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

IN THE MATTER OF THE PROTEST OF
SUPPORT TERMINALS OPERATING PARTNERSHIP; ID NO. 02-427910-00-2
ASSESSMENT NO. 2602873

No. 03-14

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on June 24, 2003, before Margaret B. Alcock, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Jeffrey W. Loubet, Special Assistant Attorney General. Support Terminals Operating Partnership ("Taxpayer") was represented by Benjamin Allison of Sutin, Thayer & Browne, P.C., and Doug Sigel of Scott, Douglass & McConnico, LLP, its attorneys. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. The Taxpayer, a partnership headquartered in Dallas, Texas, operates a bulk liquid warehouse business with storage terminals throughout the world.

2. During the 1990s, the Taxpayer held federal government contracts to transport and provide storage facilities for jet fuel used by the government at Holloman Air Force Base in New Mexico.

3. During the period January 1994 through December 1999 (the audit period at issue in this protest), the Taxpayer had receipts from three government contracts: the first contract was for pipeline transportation of fuel from refineries in West Texas to the Taxpayer's storage terminal in Alamogordo, New Mexico; the second contract was for the storage of fuel in two

35,000-barrel storage tanks located at the facility; and the third contract was for pipeline transportation of fuel from the Alamogordo storage tanks to Holloman Air Force Base.

4. In March 2000, the Department audited the Taxpayer's payment of New Mexico gross receipts tax on its receipts from the three government contracts.

5. The Department's audit concluded that the Taxpayer's receipts from the first contract for transportation of fuel from Texas to New Mexico were receipts from transactions in interstate commerce and were deductible under NMSA 1978, § 7-9-55.

6. The Department's audit concluded that the Taxpayer's receipts from the second and third contracts were receipts from performing services in New Mexico and were subject to New Mexico gross receipts tax.

7. On November 22, 2000, the Department issued Assessment No. 2602873 to the Taxpayer in the total amount of $197,537.86, representing $117,814 of gross receipts tax for the period January 1994 through December 1999, plus related penalty and interest accrued through the date of the assessment. $72,585 of the tax principal assessed was attributable to receipts from the storage contract; $45,228 of the tax principal assessed was attributable to receipts from the contract for transportation of fuel from Alamogordo to Holloman Air Force Base.

8. On December 22, 2000, the Taxpayer filed a written protest to the Department's assessment. As grounds for its protest, the Taxpayer argued: (1) that its receipts from the storage contract were receipts from the lease of real property and were deductible under NMSA 1978, § 7-9-53; and (2) that its receipts from the transportation contract were receipts from transporting property in interstate commerce under a single contract and were deductible under NMSA 1978, § 7-9-56.

9. At the administrative hearing held on June 24, 2003, the Taxpayer withdrew its protest to the $45,228 of tax principal, plus related penalty and interest, assessed on the Taxpayer's receipts from the transportation contract. As a result of this withdrawal, the assessment of tax on the Taxpayer's receipts from the storage contract was the only matter remaining in dispute and the only issue addressed at the hearing.

10. The "storage contract" at issue was actually two consecutive contracts entered into between the Taxpayer and the federal government during the audit period.

11. The first contract consisted of the following documents: (1) the government's solicitation of offers; (2) the Taxpayer's offer dated October 15, 1993 with October 18, 1993 cover letter, amended by correspondence dated March 15 and March 25, 1994, best and final offer dated April 7, 1994, and correspondence dated April 14 and April 26, 1994; and (3) the government's award of contract dated April 29, 1994.

12. The second contract consisted of the following documents: (1) the government's solicitation of offers; (2) the Taxpayer's offer dated April 24, 1998, revised July 9, 1998; and (3) the government's award of contract dated July 21, 1998.

13. Although the two storage contracts were not identical, the differences between the contracts are not material for purposes of this protest.

14. The government's solicitation of offers for the second storage contract stated the purpose of the contract as follows: "to obtain the necessary services and facilities to receive, store and ship one government-owned petroleum product (JP8) in the El Paso, Texas, area." (Department Exhibit B).

