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

IN THE MATTER OF THE PROTEST OF
DELL CATALOG SALES, L.P. **No. 06-11**
NM ID NO. 02-416593-00 0
TO ASSESSMENT NO. 2549063

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on December 5 and 6, 2005, before Margaret B. Alcock, Hearing Officer. Dell Catalog Sales L.P. ("DCSLP") was represented by John W. Boyd and Martha E. Mulvany, with the law firm of Freedman Boyd Daniels Hollander & Goldberg, P.A, and by Maryann B. Gall, Todd S. Swatsler and Eric Gale, with the law firm of Jones Day. The Taxation and Revenue Department ("Department") was represented by Bruce J. Fort, Special Assistant Attorney General. At the close of the hearing, a briefing schedule was established and the final brief of the parties was filed on April 17, 2006, at which time the matter was submitted for decision. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

Corporate Structure of Dell Computer Corporation and its Subsidiaries

1. During the audit period, Dell Computer Corporation was a holding company listed on the NASDAQ exchange (unless otherwise noted, all Findings of Fact relate to facts as they existed during the audit period). Transcript of Proceedings ("Tr.") 49.

2. Dell Computer Corporation was the parent corporation of a series of "C" corporation holding companies which, in turn, owned a series of limited partnerships that carried

out the day-to-day operation of the business (references to "Dell" in these findings are to the aggregate group of corporations and partnerships). Tr. 49, 297.

3. The following limited partnerships are relevant to this proceeding:

(a) Dell USA L.P. performed general and administrative services for the other limited partnerships, who were charged for these services. Tr. 57-58, 138, 298-299, 350.

(b) Dell Products L.P. engaged in research and development and manufactured computer products. Tr. 56. Dell Products L.P. also engaged in procurement activities for other limited partnerships and, by default, Dell Products L.P.'s name was sometimes put on contracts pertaining to other Dell entities. Tr. 302.

(c) Dell Marketing L.P. sold computer products to large corporations, government agencies, and educational and healthcare institutions. Tr. 52.

(d) Dell Direct Sales L.P. sold computer products to small and medium-sized businesses and institutions. Tr. 52-53.

(e) Dell Catalog Sales L.P. sold computer products to individual consumers (Tr. 53) and operated under the business name "Dell Home Systems." Tr. 333.

4. Dell Financial Services L.P. was a 70 percent owned Dell affiliate that began leasing Dell computers to Dell customers in April 1997. Tr. 331, 334-336.

5. Each limited partnership had its own executives, officers and employees who were responsible for the policy-making and day-to-day operations of the partnership. Tr. 55-57.

6. The decision to operate Dell Computer Corporation's business through separate legal entities was motivated, at least in part, by a desire to isolate certain activities from state tax. Tr. 61, 105-106.

7. In their advertising and contracts with outside parties, the limited partnerships did not identify themselves as separate legal entities, but referred to themselves both individually and collectively as "Dell." Stipulated Exhibits ("Stip. Exs.") S-1, S-2 and S-3 (Service Contract Sales Brokerage Agreements); Stip. Exs. S-4 and S-5 (Terms and Conditions of Sale); Ex. F, last tab (Warranties and Return Policy); Ex. K (Dell Home Systems Catalog).

DCSLP's Sales Activities

8. Dell Catalog Sales L.P. ("DCSLP") was organized as a Texas limited partnership in October 1993 and began selling computer products to individual home consumers in November 1993. Joint Stipulation of Facts ("SF") ¶ 1; Tr. 292.

9. DCSLP's principal place of business was in Round Rock, Texas. SF ¶ 2.

10. DCSLP did not own or lease any real property, did not maintain any office or other place of business, did not operate any retail stores, did not consign merchandise, and did not have any employees or independent sales agents in New Mexico. SF ¶¶ 10, 11, 13, 16, 17, 18, 19, 23.

11. DCSLP did not have any franchisee or licensee operating under its trade name or have local telephone service with local directory listings in New Mexico. SF ¶¶ 24, 27, 28.

