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

IN THE MATTER OF THE PROTEST
OF TPL, INC. No. 99-17
ID NO. 01-151191-00-5
ASSESSMENT NO. 2199612

DECISION AND ORDER

A formal hearing on the above-referenced protest was held December 15, 1999, before Margaret B. Alcock, Hearing Officer. TPL, Inc. ("TPL") was represented by Tracy J. Ahr and Claudia Gayheart Crawford of Keleher & McLeod, P.A. The Taxation and Revenue Department ("Department") was represented by Bruce J. Fort, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. TPL is a New Mexico corporation with offices in Albuquerque, New Mexico.

2. TPL is one of the leading companies in the United States in the field of demilitarization of surplus munitions and has developed methods of recovering components and constituents of the munitions, purifying the recovered materials, synthesizing new materials from the recovered components, and identifying commercial markets for the products of these activities.

3. During the audit period at issue, TPL entered into three demilitarization contracts with the U.S. Army Industrial Operations Command ("IOC"), a part of the U.S. Army Materiels Central Command ("AMCCOM"), headquartered in Rock Island, Illinois: Contact DAAA09-94-C-0386 (Exhibit E), Contract DAAA09-96-C-0064 (Exhibit D), and Contract DAAA09-96-C-0065 (Exhibit F).

4. TPL also entered into a Facility Use Contract with the IOC for use of government-owned facilities at Fort Wingate, New Mexico. The IOC approved TPL's use of these facilities on a rent-free basis to carry out its activities under the demilitarization contracts.

5. Pursuant to the demilitarization contracts, the IOC shipped surplus munitions to TPL at Fort Wingate, including pyrotechnics, propelling charges, and armor-piercing cartridges.

6. The IOC retained ownership of all munitions until after the demilitarization process was complete.

7. TPL's processes to demilitarize energetic materials were designed to have a zero waste stream; the proposals TPL submitted to the IOC emphasized TPL's ability to recover, reuse and recycle components and materials from the excess munitions.

8. The IOC's bid solicitation required the estimated value of the recovered materials to be factored into TPL's proposed price for demilitarization services.

9. After completion of TPL's demilitarization services, the IOC transferred title to all materials and components arising out of the disassembly and demilitarization of the munitions to TPL.

10. After the transfer of title, TPL assumed complete responsibility and liability for disposition of the recovered materials, most of which were resold for commercial use. TPL retained all proceeds from the resales.

11. During the audit period at issue, TPL entered into two contracts with the Naval Surface Warfare Center ("NAVSURF") located in Crane, Indiana: Contact NOO164-95-C-0009 (Exhibit B) and Contract NOO164-95-C-0023 (Exhibit C).

12. The contracts were administered by a federal entity in Phoenix Arizona; payments were made by another federal entity in Columbus Ohio. TPL was required to submit all invoices to the

federal contract auditor located at the Defense Contract Audit Agency suboffice in Albuquerque, New Mexico.

13. The NAVSURF contracts were awarded in response to two separate R&D proposals TPL submitted under the Small Business Innovation Research (SBIR) program. *See*, 15 U.S.C, Section 638.

14. Contract NOO164-95-C-0009 was a follow-on contract to an SBIR proposal to produce a precision blasting agent from explosives. During an earlier phase of the project, TPL developed the preliminary design for a surplus energetics reprocessing pilot plant (SERPP).

15. Contract C-0009 called for TPL to construct and attain operational capability for the SERPP to determine whether the manufacture of a precision blasting agent could be achieved on a commercial scale.

16. The contract required TPL to deliver drawings, equipment lists, engineering data, monthly performance and cost reports, monthly analysis summary reports, a management plan, a system safety program plan and a final technical report to NAVSURF at Crane, Indiana. The initial contract, entered into in February 1995, stated: "TPL, Inc. is not required to deliver any end items other than data as a result of the energetic materials being consumed during the performance of this contract." (Exhibit B, page 2).

17. In October 1996, Contract C-0009 was modified to provide additional clarification and guidance for contract performance. There were three deliverables listed under the revised statement of work: (1) attainment of an operational capacity for the SERPP; (2) manufacture of a precision blasting agent; and (3) documentation on processes and procedures.

18. Contract C-0009 authorized TPL to use government facilities at Fort Wingate, New Mexico, pursuant to TPL's Facility Use Contract with the IOC and this was the location of the SERPP.

19. The SERPP constructed by TPL was never put into full-scale operation. After establishing that it was possible to manufacture a precision blasting agent in larger than laboratory amounts, the pilot plant was dismantled. TPL retained the small amount of blasting agent manufactured in the plant.

20. NAVSURF never operated or took possession of the SERPP. Most of the components of the plant were rented on a month-to-month basis, and these were returned to the lessor. Other components were disassembled to be used on other projects.