15. The first contract award dated April 29, 1994 referred to "services and facilities to be provided" (Taxpayer Exhibit 4); the second contract award dated July 21, 1998 referred to "storage services" (Taxpayer Exhibit 1, sixth page from the back).

16. The facilities the Taxpayer provided to the government under the storage contracts consisted of two cone-roofed storage tanks the Taxpayer had constructed during the mid-1980s at the government's request and according to the government's specifications.

17. The tanks were built on concrete foundations and had a capacity of 35,000 barrels or approximately 1.9 million gallons each.

18. The storage tanks were located in the Taxpayer's bulk storage terminal in Alamogordo, New Mexico, which included pipelines, a truck rack, storage tanks and auxiliary buildings, and was enclosed by a ten-foot, barbed-wire fence.

19. The Alamogordo facility was dedicated to the use of the federal government. The government had a quality surveillance representative ("QSR") on-site and had 24-hour access to the storage terminal and the two storage tanks. The government also had control over third parties' access to the terminal.

20. The QSR used a small building near the storage tanks as his office. Only the QSR had a key to this building.

21. The Taxpayer provided a telephone and fax machine to the QSR, and the government reimbursed the Taxpayer for the charges related to this equipment.

22. The Taxpayer had three employees assigned to the Alamogordo storage terminal, one of which was always on duty. The employee on duty was responsible for maintenance and

security, including environmental concerns that might arise in connection with the storage of jet fuel.

23. Every Friday, the government provided the Taxpayer with the next week's schedule of deliveries to and from the storage facility. The Taxpayer's employees were responsible for opening the main gate to the facility when a truck delivery arrived and opening the tank valve when a pipeline delivery was made to one of the storage tanks.

24. Although deliveries were usually made between 7:00 a.m. and 4:00 p.m. five days a week, the government had the authority to schedule deliveries for any time of the day or night.

25. The storage contracts set a flat monthly fee for the government's use of the two 35,000-barrel storage tanks. Each month during the audit period, the Taxpayer sent the government an invoice for "tankage rental", setting out the tank number, the days covered by the invoice, and the "monthly use charge" for each tank. (Taxpayer Exhibit 5).

26. Although the government's solicitation for the storage contracts set out various services to be performed by the contractor, many of these items were not included in the final contract terms negotiated by the parties.

27. The final contracts did require the Taxpayer to provide certain services to the government upon request. These services were invoiced separately from the monthly charge for use of the two storage tanks.

28. The amount of the contract price allocated to services was a small percentage of the amount allocated to the use of the storage tanks. The July 21, 1998 contract award shows that for the period August 1998 through July 1999, the fee for the storage tanks was $228,240 per year ($19,020 "use charge per month" x 12); the maximum amount the Taxpayer could charge

for the additional services listed in the contract was $10,000 per year (sum of Line Items 1002 through 1007), plus $7,000 per year for direct out-of-pocket expenses incurred for the fax and telephone equipment provided to the QSR (sum of Line Items 1008 through 1010). (Department Exhibit B, fourth and fifth pages from the back).

29. Most of the services listed in the final contract were not requested by the government or performed by the Taxpayer during the audit period at issue.

ISSUE TO BE DECIDED

The issue to be decided is whether the Taxpayer's April 29, 1994 and July 21, 1998 contracts with the federal government were contracts for the performance of services, contracts for the lease of real property, or contracts for a license to use real property. These distinctions are important because receipts from the performance of services and the sale of licenses are subject to New Mexico gross receipts tax, while receipts from the lease of real property may be deducted from gross receipts under NMSA 1978, § 7-9-53 of the Gross Receipts and Compensating Tax Act.

BURDEN OF PROOF

There is a statutory presumption that any assessment of tax made by the Department is correct. NMSA 1978, § 7-1-17(C). *See also, Holt v. New Mexico Department of Taxation and Revenue*, 2002-NMSC-034, ¶4, 133 N.M. 11, 59 P.3d 491. Accordingly, it is the Taxpayer's burden to establish that it was entitled to deduct its receipts from the contracts at issue and that the Department's assessment of tax on those receipts should be abated.