12. DCSLP did not maintain any bank accounts or conduct credit investigations or collections in New Mexico. SF ¶¶ 15, 21.

13. DCSLP did not drop ship goods from manufacturers located in New Mexico. SF ¶ 9.

14. DCSLP purchased computers, computer peripherals and related accessories manufactured by Dell Products L.P. and other companies and resold them via national media

advertising, mail order catalogs and the internet from facilities located outside New Mexico. SF ¶ 4.

15. New Mexico residents placed orders with DCSLP by contacting DCSLP directly through the internet or by telephone, facsimile, mail or e-mail. SF ¶ 6.

16. Orders from customers residing in New Mexico were accepted by DCSLP at locations outside New Mexico. SF ¶ 7.

17. Products purchased from DCSLP by customers residing in New Mexico were shipped to the customer from locations outside New Mexico by common carrier or the U.S. Postal Service. SF ¶ 8.

18. Title to merchandise DCSLP sold to customers in New Mexico transferred on shipment from a Dell facility outside New Mexico. Stip. Ex. S-5.

19. DCSLP retained the risk of loss or damage to merchandise shipped on a carrier selected by DCSLP until the merchandise was delivered to the customer in New Mexico. Stip. Ex. S-5.

20. It was DCSLP's policy to ship all merchandise directly to its customers on a carrier selected by DCSLP, and there were no procedures whereby New Mexico customers who desired to pick up their merchandise or have other carriers pick up their merchandise at Dell warehouses or other shipping locations could do so. Stip. Ex. S-8 at 6-7.

Warranty on Dell Products Sold by DCSLP

21. Dell products sold by DCSLP were covered by a limited warranty provided by the manufacturer, Dell Products L.P. SF ¶ 29.

22. The purchaser of Dell-brand computer equipment from DCSLP did not receive any manufacturer warranties in addition to Dell Products L.P.'s warranty. SF ¶ 31.

23. Neither Dell Products L.P. nor DCSLP had any obligation to provide on-site repair services to a customer who purchased a Dell computer from DCSLP. SF ¶ 45.

24. Dell Products L.P.'s warranty covered parts and labor during the first year and parts only in years two and three. Tr. 367; Ex. F, last tab.

25. The warranty was a "return-to-factory" warranty that required the customer to pack up and return the defective product to Round Rock, Texas, at the customer's expense, for repair or replacement. Tr. 84-85; Ex. F, last tab.

26. In cases where a customer was willing to replace a defective part himself, Dell Products L.P. mailed a replacement part to the customer in a box that contained a prepaid return shipping label. Tr. 351.

27. Dell Products L.P. owned all parts removed from Dell computers. Stip. Ex. S-5, second page; Ex. F, last tab.

28. Customers who failed to return a defective part removed from a Dell computer within 30 days were charged for the part. Stip. Ex. S-5, second page; Ex. F, last tab.

Third-Party Service Agreements

29. In the mid 1980s, customers began asking Dell to provide them with on-site repair service. Tr. 87.

30. Many Dell customers did not have the expertise to fix their computers themselves and did not want the inconvenience of returning the computer to Texas under the return-to-factory warranty or trying to find a reliable local service technician. Tr. 87.

31. After considering the problem, Dell authorized a third-party service provider to repair Dell computers under service contracts that Dell sold to its customers, keeping a portion of the sales price as a commission. Tr. 87-91, 95-96.

32. In 1986, Dell chose Honeywell Bull as the company to provide on-site repair service to the owners of Dell computers. Tr. 90.

33. The relationship with Honeywell Bull ended when Dell began receiving complaints of poor service from its customers, who blamed Dell for selling them the service contracts. Tr. 92.

34. In 1989, Dell selected Xerox to provide repair service to Dell customers. Tr. 93-94.

35. That relationship ended when Xerox wanted more money for each of the service contracts Dell sold to its customers and Dell concluded that increasing the price would reduce the number of contracts sold and make its customers unhappy. Tr. 97.