21. All documentation of the work TPL conducted under Contract C-0009 was delivered to NAVSURF at Crane, Indiana.

22. Contract NOO164-95-C-0023 covered Phase II of a separate SBIR proposal submitted to NAVSURF by TPL.

23. During Phase I of that project, TPL conducted laboratory research to determine the feasibility of efficiently extracting HMX, a valuable explosive constituent, from surplus government propellants. An evaluation of the extracted HMX indicated it would be suitable for commercial use in oil and gas well perforating charges.

24. The primary purpose of Contract C-0023 was to continue TPL's work under Phase I by perfecting the HMX extraction process on a laboratory scale; designing and implementing a pilot plant to test the final extraction process; analyzing the HMX extracted in the pilot plant to verify its commercial value to oilfield service companies; and designing a commercial plant for the extraction of HMX and the disposition of all by-products.

25. If successful, the research and design work conducted under Contract C-0023 would serve as the basis for construction of a commercial-scale extraction plant in Crane, Indiana.

26. Contract C-0023 required TPL to provide "deliverables in the form of monthly Progress, Status, and Management reports and quarterly Scientific Technical Reports Summaries as required by the Contract Data Requirements Lists." (Exhibit C, page 2)

27. TPL's construction of the HMX extraction pilot plant under Contract C-0023 was coordinated with TPL's construction of the SERPP at Fort Wingate under Contract C-0009.

28. Contract C-0023 was never fully funded and only 27 pounds of HMX were produced from the pilot plant before TPL ceased operations. TPL retained the 27 pounds of HMX.

29. NAVSURF never operated or took possession of the HMX pilot plant.

30. All documentation of the work TPL conducted under Contract C-0023 was delivered to NAVSURF at Crane, Indiana.

31. In June 1997, the Department conducted an audit of TPL's gross receipts and compensating tax reporting for tax periods January 1992 through April 1997.

32. The Department disallowed TPL's deduction of its receipts from contracts entered into with the IOC and NAVSURF.

33. The Department determined that TPL had failed to pay compensating tax on certain tangible personal property purchased out-of-state for use in New Mexico.

34. At the commencement of the audit, the Department's auditor asked to see all of TPL's nontaxable transaction certificates ("NTTCs").

35. TPL maintained two separate NTTC files: one contained the NTTCs TPL had issued to its vendors and the other contained the NTTCs TPL had received from outside parties.

36. The auditor was given the file containing the NTTCs issued by TPL. She asked to see the NTTCs received by TPL, but was not given anything further to review.

37. The auditor disallowed TPL's deduction of receipts from selling tangible personal property to Bolton Enterprises and Koenigs because she had not seen any nontaxable transaction certificates from these entities.

38. Shortly after receiving the Department's audit report in October 1997, Stephen Sallot, TPL's chief financial officer, located NTTCs from Bolton and Koenigs in TPL's files. The NTTC from Bolton indicated that it was issued to TPL on 7/25/96; the NTTC from Koenigs indicated that it was issued to TPL on 1/15/96.

39. The NTTCs from Bolton and Koenigs were provided to the Department with TPL's written protest and were admitted into evidence as Exhibits H and I at the formal hearing.

40. On December 12, 1997, the Department issued Assessment No. 2199612 in the amount of $215,507.22 gross receipts tax, $6,962.30 compensating tax, $22,246.98 penalty, and $60,248.48 interest, for a total assessment of $304,964.98.

41. On January 6, 1998, TPL requested and received an extension of time to March 12, 1998 to file a protest of the assessment.

42. On March 11, 1998, TPL paid $11,773.43 of the assessment, representing $6,889.89 of compensating tax and $1,698.73 of gross receipts tax, plus related penalty and interest.

43. On the same date, TPL filed a written protest to the $293,191.55 balance of the assessment.

44. At the formal hearing, the Department stipulated that it would abate the gross receipts tax, penalty and interest assessed on receipts from the following four sales of tangible personal property: Invoice 97-050 to Sandia National Laboratory in the amount of $4,026.05; Invoice 97-091 to H. M. Stoller in the amount of $20.12; Invoice 97-090 to W. Little in the amount of $6.03; and Invoice 97-076 to Am. Metals in the amount of $618.70.

DISCUSSION

This protest raises the following issues: (1) whether TPL is entitled to deduct its receipts from performing services under five federal contracts because the product of TPL's services was neither delivered to nor initially used by the buyer in New Mexico; (2) whether denial of this deduction results in an unconstitutional interference with interstate commerce; (3) whether denial of this deduction violates TPL's rights to due process and equal protection; (4) whether TPL was entitled to deduct its receipts from selling tangible personal property to Bolton Enterprises and Koenigs based on TPL's possession of nontaxable transaction certificates from these entities.[1]

I. BURDEN OF PROOF.

Section 7-1-17(C) NMSA 1978 provides that any assessment of tax by the Department is presumed to be correct, and it is the taxpayer's burden to overcome this presumption. *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972). Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer. Once it is determined that a tax is applicable, after allowing for any statutory deduction, the statute permitting the deduction must be narrowly, yet reasonably construed. *Security Escrow Corp. v. State Taxation and Revenue Department*, 107 N.M. 540, 543, 760 P.2d 1306, 1309 (Ct. App. 1988). *See also, Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 809 P.2d 649 (Ct. App. 1991).