DISCUSSION

The Taxpayer argues that the two contracts at issue were contracts for the lease of real property. The Taxpayer presented the following facts to support its contention: the tanks were

constructed on concrete foundations and permanently affixed to the land; the government had an on-site representative with 24-hour access to the storage terminal and the two 35,000-barrel storage tanks; the government had control over third parties' access to the terminal; the government directed when fuel was moved in and out of the tanks; any services provided were incidental to the government's use of the storage facilities and represented only a small part of the contract price. In response, the Department maintains that the Hearing Officer cannot look behind the parties' own characterization of the contract. Because the contract solicitation contains several references to "services" sought by the government, the Department takes the position that no further inquiry can be made as to the nature of the contract. Alternatively, the Department argues that the government had a license to use the storage tanks and that the government's control over the facility was not sufficient to constitute a lease of real property.

Form v. Substance. New Mexico law holds that the character of a contract is not controlled by its form, but from the intention of the parties as shown by the contents of their agreement. *See, Hueschen v. Stallie*, 98 N.M. 696, 698, 652 P.2d 246, 248 (1982):

> We recognize that the substance of an instrument, not its form, controls the legal effect of a contract. *Shaeffer v. Kelton*, 95 N.M. 182, 619 P.2d 1226 (1980). It does not matter that the Stalie-Hueschen/Despres agreement is labeled a Lease if the agreement was in reality an assignment or sale of the Stalies' interest under the real estate contract.

Transamerica Leasing Corporation v. Bureau of Revenue, 80 N.M. 48, 51-52; 450 P.2d 934, 937-938 (Ct. App. 1969):

> Under general law, the character of the instrument is not to be determined by its form, but from the intention of the parties as shown by the contents of the instrument. Thus, instruments which purport to be leases have been determined to be conditional sales contracts. In sales and use tax cases, the lease has been

> determined to be a sale. In some situations the question is whether the agreement is a lease or a security agreement. (citations omitted).

Quantum Corporation v. Taxation & Revenue Department, 1998 NMCA-050, ¶¶ 11-12, 125 N.M. 49, 956 P.2d 848:

> We review the entire contents of the instrument—the language employed, the subject matter, and when doubt exists, the surrounding circumstances—to determine if exclusive control and possession of a definite space for a definite term has been granted.

The Department's position that the use of the word "services" in the solicitation is sufficient to establish the character of the final contract at issue in this case is contrary to the weight of authority.[1] The only case cited by the Department is *S.S. Kresge Co. v. Bureau of Revenue*, 87 N.M. 259, 260, 531 P.2d 1232, 1233 (Ct. App. 1975), where the court relied on a statement of intent to conclude that the parties' agreement created a license rather than a lease:

> In each instrument the following disclaimer appears.
>
> > "The parties do not intend this Agreement to constitute a joint venture, partnership, or lease and nothing herein shall be construed to create such a relationship." [Emphasis added]
>
> No intention by the parties to the agreements to create anything other than a license is clearly indicated either in the exhibited instrument or in the record. Therefore, the taxpayer has not established the necessary intent to refute the commissioner's findings.

The facts of this case are very different from those in *Kresge*. Here, there is no clear statement of the parties' intent. To the contrary, the language used in the two storage contracts is ambiguous and open to interpretation. The stated purpose of the government's solicitation for the second contract was "to obtain the necessary services and facilities to receive, store and ship one

government-owned petroleum product...." While the Department relies on the word "services" to support its position, the Taxpayer points out that one way to "obtain ... facilities" is to lease them. The first contract award dated April 29, 1994 refers to the "services and facilities to be provided," while the second contract award refers to "storage services." The first contract sets a "Price Per Tank Per Month"; the second contract sets a "Use Charge Per Month." The Taxpayer's monthly invoices refer to "tankage rental" per month.

Far from establishing that the contracts were service contracts, as argued by the Department, the language used lends equal support to the Taxpayer's position that the contracts were for the lease of facilities. The analysis is hindered by the fact that an important part of the contracts is missing. Paragraph 18 of each contract award states that the contract "consists of the following documents: (a) the Government's solicitation *and your offer*, and (b) this award/contract. No further contractual document is necessary." (Emphasis added). The Taxpayer's offer in response to the solicitation was not introduced by either party and is not part of the record of this protest. The Taxpayer did, however, present the testimony of James Tidmore, its senior vice president, to explain the changes made to the contract by the Taxpayer's offer.