36. After the agreement with Xerox expired, Dell entered into three successive Service Contract Sales Brokerage Agreements ("Brokerage Agreements") with BancTec USA, Inc. under which Dell sold BancTec service contracts to its customers and BancTec acted as the exclusive provider of on-site repair service for Dell computer products. Stip. Exs. S-1, S-2 and S-3; Tr. 338-339. (Because the terms of the three Brokerage Agreements are virtually identical, references to the record will be limited to the July 1995 agreement admitted as Stip. Ex. S-2).

**BancTec's Relationship with DCSLP
and Other Dell Entities**

37. BancTec USA, Inc. ("BancTec") was a Delaware corporation with its principal place of business in Dallas, Texas. SF ¶ 39.

38. From the beginning of the audit period until 1999, BancTec was a wholly-owned subsidiary of BancTec, Inc., a New York Stock Exchange company headquartered in Dallas, Texas. SF ¶ 40.

39. In 1999, BancTec became a privately held company. SF ¶ 41.

40. DCSLP was one of the Dell entities that marketed and sold BancTec service contracts under the terms of the Brokerage Agreements. SF ¶ 53; Ex. K.

41. DCSLP had no ownership interest in BancTec. SF ¶ 42.

42. BancTec had no ownership in DCSLP or any other Dell entity. SF ¶ 43.

43. BancTec did not solicit sales or orders on behalf of DCSLP or have the authority to bind DCSLP to any legal obligations in New Mexico. SF ¶ 46; Tr. 201-202.

44. BancTec, and not DCSLP, was responsible for any property damage (such as a scratched piece of furniture) that occurred in the course of a BancTec service technician's on-site service call. SF ¶¶ 48, 49; Tr. 202.

45. The amount of revenue BancTec received for each service contract sold by DCSLP was determined by a formula which, among other things, took into account the number of on-site service calls made by BancTec during the previous 90-day period and whether BancTec had met the required performance criteria set out in the Brokerage Agreements. SF ¶ 52; Stip. Ex. S-2 at 17.

46. DCSLP retained the difference between the retail price DCSLP charged its customers for each service contract and the amount paid to BancTec under the formula set out in the Brokerage Agreements. SF ¶ 54.

47. DCSLP's sale of service contracts on Dell computers was profitable to both BancTec and DCSLP. SF ¶ 58; Tr. 236.

48. Dell USA L.P. acted as BancTec's agent for purposes of registering BancTec with the New Mexico Taxation and Revenue Department and reporting and paying New Mexico gross receipts taxes on DCSLP's sale of service agreements to New Mexico customers. SF ¶ 50.

49. DCSLP did not provide BancTec with information concerning the New Mexico gross receipts taxes reported and paid on DCSLP's sales of BancTec service contracts, but would have provided such information if requested by BancTec. SF ¶ 51.

DCSLP's Sale of BancTec Service Contracts

50. A customer who wished to purchase a service contract on a Dell computer had to purchase the contract through DCSLP. Tr. 227-228.

51. DCSLP customers could purchase a service contract at the same time they purchased a Dell computer or could purchase a contract from DCSLP any time after the purchase of a computer. SF ¶ 44.

52. The only service contract DCSLP offered to its customers was a BancTec service contract, but BancTec's name did not appear in DCSLP's catalogs advertising the availability of the contracts. Tr. 338-339; Ex. K.

53. The service contracts between BancTec and DCSLP customers had to follow the form set out in the Brokerage Agreements. DCSLP had the right to revise the contract from time to time "to facilitate ease of understanding by Customer." Stip. Ex. S-2 at 31.

54. DCSLP set the price for the BancTec service contracts DCSLP sold to its customers. SF ¶ 53.

55. As a marking tool, DCSLP often "bundled" the cost of the service contract into a single price charged for a complete computer setup, including such components as the monitor, processor and hard drive. Ex. K; Tr. 346.