II. DEDUCTION UNDER SECTION 7-9-57 NMSA 1978.

[1] In its post-hearing briefs, TPL also argued that it was entitled to a deduction under Section 7-9-54 for selling tangible personal property to the government. As discussed in more detail under Part V, *infra*, this issue is not properly before the hearing officer and will not be considered in this decision.

Section 7-9-3(F) NMSA 1978[2] of the New Mexico Gross Receipts and Compensating Tax Act defines gross receipts as:

> the total amount of money or the value of other consideration received from selling property in New Mexico, from leasing property employed in New Mexico, from selling services performed outside New Mexico the product of which is initially used in New Mexico or from performing services in New Mexico.

TPL acknowledges that all services performed under the federal contracts at issue were performed in New Mexico. TPL asserts, however, that its receipts from those contracts are deductible under Section 7-9-57 NMSA 1978 which states:

> A. Receipts from performing a service may be deducted from gross receipts if the sale of the service is made to a buyer who delivers to the seller either a nontaxable transaction certificate or other evidence acceptable to the secretary that the transaction does not contravene the conditions set out in Subsection C of this section.

Subsection C states:

> C. Receipts from performance of a service shall not be subject to the deduction provided in this section if the buyer of the service or any of the buyer's employees or agents:
>
> (1) makes initial use of the product of the service in New Mexico; or
>
> (2) takes delivery of the product of the service in New Mexico.

The issue to be decided is whether the product of the service TPL performed under each of the five federal contracts was either delivered to or initially used by the buyer in New Mexico.

A. Demilitarization Contracts. During the audit period, TPL entered into three demilitarization contracts with the U.S. Army Industrial Operations Command ("IOC"), a part of the U.S. Army Materiels Central Command ("AMCCOM"), headquartered in Rock Island, Illinois: Contact DAAA09-94-C-0386 (Exhibit E), Contract DAAA09-96-C-0064 (Exhibit D), and Contract

[2] Unless otherwise noted, the version of the statutes in effect during the audit period are compiled in the 1995 Replacement Pamphlet.

DAAA09-96-C-0065 (Exhibit F). TPL also entered into a Facility Use Contract with the IOC for use of government-owned facilities at Fort Wingate, New Mexico. The IOC approved TPL's use of these facilities on a rent-free basis to carry out its activities under the demilitarization contracts.

Pursuant to the terms of the three contracts, the IOC shipped surplus munitions to TPL at Fort Wingate, including pyrotechnics, propelling charges, and armor-piercing cartridges. The IOC retained ownership of all munitions until after the demilitarization process was complete. TPL's processes to demilitarize energetic materials were designed to have a zero waste stream, and the proposals TPL submitted to the IOC emphasized TPL's ability to recover and reuse components and materials from the excess munitions. For example, page 3 of TPL's technical proposal for Contract C-0064 (Exhibit D) stated:

> Our primary goal in the demilitarization work undertaken to date is to reutilize the materials from our demilitarization activities, preserving as much as possible of the high quality energetic materials used in military munitions and retaining the maximum economic value of those materials. A secondary goal is to minimize the environmental impact of our demilitarization efforts, by minimizing destruction of energetic materials by incineration and by minimizing the waste stream from our reclamation process.

After completion of TPL's demilitarization services, the IOC transferred title to all materials and components arising out of the disassembly and demilitarization to TPL. At this point, TPL assumed complete responsibility and liability for disposition of the recovered materials, most of which were resold for commercial use. TPL retained all proceeds from the resales.

TPL argues that its receipts from its contracts with the IOC are deductible under Section 7-9-57 because there was no "product" of its demilitarization services. TPL further argues that even if such a product existed, the IOC could not have taken delivery or initially used the product of TPL's services in New Mexico because the IOC had no presence in New Mexico. The evidence does not support either of these contentions.

(1) IOC Presence in New Mexico. During the period at issue, the IOC owned hundreds of thousands of rounds of munitions physically located in New Mexico. At the hearing, TPL's chief financial officer testified that AMCCOM, of which the IOC is a part, had ownership and control over the munitions on which TPL performed services under the three demilitarization contracts. The contracts provided for the IOC to ship the munitions into New Mexico at government expense, stating that the "method of transportation will be the most economical as determined by the government. Initial delivery of [government furnished material] shall be within ninety (90) days after date of contract award" (Exhibits D and F, Contract Solicitation, Attachment 5, page 8). The IOC retained ownership of the munitions until after TPL completed the demilitarization process.