Mr. Tidmore is responsible for leases and contracts entered into by the Taxpayer and has personal knowledge of the federal contracts at issue in this case. Mr. Tidmore testified that he rarely accepts all of the terms set out in a federal contract solicitation. In this case, the Taxpayer and the government negotiated several changes to the terms of the contract. As a result, a

[1] The Department's argument is also ill-advised from a tax policy standpoint. If accepted, it would open the door for taxpayers to evade the payment of tax simply by inserting a statement in their contracts characterizing the transaction in such a way as to qualify for a tax deduction or exclusion.

number of the services listed in the solicitation were either deleted or transferred to the two transportation contracts awarded to the Taxpayer at about the same time. Other than routine maintenance and security services, the only services to be performed under the storage contracts were the services listed in the final contract awards. Mr. Tidmore testified that these services were performed only when requested by the government and were invoiced separately from the flat monthly fee charged for the government's use of the two 35,000-barrel storage tanks. He did not think that the additional services were ever requested by the government during the audit period.

Although the Department's attorney questioned the reliability of Mr. Tidmore's testimony during closing argument, the Department did not produce any evidence to refute that testimony. The Department's protest auditor admitted that the Department never requested or reviewed the Taxpayer's offers in response to the government's solicitations. Nor did the Department contact the QSR or anyone else from the federal government to verify the terms of the final contracts. On the other hand, there is evidence in the record to corroborate much of Mr. Tidmore's testimony:

(1) The April 29, 1994 award of the first storage contract confirms that the parties engaged in lengthy negotiations, referencing the Taxpayer's offer of "15 October 1993 with cover letter of 18 October 1993, amended by correspondence dated 15 March 1994, 25 March 1994, best and final offer dated 7 April 1994, and correspondence dated 14 April 1994 and 26 April 1994."

(2) The April 29, 1994 award also confirms that the Taxpayer would be separately reimbursed for the services (including telephone and facsimile equipment and

services) set out in Subline Items 0002 through 0009 and ¶C19.07, and that these charges were not included in the monthly fee for use of the two storage tanks.

(3) In line with Mr. Tidmore's recollection, the Department's own audit work papers indicate that the Taxpayer was not asked to perform the additional services shown in the contract awards. For each month of the audit period, the auditor listed the Taxpayer's receipts from "storage of fuel" (which corresponds to the "Price Per Tank Per Month" and "Use Charge Per Month" set out in the contract awards) and reimbursed phone expenses. Each quarter, there is an additional line for reimbursement of "facsimile rental". The other receipts listed in the work papers pertain to the transportation of fuel under the Taxpayer's separate transportation contracts. The audit work papers do not show any receipts from the performance of additional services under the storage contracts.

NMSA 1978, § 7-9-3(K) defines "service" as "all activities engaged in for other persons for a consideration, which activities involve predominantly the performance of a service as distinguished from selling or leasing property...." Based on the evidence presented, which includes the testimony of Mr. Tidmore, the two storage contracts at issue were not service contracts. The service component of the contracts was incidental to their primary objective, which was to provide the government with use of the Taxpayer's storage tanks and storage terminal in Alamogordo, New Mexico.

Lease v. License. The next issue to be decided is whether the Taxpayer's storage contracts constituted a lease of real property or a license to use that property. NMSA 1978, § 7-9-3(J) defines the term "leasing" as "an arrangement whereby, for a consideration, property is employed for or by any person other than the owner of the property, except that the granting of a license to use property

is the sale of a license and not a lease." In *Cutter Flying Service, Inc. v. Property Tax Department*, 91 N.M. 215, 219, 572 P.2d 943, 947 (Ct. App. 1977), the court defined leasing as "an agreement under which the owner gives up the possession and use of his property for a valuable consideration and for a definite term." As noted in 3 Thompson on Real Property, §§ 1031 and 1032 (Thompson ed. 1994):

> It is said that the difference between a license and a lease is that a lease gives to the tenant the right of possession against the world, while a license creates no interest in the land, but it is simply the authority or power to use it in some specific way.

