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

IN THE MATTER OF THE PROTEST OF
MARC K. SCHAEFER **NO. 99-10**
ID. NO. 02-195441-00 0, PROTEST TO
ASSESSMENT NO. 2052747

DECISION AND ORDER

This matter comes on for determination based upon a Stipulation of Fact with exhibits and briefs of the parties. Marc K. Schaefer, hereinafter, "Taxpayer', is represented by Marylee V. Warwick, Esq. and Gary D. Sanders, Esq. of Krafsur Gordon Mott Davis & Woody, P.C. The Taxation and Revenue Department, hereinafter, "Department", was represented by Monica M. Ontiveros, Special Assistant Attorney General. Based upon the stipulated facts and exhibits and the briefs of the parties, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer operates a Sears authorized retail merchandise sales facility located in Hobbs, New Mexico.

2. On July 24, 1996, the Department issued the Taxpayer Assessment No. 2052747, assessing $22,710.96 in gross receipts tax, $5,810.59 in interest and $2,271.12 in penalty for the reporting periods January, 1993 through December, 1995.

3. As an authorized Sears retail dealer, Taxpayer sells and distributes Sears merchandise to retail customers in its market territory. The relationship between Taxpayer and

Sears is primarily governed by the terms of a Sears Authorized Retailer Dealer Agreement ("the Sears Agreement").

4. Sears also provides the taxpayer with a Dealer Operating Guide ("the Guide") and a Training Manual ("the Training Manual") to be used by Taxpayer in operating its Sears retail sales facility. In addition, Taxpayer receives directives and other materials from Sears from time to time regarding the operation of Taxpayer's Sears retail sales facility ("the Directives").

5. The Sears Agreement, the Guide, the Training Manual and the Directives contain procedures and controls that Taxpayer must follow covering substantially every aspect of operating Taxpayer's Sears retail sales facility. Sears has established procedures for Taxpayer and its other dealers relating to (I) sales floor layout and displays; (ii) inventory requirements based on seasonal demands and proper inventory control: (iii)inventory tagging and in-store signs; (iv) receiving and returning merchandise inventory shipped from Sears: (v) computer system installation, use and maintenance, including the sears E-mail system and access to on-line information (such as warranty information, status of orders, etc.); (vi) proper sales techniques and prohibited sales practices; (vii) customer merchandise returns: (vii) inventory pricing and mark-down procedures; (ix) repair and installation services; (x) point of sale ordering procedures; (xi) daily control procedures (i.e., cash register balancing and daily reporting); (xii) processing credit transactions; (xiii) product warranty matters; (xiv) local advertising; (xv) banking procedures; (xvi) insurance matters; (xvii) security procedures; and (xviii) required business hours.

6. Taxpayer, who operates as a sole proprietorship, is responsible for all costs associated with the operation of its Sears authorized dealership, including the cost of the building in which the retail facility is located and costs associated with the employees hired by Taxpayer to assist in its sales operation.

7. Generally, Sears provides Taxpayer with a limited inventory of merchandise for direct sales to customers. For items not maintained in inventory, taxpayer places orders for merchandise from Sears for its customers. Such items are delivered by Sears to Taxpayer who will then deliver the merchandise to the customer.

8. All merchandise inventory, whether it is maintained in inventory at Taxpayer's facility or ordered from Sears, remains the exclusive property of Sears until it is delivered to the customer, and all revenues from the sale of the merchandise belong to Sears.

9. Taxpayer is also responsible for providing installation, hook-up and delivery for merchandise purchased through its facility. Taxpayer pays all of the costs associated with providing these services and is entitled to retain all of the revenues from such services.

10. Taxpayer, as an authorized Sears dealer, is responsible for collecting the proceeds from sales of Sears merchandise by Taxpayer, including the applicable gross receipts tax.