The IOC also had sufficient authority over the Army's facilities at Fort Wingate, New Mexico, to negotiate an agreement with TPL for use of those facilities. The February 2, 1995 amendment to Contract C-0386 (Exhibit E) provided for a contract price reduction of $7,757.50 as consideration for IOC approval of TPL's use of the Fort Wingate facilities. TPL's Technical Proposal in response to the solicitation for Contract C-0064 (Exhibit D) stated:

> [T]he operational demilitarization activities on this project will take place at our Fort Wingate Demilitarization Facility.... We have a Facility Use Contract (Contract DAAA09-94-E-0014) with IOC for use of a portion of the facility.... On 22 April 1996, we received formal permission from James D. Munson of the IOC Commercial Facilities Section to use the facility covered by the Facility Use Contract for performance of the demilitarization efforts under this solicitation.

The fact that TPL's contract for use of Fort Wingate was entered into directly with the IOC and formal permission to extend the scope of the agreement was granted through the IOC Commercial Facilities Section establishes that the IOC exercised at least some degree of control or authority over the Army's New Mexico facilities.

(2) Product of TPL's Service. TPL argues that its deconstructive services did not result in a product the IOC could have either taken delivery of or made initial use of in New Mexico. This position is contrary to the statement in TPL's contract proposal that the "primary goal" of its demilitarization work was "to reutilize the materials from our demilitarization activities, preserving as much as possible of the high quality energetic materials used in military munitions and retaining the maximum economic value of those materials." The recovery and reuse of materials was an important aspect of the demilitarization contracts for both environmental and economic reasons. The IOC's bid solicitation expressly stated: "The contractor shall use best efforts to recover maximum material/components possible.... The proposed price shall reflect any estimated or anticipated proceeds from recovered materials/components" (Exhibits D & F, Contract Solicitation, Attachment 5, page 1, para. 1.3). By letter dated July 26, 1996, TPL confirmed to the IOC that "the effects of resource recovery and reuse has been factored in our bid to reduce the price substantially from our 'demil only' costs" (Exhibit D, attachment to Award/Contract).

Under the terms of the demilitarization contracts, the IOC shipped hundreds of thousands of rounds of munitions into New Mexico to be demilitarized. The result or "product" of TPL's demilitarization services was the transformation of formerly dangerous munitions into components and materials suitable to be recycled and reused for other purposes. The IOC took delivery of this product in New Mexico by virtue of the fact that TPL's services were performed on IOC property that was physically located in New Mexico and remained in New Mexico after completion of the services. The IOC made initial use of the deconstructed materials and components when it transferred title and risk of loss to TPL as consideration for TPL's reduction of the bid price on its demilitarization services. This transfer took place in New Mexico. After the transfer, TPL assumed complete responsibility and liability for disposition of the recovered materials.

The IOC took delivery and made initial use of the product of TPL's demilitarization services in New Mexico, and TPL is not entitled to claim the deduction provided in Section 7-9-57 for the receipts from its contracts with the IOC.

B. Pilot Plant Contracts. During the audit period, TPL entered into two contracts with the Naval Surface Warfare Center ("NAVSURF") located in Crane, Indiana: Contact NOO164-95-C-0009 (Exhibit B) and Contract NOO164-95-C-0023 (Exhibit C).

Contract C-0009 called for TPL to construct and attain operational capability for a surplus energetics reprocessing pilot plant (SERPP) to determine whether the manufacture of a precision blasting agent could be achieved on a commercial scale. Contract C-0023 required TPL to design and implement a pilot plant to test the laboratory process TPL had previously developed to extract HMX, a valuable explosive constituent, from surplus government propellants.

TPL's construction of the pilot plants was coordinated at Fort Wingate, New Mexico. Neither project achieved full-scale operation. Contract C-0023 was never fully funded and only 27 pounds of HMX were produced from the pilot plant before TPL ceased operations. After establishing that it was possible to manufacture a precision blasting agent in larger than laboratory amounts, the SERPP was dismantled. Most of the components of the plant were rented on a month-to-month basis and were returned to the lessor. Other components were disassembled and transferred to other projects. NAVSURF never operated or took possession of the pilot plant. All data resulting from the services TPL performed under the contracts was delivered to NAVSURF at Crane, Indiana.

TPL argues that its receipts from its contracts with NAVSURF are deductible under Section 7-9-57 because the product of its services was the data delivered and initially used by NAVSURF in Crane, Indiana. The Department maintains that the product of TPL's services was the construction

and operation of a pilot plant to manufacture a precision blasting agent and extract HMX. On this issue, the evidence supports TPL's position.

TPL's contracts with NAVSURF called for the design and construction of a prototype plant to be used to determine whether new manufacturing methods developed in the laboratory could be implemented on a commercial scale. The HMX contract required TPL to provide "deliverables in the form of monthly Progress, Status, and Management reports and quarterly Scientific Technical Reports Summaries as required by the Contract Data Requirements Lists." (Exhibit C, page 2) The SERPP contract required TPL to deliver drawings, equipment lists, engineering data, monthly performance and cost reports, monthly analysis summary reports, a management plan, a system safety program plan and a final technical report. In October 1996, the contract was modified to provide additional clarification and guidance for contract performance. There were three deliverables listed under the revised statement of work: (1) the attainment of an operational capacity for the SERPP; (2) manufacture of a precision blasting agent; and (3) documentation on processes and procedures.