56. BancTec was required to accept all service contracts sold by DCSLP. Stip. Ex. S-2 at 5.

57. Approximately 75 percent of DCSLP's New Mexico customers purchased a BancTec service contract. SF ¶ 55.

Procedures for On-Site Service Calls

58. When a New Mexico customer with a BancTec service contract had a problem with a Dell computer, the customer could not contact BancTec directly, but was first required to call Dell Customer Technical Support ("Dell Tech Support"). SF ¶¶ 56, 57.

59. Dell Tech Support was located outside New Mexico and was staffed 24 hours a day, seven days a week, by employees who worked for Dell USA L.P. SF ¶¶ 34, 35; Tr. 350.

60. Dell USA L.P. charged DCSLP for the technical support services provided to DSCLP customers. Tr. 350.

61. In the majority of cases, Dell Tech Support was able to solve a customer's problem over the telephone. SF ¶ 37.

62. Only after Dell Tech Support diagnosed a customer's computer problem and determined that it could not be corrected over the telephone did Dell Tech Support authorize BancTec to dispatch a technician to the customer's address for service. SF ¶ 56.

63. During the audit period, Dell Tech Support dispatched BancTec technicians on 1,273 service calls and installation visits to customers in New Mexico. Ex. E; Tr. 362-365.

64. The Brokerage Agreements set out detailed "Service Call Procedures" that BancTec was required to follow. Stip. Ex. S-2 at 30.

65. BancTec was required to contact DCSLP customers within a specified time period after receipt of a dispatch notice from Dell Tech Support. With regard to same business day service, for example, a BancTec technician was required to contact the customer within 30 minutes of the dispatch notice. Stip. Ex. S-2 at 30.

66. BancTec was required to track every service call against targeted arrival times and to cooperate with DCSLP "to establish and implement effective escalation or remedial procedures to produce optimum customer satisfaction." Stip. Ex. S-2 at 30.

67. BancTec's service technicians were required to undergo training and meet the technical skill levels set out in the Brokerage Agreements. Stip. Ex. S-2 at 30.

68. BancTec's service technicians were required to conduct themselves in a manner that would "professionally and positively represent the parent company as well as Dell Computer Corporation and other partners." Stip. Ex. S-2 at 20.

69. After determining the nature of a customer's computer problem, Dell Tech Support shipped the replacement parts needed to repair the computer to an area within Dell's warehouse in Austin, Texas, that was subleased by BancTec. Stip. Ex. S-2 at 2, 7.

70. BancTec was prohibited from using replacement parts other than the parts supplied by Dell Tech Support. Ex. S-2 at 29.

71. BancTec was prohibited from using the replacement parts for any purpose other than servicing the computers of Dell customers and could not "repair, scrap or sell any faulty System parts or any spare parts acquired from Dell to any party other than Dell or Customers." Stip. Ex. S-2 at 29-30.

72. BancTec was not in the business of selling computer parts. Tr. 206-207, 213-215.

73. BancTec acted as a bailee of the replacement parts provided by Dell Tech Support and was liable to Dell for any loss or damage to those parts while they were in BancTec's possession. Tr. 206-207, 213-215.

74. Once on-site, the BancTec technician verified the advisory diagnosis provided by Dell Tech Support; if the technician ran into a problem, the technician was required to call Dell Tech Support for additional assistance. Stip. Ex. S-2 at 30.

75. When a service call was completed, the BancTec technician closed the call on the BancTec system, noting parts used, and this information was electronically uploaded to Dell. Stip. Ex. S-2 at 30.

76. In the event a customer was not satisfied with the services performed by BancTec, the customer registered a complaint with Dell Tech Support and not with BancTec. Dell Tech Support then acted as an intermediary, reporting the problem to BancTec management for resolution. SF ¶ 57.

77. BancTec warranted its services to DCSLP, but disclaimed all warranties in its contracts with DCSLP customers. Stip. Ex. S-2 at 31, 24.