See also, *Tarin's, Inc. v. Tinley*, 2000-NMCA-048, ¶ 21, 129 N.M. 185, 3 P.3d 680, where the court stated:

> The most salient feature of a license is its revocability. "Generally, a license is revocable at the will or the pleasure of the servient tenant.... It may be revoked without notice and without cause, because ... a licensee has no possessory interest in the property. The license may be revoked at will no matter how long it has continued." 25 Am. Jur. 2d Easements & Licenses § 143 (1996)....

In this case, there is no question that the contracts were for a definite term and that the government's use of the storage tanks could not be revoked at the will of the Taxpayer. The evidence also supports the conclusion that the government had exclusive control and possession of the storage tanks and the storage terminal in which they were located. This evidence includes testimony that the government had an on-site representative with 24-hour access to the storage terminal and the two 35,000-barrel storage tanks; the government had control over the movement of fuel in and out of the storage tanks; and the government had control over third parties' access to the terminal and had the right to exclude any third party from the premises.

The Department argues that the presence of the Taxpayer's employees at the storage terminal is sufficient to negate a finding that the government had exclusive possession and control of the premises. This argument is not supported by case law. In *Chavez v. Commissioner of Revenue*, 82 N.M. 97, 476 P.2d 67 (Ct. App. 1970), the court held that the receipts of a taxpayer who leased motel premises to a railroad, and who furnished clean linens and kept the bathroom facilities clean for use by the railroad's employees, were receipts from leasing real property. There, as here, the Department argued that the presence of the taxpayer's employees on the premises and the fact that they performed certain services for the railroad prevented the transaction from qualifying as a lease. The court rejected the Department's argument, stating:

> The fact that the taxpayer also furnished clean linens for the beds when used and kept the bath and toilet facilities clean, did not convert the taxpayer into the operator of a hotel or rooming house. All utilities and all other services were apparently furnished by the Railway. It was in charge of the operation and control of the premises. It determined who should occupy any room or other portion of the premises, when rooms or other portions of the premises should be so occupied, and the terms and conditions of the occupancy. At least the stipulation of facts states or clearly implies that the taxpayer had no right or responsibility to do more than to furnish the bed linens and to keep the bath and toilet facilities clean. For these two services and the use of the premises as lessee thereof, the Railway paid a fixed amount by way of rental.

82 N.M. at 100, 476 P.2d at 70. *See also*, *Quantum Corporation v. Taxation & Revenue Department*, 1998 NMCA-050, ¶ 20, 125 N.M. 49, 956 P.2d 848 ("other provisions of the agreements which may indicate that Taxpayer has some degree of control over the premises, such as those regarding public liability insurance, security guards, parking, thermostat settings, bankruptcy, and right of entry, are not uncommon to modern commercial leasing.").

In this case, the Taxpayer had one employee on the premises at all times. The employee was responsible for the maintenance and security of the storage terminal, as well as opening the

main gate for scheduled truck deliveries and opening the valve on the storage tanks for scheduled pipeline deliveries. As the Taxpayer's witness pointed out, the storage of jet fuel is different than the storage of furniture, and certain safety procedures must be followed to insure compliance with environmental regulations. The fact remains that the government had its own representative on-site to oversee the operation of the terminal, and the government retained complete access to and control over the premises. This access and control was sufficient to constitute a leasehold interest.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to Assessment No. 2602873, and jurisdiction lies over the parties and the subject matter of this protest.

2. The Taxpayer's April 29, 1994 and July 21, 1998 contracts with the federal government were contracts for the lease of real property, and the Taxpayer is entitled to claim the deduction from gross receipts provided in NMSA 1978, § 7-9-53.

For the foregoing reasons, the Taxpayer's protest is granted. The Department is ordered to abate the $72,585 of tax principal assessed against the Taxpayer's receipts from the April 29, 1994 and July 21, 1998 contracts, plus related penalty and interest.