Based on the amended statement of work for the SERPP contract, the Department argues that the product of TPL's services under both the SERPP and HMX contracts was the construction and operation of a pilot plant. The Department maintains the "plant was used by the government to determine the feasibility of recycling propellant into commercial explosive." Response Brief at 5. This argument confuses the performance of a service with the product of that service. Section 7-9-57 grants a deduction for receipts from performing services in New Mexico unless the buyer takes delivery or makes initial use of the product of the service in New Mexico. In this case, the pilot plant was constructed and used by the seller—TPL—to carry out the terms of its research contracts. There is no evidence that the buyer—NAVSURF—ever took delivery of or operated the pilot plant TPL used to conduct its research.

Construction and operation of the pilot plant constituted TPL's *performance* of services under the contracts. The *product* of TPL's services was the research data generated through operation of the plant. The SERPP contract expressly states: "TPL, Inc. is not required to deliver any end items other than data as a result of the energetic materials being consumed during the performance of this contract." (Exhibit B, page 2). The pilot plant was simply the means to an end. Upon completion of the contracts, the plant was not turned over to NAVSURF or any other federal agency, but was dismantled. All data generated from TPL's operation of the plant was delivered to NAVSURF at Crane, Indiana. NAVSURF's initial use of this data to determine the feasibility of manufacturing explosives on a commercial scale also took place in Crane, Indiana.

Finally, the Department argues that TPL is not entitled to the deduction in Section 7-9-57 because it did not sell its services to an out-of-state buyer. The Department contends first, that the buyer of TPL's services was not NAVSURF, but the federal government as a single, unitary entity; and second, that the federal government does not qualify as an "out-of-state buyer" for purposes of Section 7-9-57 because the federal government is physically present in New Mexico. Response Brief at 10. The Department's position is untenable. Even assuming all federal agencies may be treated as a single federal entity, there is no authority for the argument that a buyer who has a presence both within and without New Mexico cannot be an "out-of-state buyer" for purposes of Section 7-9-57. To the contrary, Regulation 3 NMAC 2.57.12.2.2. confirms that a seller will not forfeit the deduction in Section 7-9-57 even under the following circumstances:

> 12.2.2.2. the purchaser has a person or persons in New Mexico assigned to the project who work in conjunction with employees of the seller on the product or the service required by the contract but the product of the service is delivered to the purchaser outside of this state and the purchaser initially uses the product of the service outside this state; ...
>
> 12.2.2.4. the purchaser maintains a place of business in New Mexico and is performing work in this state related to the subject matter of the contract but

> the product of the service is delivered to the purchaser outside of this state and the purchaser initially uses the product of the service outside this state.

The determining factors under Section 7-9-57 are delivery and initial use, not physical presence.

The buyer of TPL's services did not, as the Department argues, use the pilot plant in New Mexico to determine the feasibility of manufacturing explosives on a commercial scale. It used the data generated from TPL's operation of the plant to make this determination. NAVSURF took delivery and made initial use of this data—the product of TPL's services—outside New Mexico, and TPL is entitled to claim the deduction provided in Section 7-9-57 for its receipts from the HMX and SERPP contracts.

III CONSTITUTIONAL ISSUES.

A**. Commerce Clause**. TPL maintains that imposition of New Mexico's gross receipts tax on TPL's receipts from performing services for an out-of-state buyer impermissibly impacts interstate commerce and violates the Commerce Clause of the United States Constitution. A state tax survives a Commerce Clause challenge when the tax: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

TPL argues that New Mexico's tax on TPL's receipts from performing services for the IOC and NAVSURF fails to comply with the fair apportionment prong of the *Complete Auto Transit* test: "Because New Mexico imposes a gross receipts tax on the seller, and Illinois and Indiana could impose taxes on the buyer, both the New Mexico seller and the out-of-state buyers would be subject to tax on the same transaction."[3] TPL Brief at 21. TPL further argues that the possibility of multiple

[3] TPL does not explain by what authority either Indiana or Illinois could impose a tax on an agency of the federal government. Under the doctrine of intergovernmental immunity, first articulated in *McCulloch v. Maryland*, 17 U.S. 316 (1819), states are barred from taxing the federal government except to the extent immunity is waived by Congress.

taxation discriminates against interstate commerce because "interstate transactions involving out-of-state buyers would be subject to double taxation in contravention of the Commerce Clause." *Id*.