78. If BancTec's "service level performance" as set out in the Brokerage Agreement fell below 95% for two consecutive months, DCSLP had the exclusive right to take over BancTec's service obligations under all of BancTec's existing service contracts with DCSLP customers, or to assign BancTec's service obligations to a third party chosen by DCSLP. Stip. Ex. S-2 at 6-7.

79. The availability of in-home service was an important factor in establishing DCSLP's market for sales. Tr. 165.

DCSLP Catalogs

80. Beginning in July 1997, DCSLP began mailing catalogs to potential customers in New Mexico under the name "Dell Home Systems." Tr. 300-301, 309; Ex. K.

81. DCSLP did not use vendors in New Mexico to design, prepare, print, store, or mail the catalogs. SF ¶ 22.

82. DCSLP's catalogs were prepared and mailed into New Mexico from outside the state under the terms of an Advertising Agency Master Services Agreement ("Advertising Agreement") entered into between Dell Products L.P. and Rapp Collins Worldwide. Ex. 17.

83. DCSLP's sales were supplemented by advertising in national magazines, such as specialty magazines dealing with computers, and national newspapers. SF ¶ 26.

84. DCSLP did not enter New Mexico to purchase or display advertising for itself or others. SF ¶ 25.

Audit and Assessment

85. In July 1999, the New Mexico Taxation and Revenue Department ("Department") conducted an audit of DCSLP in Round Rock, Texas. Tr. 300.

86. The Department determined that DCSLP had never registered to do business in New Mexico and had never reported or paid gross receipts or compensating taxes to New Mexico. SF ¶ 14, Ex. A.

87. Dell's legal and accounting staff made the determination as to which Dell entities, including DCSLP, were required to register and pay tax to New Mexico and other states.

88. On June 28, 2000, the Department issued a Notice of Assessment of Taxes and Demand for Payment to DCSLP in the total amount of $1,817,693.43, representing $1,140,735.71 of gross receipts tax and $31,908.69 of compensating tax, plus penalty and interest, for the period January 1993 through June 1999. Joint Prehearing Statement at 1.

89. On September 22, 2000, pursuant to an extension of time granted by the Department, DCSLP filed a written protest to the assessment. Joint Prehearing Statement at 1.

ISSUES TO BE DECIDED

Issue I. Whether DCSLP was selling property in New Mexico and is therefore liable for New Mexico gross receipts tax on its sales to New Mexico customers.

Issue II. Whether imposition of New Mexico gross receipts tax on DCSLP's sales to New Mexico customers violates the Commerce Clause of the United States Constitution.

Issue III. Whether DCSLP is liable for compensating tax on catalogs mailed into New Mexico.

Issue IV. Whether DCSLP is liable for the ten percent negligence penalty on its failure to report and pay New Mexico gross receipts and compensating taxes during the audit period.

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, MPC Ltd. v. New Mexico Taxation & Revenue Department*, 2003 NMCA 21, ¶ 13, 133 N.M. 217, 62 P.3d 308. Accordingly, it is DCSLP's burden to present evidence and legal argument to show that it is entitled to an abatement, in full or in part, of the assessment issued against it.

DISCUSSION

Issue I: Whether DCSLP was selling property in New Mexico and is therefore liable for New Mexico gross receipts tax on its sales to New Mexico customers.

DCSLP maintains that it is not liable for New Mexico gross receipts tax on its sales of computers and related products to customers located in New Mexico because those sales did not take place in New Mexico. DCSLP bases this conclusion on the "Terms and Conditions of Sale" governing the transactions, which provided that title to goods passed to the buyer "on shipment from Dell's facility" in Texas. Stip. Ex. S-5 ¶ 5. The Department focuses on another provision of the sales agreement, which stated that "loss or damage that occurs during shipping by a carrier

selected by Dell is Dell's responsibility." *Id.* DCSLP concedes that all of the goods it sold during the audit period were shipped to its customers on a carrier selected by DCSLP and that "there are no procedures whereby customers who desired to pick up their merchandise or have other carriers pick up their merchandise at Dell warehouses or other shipping locations out of state could do so." Stip. Ex. S-8 at 6-7. Because DCSLP retained both risk of loss and control of the goods it sold until the goods were physically delivered to its customers in New Mexico, the Department argues that DCSLP owes gross receipts tax on those sales.