11. Taxpayer deposits all cash sales proceeds (including the applicable gross receipts tax collected by Taxpayer) daily into a local bank account established for and owned by Sears, and Sears sweeps the account daily (i.e., electronically transfers the proceeds to its corporate accounts).

12. For credit sales, Taxpayer obtains the necessary approvals for the credit transaction from Sears (or the third-party credit card company), processes the credit transaction for Sears, and sends the credit sales receipts to Sears on a daily basis.

13. Sears pays Taxpayer a commission on the sale of Sears merchandise and the sale of maintenance agreements by Taxpayer. The commission rate varies depending on the type of merchandise sold. Sears will pay a sales volume bonus to Taxpayer if Taxpayer attains a specified net commissionable merchandise sales goal.

14. Sears also pays Taxpayer a set monthly customer fee for performing certain customer services, including, but not limited to, handling non-commissioned returns, adjustment transactions, credit complaints, credit payments, processing NSF checks, service orders and repair handling.

15. Under the terms of the Sears Agreement between Taxpayer and Sears, Taxpayer is responsible for payment of all license fees and local and state taxes, with the exception of taxes on Sears owned merchandise present at the Taxpayer's sales facility. Sears is responsible for paying sales, use, gross receipts and/or retail excise taxes applicable to the sale of Sears owned merchandise by Taxpayer, and Taxpayer has no responsibility for those taxes.

16. Based on information obtained from other Sears authorized retail dealers, it was Taxpayer's understanding that the New Mexico Taxation and Revenue Department did not require Sears authorized dealers to pay gross receipts tax on their sale of Sears merchandise or on the commissions they received from Sears. Accordingly, Taxpayer did not report or pay gross receipts tax on commissions received from Sears during the assessment period.

17. The information Taxpayer relied on in determining it did not owe gross receipts tax on its commissions included a November 23, 1988 protest letter filed with the Department by the law firm of Miller, Stratvert, Torgerson & Schlenker, P.A. in connection with an assessment issued against a Sears authorized dealer located in Portales, New Mexico, and a September 25, 1990 letter from the Department to the Miller firm stating that the Department would abate the assessment.

18. Taxpayer did not consult with a tax attorney or a certified public accountant concerning its liability for gross receipts tax on its revenues from acting as a Sears authorized retail dealer, nor did the Taxpayer contact the Department directly on this issue.

19. In January, 1994, the Department's Hearing Officer entered a nonconfidential Decision and Order in the protest of Maria Lujan Scoggin, a Sears authorized retail dealer located in Artesia, New Mexico. The decision held that Ms. Scoggin was liable for gross receipts tax on the commissions she received from Sears.

20. In October, 1995, the Department issued Ruling No. 401-95-10 based on facts virtually identical to the facts in this case. The ruling concluded that someone acting as an authorized dealer for a retail merchandiser is liable for gross receipts tax on commissions received from the retailer merchandiser.

21. On October 20, 1997, Decision and Order No. 97-37 was entered in the matter of Jesse C. and Shirley Orr, a Sears authorized retail dealer located in Taos, New Mexico. The decision held that the Orrs were liable for gross receipts tax on commissions received from Sears. This decision was appealed to the New Mexico Court of Appeals wherein the court upheld the hearing officer's decision.

22. The Department receives information from the Internal Revenue Service with respect to income reported by New Mexico residents. Through its Schedule C matching program, the Department attempts to match a taxpayer's receipts from engaging in business as reported on Schedule C of the taxpayer's federal form 1040 to the receipts reported to the Department for gross receipts tax purposes.

23. The Department received information concerning business income reported by the Taxpayer to the Internal Revenue service for tax years 1993 through 1995. The Department then contacted the Taxpayer to determine the source of Taxpayer's Schedule C income. Taxpayer responded with the information that it was a Sears authorized retail dealer.

24. The Department's records showed that the Taxpayer had never reported or paid gross receipts tax to the Department, nor had anyone filed a Form TS-22 agreement to pay tax on behalf of the Taxpayer. A Form TS-22 agreement is a means by which one taxpayer can apply to the Department to pay gross receipts tax on behalf of another taxpayer.