This same multiple taxation argument was raised in *Markham Advertising Company v. Bureau of Revenue*, 88 N.M. 176, 538 P.2d 1198 (Ct. App.), *cert. denied*, 88 N.M. 318, 540 P.2d 248 (1975), where the court rejected the taxpayer's Commerce Clause challenge to a tax on its receipts from posting billboard messages for out-of-state advertisers on signs located within New Mexico. The court of appeals found the taxpayer's services were performed entirely within New Mexico and were not subject to tax by any other state:

> Hypothetical situations raised by the taxpayer (*e.g*., possible taxation of the foreign advertiser in its home state) do not deal with the reality that it is only taxpayer's activity which is being taxed by New Mexico. Therefore, no basis is demonstrated upon which a claim of potential multiple taxation as to this taxpayer can be found. *See General Motors Corp. v. Washington*, 377 U.S. 436, 84 S. Ct. 1564, 12 L. Ed. 2d 430 (1964).

88 N.M. at 177, 538 P.2d at 1199.

In this case, gross receipts tax was imposed on TPL's receipts from performing services wholly within New Mexico. Even more than in *Markham*, TPL's conjecture that another state might tax a federal agency for services TPL performs for that agency in New Mexico fails to raise a viable Commerce Clause issue.

B. Equal Protection and Due Process. TPL raises an equal protection challenge to the Department's position that TPL contracted to perform services for the federal government as a single, unitary entity, rather than for an individual federal agency. TPL raises a due process challenge to the Department's position that a buyer without a physical presence in New Mexico can still take delivery and make initial use of the product of a service in New Mexico. Because the conclusions reached in this decision are not based on the position taken by the Department on either of these issues, there is no need to address the constitutional arguments TPL has raised in response.

IV NONTAXABLE TRANSACTION CERTIFICATES

At the commencement of the audit in June 1997, the Department's auditor asked to see all of TPL's nontaxable transaction certificates ("NTTCs"). TPL maintained two separate NTTC files: one contained the NTTCs TPL had issued to its vendors and the other contained the NTTCs TPL had received from outside parties. The auditor was given the file containing the NTTCs issued by TPL. She asked to see the NTTCs received by TPL, but was not given anything further to review. The auditor disallowed TPL's deduction of receipts from selling materials derived from deconstructed munitions to Bolton Enterprises and Koenigs because she had not seen any nontaxable transaction certificates from these entities.

Shortly after receiving the Department's audit report in October 1997, Stephen Sallot, TPL's chief financial officer, located Type 2 (Resale) NTTCs from Bolton and Koenigs in TPL's files. The NTTC from Bolton indicated that it was issued to TPL on 7/25/96 (Exhibit H); the NTTC from Koenigs indicated that it was issued to TPL on 1/15/96 (Exhibit I). Mr. Sallot testified that his staff informed him the NTTCs had been obtained by TPL on the dates shown on the certificates and had been presented to the auditor for review. Mr. Sallot acknowledged, however, that he had no personal knowledge of these facts.

Section 7-9-47 NMSA 1978 provides that receipts from selling tangible personal property for resale may be deducted from gross receipts "if the sale is made to a person who delivers a nontaxable transaction certificate to the seller." The requirements for obtaining NTTCs to support deductions from gross receipts is governed by Section 7-9-43 NMSA 1978. At issue is whether evidence that TPL had NTTCs from Bolton and Koenigs in its files in October 1997 is sufficient to establish TPL's right to the resale deduction.

A. History of Section 7-9-43 NMSA 1978. Prior to 1992, Section 7-9-43 stated that a taxpayer "should" have the NTTC required to support a particular deduction in the taxpayer's possession at the time of the transaction for which the deduction was claimed. The statute nonetheless allowed the taxpayer a 60-day period, beginning on the date the Department gave the taxpayer written notice requiring possession of NTTCs (commonly known as a "60-day letter"), to obtain possession of the NTTC. If the taxpayer failed to obtain possession of the NTTC within the 60-day period, the deduction was disallowed.

Effective July 1, 1992, Section 7-9-43 was amended to change the time within which a taxpayer must be in possession of NTTCs required to support deductions from gross receipts. Laws 1992, Chapter 39, Section 3. The 1992 amendment substantially tightened the requirements with respect to NTTCs. The language providing that a taxpayer "should" have possession of the NTTC at the time of the nontaxable transaction was changed to state that the taxpayer "shall" have possession of the NTTC by the due date of the return reporting the taxpayer's receipts from the transaction. The taxpayer was required to demonstrate possession of all necessary NTTCs at the commencement of an audit or, in response to a 60-day letter from the Department, demonstrate that the NTTCs were in the taxpayer's possession at the time the receipts from each transaction were required to be reported. Otherwise, the deductions claimed were disallowed.

Five years later, the 1997 legislature amended Section 7-9-43 to again allow taxpayers a 60-day grace period within which to obtain NTTCs required to support deductions taken. Laws 1997, Chapter 72, Section 1. The effective date of this amendment was July 1, 1997. A comparison of the pertinent language in effect before and after the 1997 amendment appears below:

Prior Version, Laws 1992, Chapter 39, Section 3 (effective July 1, 1992):

> A. The provisions of this subsection apply to transactions occurring on or after July 1, 1992. All nontaxable transaction certificates of the appropriate

> series executed by buyers or lessees shall be in the possession of the seller or lessor for nontaxable transactions at the time the return is due for receipts from the transactions. If the seller or lessor does not demonstrate possession of any required nontaxable transaction certificates to the department at the commencement of an audit or demonstrate 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 that the seller or lessor was in possession of such certificates at the time receipts from the transactions were required to be reported, deductions claimed by the seller or lessor that require delivery of these nontaxable transaction certificates shall be disallowed.

