural purposes. Thus, the Department's actions misled the Taxpayer and this provides a basis for concluding that the Taxpayer was not negligent under the circumstances of this case. There being no

---

should be considered an agricultural implement subject to the deduction.

negligence by the Taxpayer in the manner in which it reported its taxes, the assessment of penalty is improper.

CONCLUSIONS OF LAW

1. The Taxpayer filed timely, written protests, pursuant to Section 7-1-24 NMSA 1978 to Assessment Nos. 1982481 and 2004322 and jurisdiction lies over both the parties and the subject matter of this protest.

2. The construction materials used by the Taxpayer in its construction business are not agricultural implements within the meaning of Section 7-9-62 NMSA 1978 even though they may be used in constructing buildings used for agricultural purposes and thus, the Taxpayer was not entitled to claim the deduction provided by Section 7-9-62 with respect to the sale of those materials.

3. The Taxpayer was not negligent in claiming the deduction found at Section 7-9-62 NMSA 1978 with respect to the materials it used in building structures used for agricultural purposes and therefore the assessment of penalty was improper.

For the foregoing reasons, the Taxpayer's protest IS HEREBY GRANTED IN PART AND DENIED IN PART. The Department IS HEREBY ORDERED TO ABATE THE PENALTY ASSESSED BY ASSESSMENT NOS. 1982482 AND 2004322 RELATING TO THE GROSS RECEIPTS TAX ASSESSED THEREIN.

DONE, this 4th day of December, 1997.