25. On July 24, 1996, the Department issued Assessment No. 2052747 to the Taxpayer for gross receipts tax, interest and penalty for the periods January 1993 through December, 1995.

26. On August 19, 1996, the Taxpayer sent a letter to the Department requesting an extension of time to file a formal protest to Assessment No. 2052741.

27. An extension of time was granted until October 22, 1996. On October 18, 1996, a timely formal protest to Assessment No. 2052747 was filed on behalf of Taxpayer by Gary D. Sanders, Esq. of Krafsur, Gordon, Mott, Davis & Woody, P.C.

28. On May 13, 1997, Taxpayer appointed Gary D. Sanders, Patrick R. Gordon and Marylee Warwick as Taxpayer's representatives. Ms. Warwick is an attorney licensed to practice law in New Mexico.

DISCUSSION

The Taxpayer sells and distributes Sears merchandise to retail customers in a designated market territory pursuant to the terms of a Sears Authorized Retailer Dealer Agreement. The merchandise sold by the Taxpayer is owned by Sears and Sears pays gross receipts taxes upon the total sales price of the merchandise. At issue herein is whether the Taxpayer is liable for gross receipts tax upon the commissions it receives on the sale of Sears merchandise.[1]

[1] The Taxpayer also receives a set monthly customer fee from Sears for performing certain customer services, such as handling returns, and also has receipts from the hook-up, delivery and installation of Sears merchandise. The

The first argument the Taxpayer raises is that because Sears has already paid gross receipts taxes upon the total receipts from the sale of merchandise, that to subject the Taxpayer to additional gross receipts tax upon the commissions it receives constitutes unlawful double taxation. There are two problems with this argument. The first is that there is no double taxation under the circumstances of this case. Although the Taxpayer argues that it is a single transaction which is being taxed, the sale of merchandise, there are two separate transactions involved, although a single event triggers the two transactions. First, there is the sale of Sears merchandise to a retail customer. The second transaction, however, is the payment of a commission by Sears to the Taxpayer. Both Sears and the Taxpayer are engaged in business in New Mexico and both are subject to gross receipts tax upon their receipts from engaging in business in New Mexico. Sears has receipts from the sale of its merchandise and the Taxpayer has receipts from performing services for Sears which are compensated on a commission basis pursuant to the terms of the agreement between the Taxpayer and Sears. We have two different taxpayers and two different transactions being taxed. Thus, there is no double taxation. ***See, House of Carpets, Inc. v. Bureau of Revenue,*** 87 N.M. 747, 507 P.2d 1078 (Ct. App. 1973), ***New Mexico Sheriffs & Police Association v. Bureau of Revenue,*** 85 N.M. 565, 514 P.2d 616 (Ct. App. 1973).

The second problem with the Taxpayer's argument is that although double taxation is not desirable from a tax policy perspective, there is nothing inherently illegal or unconstitutional about it. As noted by the Supreme Court in ***Ft. Smith Lumber Co. v. Arkansas,*** 251 U.S. 532, 533 (1920), "[T]he Fourteenth Amendment no more forbids double taxation than it does doubling the amount of a tax..." New Mexico's courts have also held that there is no

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Taxpayer has presented no arguments disputing its liability for gross receipts tax, penalty or interest on those receipts

constitutional prohibition against double taxation. ***New Mexico State Board of Public Accountancy v. Grant,*** 61 N.M. 287, 299 P.2d 464 (1956); ***Amarillo-Pecos Valley Truck Line, Inc. v. Gallegos,*** 44 N.M. 120, 99 P.2d 447 (1940); ***State ex rel. Attorney General v. Tittmann,*** 42 N.M. 76, 75 P.2d 701 (1938).