Current Version, Laws 1997, Chapter 72, Section 1 (effective July 1, 1997):

> A. All nontaxable transaction certificates of the appropriate series executed by buyers or lessees should be in the possession of the seller or lessor for nontaxable transactions at the time the return is due for receipts from the transactions. If the seller or lessor is not in possession of the required 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.

B. TPL's Possession of NTTCs from Bolton and Koenigs. The Department argues that TPL is not entitled to claim a deduction on its sales to Bolton and Koenigs because TPL failed to meet the requirements of Section 7-9-43 in effect between July 1, 1992 and July 1, 1997. To meet those requirements, TPL would have to show (1) that it had possession of the NTTCs at the time of its sales to Bolton and Koenigs and (2) that it presented the auditor with the NTTCs at the commencement of the audit or within 60 days after the auditor issued TPL written notice requiring possession of the NTTCs. The Department points to the fact that Stephen Sallot, TPL's sole witness, had no personal knowledge of these facts and could only testify that TPL had the required NTTCs in its possession in October 1997.

The Department's argument fails for two reasons. First, the law applicable to TPL's audit is not the 1992 version of Section 7-9-43, but the more relaxed 1997 version. The 1992 amendment specifically states that it applies to transactions occurring on or after its effective date. The 1997

amendment does not contain similar language, and application of its 60-day grace period to obtain required NTTCs is not restricted to transactions occurring on or after July 1, 1997. I take administrative notice that the Department has consistently applied the 1997 amendment to all audits where the 60-day period expired after the amendment's July 1, 1997 effective date, regardless of the date of the underlying NTTC transaction. *See also*, Regulation 3 NMAC 2.43.1.12.4. In this case, the audit commenced June 4, 1997. Any 60-day letter issued by the Department would have had to expire after July 1, 1997. The Department has not argued that its policy concerning application of Section 7-9-43 is incorrect, nor has it given any reason for not applying that policy to TPL. In fact, the Department's post-hearing brief does not include any argument or legal authority to explain the basis for its conclusion that the pre-July 1, 1997 version of Section 7-9-43 applies in this case.

The second problem with the Department's position on the NTTC issue is the absence of any evidence the auditor issued a 60-day letter to TPL. During opening argument, Department counsel argued that TPL failed to present the required NTTCs within the period provided by the 60-day letter. There was no testimony from the auditor, however, to establish that she gave TPL a 60-day letter or when the 60-day period expired. Nor does the audit report, admitted into evidence as Exhibit A, contain any reference to a 60-day letter. There is simply no indication whether or when such notice was given to TPL.

Under the July 1, 1997 version of Section 7-9-43, TPL is required to show that it had possession of NTTCs from Bolton and Koenigs within 60 days after the Department gave TPL notice that such possession was required. TPL presented evidence that it had the NTTCs in its possession in October 1997. Copies of those NTTCs were provided to the Department with TPL's written protest and were admitted into evidence at the formal hearing. In the absence of any evidence the auditor even issued a 60-day letter to TPL, the Department is required to accept TPL's presentation of NTTCs as

timely and allow TPL's deduction of its receipts from sales of tangible personal property to Bolton and Koenigs.

V EXHIBITS NOT ADMITTED INTO EVIDENCE

On March 11, 1998, TPL filed a written protest to the Department's assessment. Pursuant to the requirements of Section 7-1-24 NMSA 1978, TPL included a statement of the grounds for its protest and a summary of the evidence supporting each ground asserted. TPL attached several schedules and other documents as exhibits to the protest.

On June 24, 1998, counsel for the Department filed a Request for Hearing. On July 9, 1998, the hearing officer issued a Scheduling Order setting the hearing on TPL's protest for December 15, 1998, and establishing a schedule to govern the conduct of the case. Paragraph 5 stated:

> 5. **Prehearing Statement**. No later than November 20, 1998, the parties shall file a joint statement setting out the following:
>
> (a) unresolved issues, with a summary of each party's position on each issue;
> (b) any stipulation of facts reached by the parties;
> (c) each party's final witness list;
> (d) each party's final exhibit list with a statement of any objections to the opposing party's exhibits;
> (e) a list of pending motions or other matters to be decided before hearing.
>
> A prehearing conference will be set upon the request of either party or may be set on the hearing officer's own motion.

The parties filed their joint statement on November 13, 1998. At the beginning of the hearing on December 15, 1998, TPL indicated that it wished to raise an issue concerning NTTCs that was not included in the joint statement. Upon questioning by the hearing officer, counsel for TPL explained that the taxpayer had mistakenly believed the matter was resolved. Because the Department's auditor was present and had knowledge of the NTTC issue, counsel for the Department waived objection to TPL's presentation of evidence and argument on this issue.

Following the hearing, the parties were directed to submit legal memoranda in lieu of closing argument. In its brief, TPL attempted to supplement the evidence it had presented on the NTTC issue by attaching the affidavit of a TPL employee who was not listed as a witness in the joint statement and was not present at the hearing. TPL also included argument on whether it was entitled to claim a deduction for receipts from selling tangible personal property to the government. Although raised in the taxpayer's original protest, this issue was not included in the joint statement and no evidence relating to the issue was presented at the hearing. In an effort to remedy this oversight, TPL attached a schedule included with TPL's protest letter as an exhibit to its post-hearing brief.

Section 7-1-24 requires the Department to resolve taxpayer protests through the process of an administrative hearing. Subsections F and G to Section 7-1-24 state:

> F. In hearings before the hearing officer, the technical rules of evidence shall not apply, but in ruling on the admissibility of evidence, the hearing officer may require reasonable substantiation of statements or records tendered, the accuracy or truth of which is in reasonable doubt.
>
> G. In hearings before the hearing officer, the Rules of Civil Procedure for the District Courts shall not apply, but the hearing shall be conducted so that both complaints and defenses are amply and fairly presented. To this end, the hearing officer shall hear arguments, permit discovery, entertain and dispose of motions, require written expositions of the case as the circumstances justify and render a decision in accordance with the law *and the evidence presented and admitted*. (emphasis added).

The schedules and other documents included with TPL's protest letter were not admitted into evidence. As with a complaint filed in district court, a protest letter simply sets out the contentions of the taxpayer. It is not a substitute for the presentation of evidence at a hearing where testimony is subject to cross-examination and exhibits are subject to objections of hearsay and lack of foundation. To allow either party to submit evidence in the form of exhibits for which no foundation has been laid and to which the other side has no opportunity to object would violate the requirement in

Section 7-1-24 that hearings be conducted "so that both complaints and defenses are amply and fairly presented." *See also*, Regulation 3 NMAC 1.8.8.2 ("Every party shall have the right of due notice, cross-examination, presentation of evidence, objection, motion, argument and all other rights essential to a fair hearing....").

It would also violate the legal residuum rule applicable to administrative hearings in New Mexico. Under that rule, an administrative agency may consider evidence that would not be admissible under the rules of evidence, but the agency's decision must be supported by some evidence that would be admissible under the rules. *Chavez v. City of Albuquerque*, 124 N.M. 239, 947 P.2d 1059 (Ct. App. 1997); *See also*, *Bransford v. State Taxation and Revenue Department*, 125 N.M. 285, 960 P.2d 827 (Ct.App. 1998). Here, the only evidence TPL presented in support of its claim to a deduction for receipts from sales of tangible personal property to the government was a summary schedule attached to its protest letter and post-hearing brief. The person who prepared the schedule is not identified, nor is there any information concerning the source documents used to prepare the schedule. The schedule attached to TPL's post-hearing brief is inadmissible hearsay. Any decision based on this exhibit would be subject to reversal under the legal residuum rule.

Exhibits attached to TPL's protest letter and brief, but not presented at the formal hearing, have not been admitted into evidence and will not be considered by the hearing officer.

CONCLUSIONS OF LAW

1. TPL filed a timely, written protest to Assessment No. 2199612, and jurisdiction lies over the parties and the subject matter of this protest.

2. Delivery and initial use of the product of TPL's demilitarization services took place in New Mexico, and TPL is not entitled to claim the deduction provided in Section 7-9-57 NMSA 1978 for the receipts from its three contracts with the IOC.

3. Delivery and initial use of the product of TPL's services under the SERPP and HMX contracts took place outside New Mexico, and TPL is entitled to claim the deduction provided in Section 7-9-57 NMSA 1978 for the receipts from its contracts with NAVSURF.

4. Imposition of New Mexico's gross receipts tax on TPL's receipts from performing services in New Mexico does not violate the Commerce Clause of the United States Constitution.

5. TPL's presentation of NTTCs was timely under Section 7-9-43 NMSA 1978 (1997 Cum.Supp.), and TPL is entitled to the deduction provided in Section 7-9-47 NMSA 1978 for its receipts from sales of tangible personal property to Bolton and Koenigs.

IT IS THEREFORE ORDERED:

TPL's protest IS GRANTED with regard to the assessment of gross receipts tax, penalty and interest on its receipts from the two contracts with NAVSURF and from sales of tangible personal property to Bolton Enterprises and Koenigs.

TPL's protest IS DENIED with regard to the assessment of gross receipts tax, penalty and interest on its receipts from the three contracts with the IOC and the assessment of compensating tax, penalty and interest.

DATED this 5th day of April 1999.