Next, the Taxpayer argues that the imposition of gross receipts tax upon its commissions is unconstitutional because it violates the principles of equal protection guaranteed by the federal and New Mexico constitutions. Specifically, the Taxpayer argues that it is treated differently than three other types of taxpayers who receive commissions. First, it is treated differently than commissioned employees, whose wages and commissions are exempt from gross receipts tax pursuant to Section 7-9-17 NMSA 1978. Second, it is treated differently than real estate brokers who receive sales commissions on the sale of real property under certain circumstances. Section 7-9-66.1 provides a deduction from gross receipts tax on that portion of the transaction which is subject to gross receipts tax under Section 7-9-53(A) NMSA 1978. Section 7-9-53(A) provides for a deduction from gross receipts tax for receipts from the sale of real property, except for the portion of the receipts attributable to the value of improvements constructed on the real property by the seller in the ordinary course of his construction business. Thus, the effect of Section 7-9-66.1 is to provide a deduction for real estate commissions on the sale of real property to the extent that those receipts are attributable to the value of improvements constructed on the real property by the seller in the ordinary course of its construction business. The third situation in which the Taxpayer alleges a denial of equal protection is that pursuant to Section 7-9-66 NMSA 1978, commissions received on the sale of tangible personal property are deductible if the sale of the tangible personal property is not subject to gross receipts tax. It is not disputed that

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and it is presumed that the Taxpayer is not disputing its liability for those amounts.

New Mexico's gross receipts tax scheme operates to subject the Taxpayer's commissions to gross receipts tax and that under the circumstances outlined above, the commissions of the real estate brokers, employees and other taxpayers receiving commissions under the circumstances outlined above would not be subject to gross receipts tax, but the Department disputes that such differential taxation violates equal protection and disputes that the Taxpayer has carried its burden of proving such a violation.

The standards for determining whether a violation of the equal protection clauses of the New Mexico and United States constitutions are the same. ***Garcia v. Albuquerque Public Schools Board of Education,*** 95 N.M. 391, 622 P.2d 699 (Ct. App. 1980). Unless a challenged statute trammels fundamental personal rights or is drawn upon an inherently suspect classification, such as race, religion, sex, or national origin, the constitutionality of the statutory discrimination is presumed and requires only that the classification challenged be rationally related to a legitimate state interest. ***Id.***

In making its equal protection argument, the Taxpayer has merely asserted that there is no rational basis for the differential tax treatments of commissions received by employees or by taxpayers where the underlying sale upon which the commission was based was not subject to tax. The Department is correct in its assertion that the mere allegation of a lack of a rational basis does not sustain the Taxpayer's burden of proof on this issue. This is because the courts have long recognized that in the area of taxation, especially, that the legislature must have broad discretion to impose taxes differently upon different classifications of taxpayers. As noted by the Supreme Court in ***Madden v. Commonwealth of Kentucky***, 309 U.S. 83, 87-88 (1940):

> [I]n taxation, even more than in other fields, legislatures possess the greatest freedom in classification....The presumption of constitutionality can be overcome

> only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. *The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.* (emphasis added.)

The New Mexico Supreme Court has adopted this standard of proof for equal protection challenges to tax classifications. ***See, Michael J. Maloof & Co. v. Bureau of Revenue,*** 80 N.M. 485, 458 P.2d 89 (1969).

Not only has the taxpayer failed to meet its burden of proof on this issue, there are rationales which can be posited for each of the scenarios of differential taxation. With respect to the deduction for wages and commissions received by employees, there are substantial differences between employees and those engaged in business to whom the gross receipts tax applies. An employee is subject to income tax on his entire income, including wages and commissions earned. A business is allowed to deduct business expenses in determining taxable income prior to the imposition of income tax, among other differences. This distinction alone provides a rational basis for the legislature to determine that they should be taxed differently for gross receipts tax purposes.

With respect to the deduction provided at Section 7-9-66.1 for real estate commissions attributable to the value of improvements constructed on a property by the seller in the ordinary course of its construction business, there is also a rational basis for this distinction. The value of the improvements would already be subject to the imposition of gross receipts tax upon their sale because the seller who is engaged in the construction business who built those improvements would be liable for gross receipts tax upon its receipts from performing those construction services. Thus, the deduction at Section 7-9-66.1 operates to prevent the pyramiding or stacking

of gross receipts tax upon the value of improvements to real property. Finally, there is also a rational basis for providing a deduction for commissions received on the sale of tangible personal property where the sale of the tangible personal property itself was not subject to gross receipts tax. This merely provides consistency of taxation. If the legislature saw fit to provide an exemption or deduction on the sale of certain tangible personal property, then it makes sense to provide a deduction for commissions derived from the sale of the same property.

The Taxpayer has also argued that the differential taxation which occurs with respect to its commissions and other commissions received violates the requirement of equal and uniform taxation contained in Article VIII, Section 1 of the New Mexico Constitution, which provides as follows:

> Taxes levied upon tangible property shall be in proportion to the value thereof, and taxes shall be equal and uniform upon subjects of taxation of the same class. Different methods may be provided by law to determine value of different kinds of property but the percentage of value against which tax rates are assessed shall not exceed thirty-three and one-third percent.

By its very wording, this provision applies to *ad valorem* or property taxes, which are imposed as a percentage of value of the property. Although "gross receipts" upon which the gross receipts tax is imposed may be measured by the value of the goods or services sold, Section 7-9-3(F) NMSA 1978, the gross receipts tax is a privilege tax, imposed upon the privilege of engaging in business in New Mexico. ***See,*** Section 7-9-4 NMSA 1978. The New Mexico Supreme Court has recognized that this section of the constitution does not apply to privilege taxes or non-property taxes. ***Sunset Package Store, Inc. v. City of Carlsbad***, 79 N.M. 260, 442 P.2d 572 (1968).

Next, the Taxpayer argues that its commissions are not subject to gross receipts tax because Section 7-9-3(F)(2)(f) excludes from "gross receipts" "amounts received solely on behalf of another in a disclosed agency capacity." There is no dispute that the Taxpayer is a disclosed agent for Sears. This agency relationship is disclosed to the public according to the requirements of Paragraph 2.04 of the Sears Agreement, which provides:

> [I]n order to maintain a clear distinction between the Dealer's business and the business of Sears, Dealer agrees ...to clearly display on or near the principal entrance to the Dealer Facility the statement "Sears Authorized Retail Dealer. Independently owned and operated by (Dealer's name)."

Thus, Section 7-9-3(F)(2)(f) operates to establish that when the Taxpayer collects sales revenue as a disclosed agent of Sears, those are not the Taxpayer's gross receipts.

The Taxpayer's argument, however, would turn the disclosed agency relationship on its head. When the Taxpayer receives commissions on sales it makes, the commissions are treated as gross receipts by the Department. The Taxpayer does not receive those commissions "solely on behalf of another [Sears] in a disclosed agency capacity." The Taxpayer receives those commissions on its own behalf. There is no evidence that the customer is even aware of the commissions being paid the Taxpayer. The customer only knows that it is paying an established price for the merchandise being purchased. This reaffirms that there are two separate transactions occurring. There is the sale of merchandise by Sears, which the Taxpayer makes as a disclosed agent for Sears, and there is a separate, and non-disclosed transaction between the Taxpayer and Sears whereby the Taxpayer has performed certain services for Sears and receives compensation in the form of a commission on sales for performing those services. Section 7-9-3(F)(2)(f) simply has no application to the second transaction.

The final issue to be determined is whether the Taxpayer should be held liable for penalty assessed on the commissions received by the Taxpayer.[2] 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. 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;
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> 2) inaction by taxpayers where action is required;
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> 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 from other Sears retailers where the Department agreed that a Sears catalogue merchant, who also received commissions from Sears upon its sales, was determined

[22] Because the Taxpayer did not protest the imposition of gross receipts tax upon its receipts from installation, hook-up and delivery charges, or upon its set monthly customer fee, and because the evidence submitted with respect to abatement of penalty only addressed commissions received from Sears, it is presumed that the Taxpayer has not protested the imposition of penalty upon its receipts other than commissions. Even if it had, having failed to submit

not to be subject to gross receipts tax upon its commissions from the sale of Sears merchandise. The information that the Taxpayer had was a copy of the protest filed on behalf of the Sears catalogue merchant by its attorney and the Department's response agreeing to abate the tax based upon a 1974 Decision and Order of the Department which had, in essence, concluded that Sears was paying the tax on the commissions on behalf of its authorized merchants.

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. The Department argues that the correspondence relied upon by the Taxpayer does not establish an affirmative misleading by the Department because it was not addressed to the Taxpayer, and because these documents are confidential documents which the Taxpayer would not be entitled to rely upon. The Department also points out that it has now reversed its prior position in a subsequent Decision and Order and in a ruling issued at the request of another Sears retailer. The Department also argues that because the Taxpayer never consulted with a tax professional about its gross receipts tax liability nor did it seek a ruling itself, it should not be entitled to rely upon the information provided it by other Sears retailers.

No doubt, the most prudent action by the Taxpayer in this case would have been to have consulted with a tax professional or to seek a ruling from the Department. Depending upon when that advice was sought, however, there could have been differing results, given the Department's change of position on this issue. Although the documents relied upon by the Taxpayer would be confidential in the hands of the Department, pursuant to Section 7-1-8 NMSA 1978, they are not confidential when provided by another source, such as the Sears

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evidence or argument upon this issue, the Taxpayer would not be entitled to relief from penalty on these other

merchant who must have made them available to other Sears merchants. With respect to the fact that the Department has issued a more recent ruling and decision to the effect that the Taxpayer's commission receipts would not be taxable, if the Department had established that the Taxpayer was also aware of these, then it would make it unreasonable for the Taxpayer to have relied upon the Department's earlier actions. In the absence of such proof, however, I conclude that it was not unreasonable for the Taxpayer to have relied upon the Department's own actions with respect to another Sears merchant who was compensated on a commission basis. Although the Department in no way affirmatively misled this particular taxpayer, the Taxpayer was exercising ordinary business care and prudence in relying upon the Department's actions with respect to a similarly situated taxpayer under the circumstances of this case. There being no taxpayer negligence upon which to base the imposition of penalty, the penalty should be abated with respect to the gross receipts tax upon the Taxpayer's commissions.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest, pursuant to Section 7-1-24 NMSA 1978 to Assessment No. 2052747 and jurisdiction lies over both the parties and the subject matter of this protest.

2. The imposition of gross receipts tax upon the Taxpayer's commissions does not amount to double taxation and is not unlawful.

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receipts because of its failure to meet its burden of proof on that aspect of the case.

3. The Taxpayer has not been denied the equal protection of the law as guaranteed by the New Mexico and United States Constitutions with respect to New Mexico's statutory scheme imposing gross receipts tax upon the commissions received by the Taxpayer.

4. The guaranty of equal and uniform taxation as contained in Article VIII, Section 1 of the New Mexico Constitution does not apply to the imposition of the gross receipts tax upon the commissions received by the Taxpayer.

5. The Taxpayer does not receive the commissions received from Sears "solely on behalf of another in a disclosed agency capacity" as required by Section 7-9-3(F)(2)(f) NMSA 1978 in order for the Taxpayer to claim an exemption from gross receipts tax.

6. The Taxpayer was not negligent for purposes of Section 7-1-69 NMSA 1978 with regard to its failure to report and pay gross receipts taxes on the commission portion of its gross receipts.

For the foregoing reasons, the Taxpayer's protest IS HEREBY DENIED.

DONE, this 4th day of February, 1999.