Gross receipts tax is imposed on the receipts of any person engaging in business in New Mexico. NMSA 1978, § 7-9-4. The term "gross receipts" is defined, in pertinent part, as "the total amount of money or the value of other consideration received from selling property in New Mexico…." NMSA 1978, § 7-9-3.5(A)(1).[1] In *Kmart Corporation v. Taxation and Revenue Department*, 2006-NMSC-006, ¶ 18, 131 P.3d 22, the New Mexico Supreme Court held that the gross receipts tax applies "when the selling of property takes place within the borders of New Mexico." Pursuant to NMSA 1978, § 7-9-3(A), "'selling' means a transfer of property for consideration." The question to be addressed is whether DCSLP's sales agreement with its New Mexico customers required DCSLP to transfer property to those customers within the borders of New Mexico.

DCSLP argues that the transfer of computers and related products sold to New Mexico customers occurred when title passed to the customers at DCSLP's facility in Texas. In support of its argument, DCSLP relies on the definition of "sale" in NMSA 1978, § 55-2-106(1) of New Mexico's Uniform Commercial Code ("UCC"), which provides that a sale consists in the passing of title from the seller to the buyer for a price. DCSLP then concludes that "[t]he terms 'transfer of

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[1] This is the definition of gross receipts in effect during the period at issue in this protest. As of July 1, 2006, the definition has been amended to read: "the total amount of money…received from selling property located in New Mexico…." H.B. 583, 47th Legislature, Regular Session (2006).

property' used in the Tax Act and 'passing of title' used in the UCC are interchangeable." Post-Hearing Brief at 7. As discussed below, there is no authority to support this conclusion.

A. Application of the UCC. Article 2 of the UCC applies to the rights and remedies of the parties to a sale of goods. As noted in the official comments to § 55-2-101:

> The arrangement of the present article is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it *without resorting to the idea of when property or title passed or was to pass as being the determining factor.* The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character. (emphasis added).

This comment is further explained as follows:

> Like the common law, the Uniform Sales Act ("U.S.A.") that preceded the U.C.C. was predicated on the notion that, absent a convincing reason to the contrary, the central problem-solver for questions involving risk of loss, action for price, the place and time for measuring damages, the power to replevy goods, and a myriad of other questions was the transfer of title, meaning who took title and when. As discussed elsewhere, the drafters of the U.C.C. rejected this concept in favor of a more flexible contract approach that looks at the performance and intentions of the parties. Consequently, the U.C.C., for the most part, decides legal consequences based on what the parties intended rather than on some arbitrary event such as the formal passage of title. As commerce in goods became more complicated, title as a problem-solving modality became too simplistic.

Michael Madison, *The Real Properties of Contract Law*, 82 B.U.L. Rev. 405, 473-474 (April 2002) (footnotes omitted). As a result of this change in focus, Article 2 of the UCC is divided into subparts. In analyzing the rights of parties to a sales agreement and other affected third parties, such as creditors, each component of the transaction must be analyzed in accordance with the specific provisions of the Code intended to address that particular situation.

Part 4 of Article 2 addresses the passage of title. As a general rule, title passes to the buyer at the time and place at which the seller completes its performance with reference to the physical delivery of the goods:

> (a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require the seller to deliver them at destination, title passes to the buyer at the time and place of shipment; but
>
> (b) if the contract requires delivery at destination, title passes on tender there;

NMSA 1978, § 55-2-401(1). Under this general rule, the terms and conditions governing DCSLP's sale of goods to New Mexico customers would create a destination contract and title to the goods would pass upon physical delivery to the customer in New Mexico. As an alternative to the general rule, however, § 55-2-401(1) provides that "title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties." In this case, the agreement between DCSLP and its customers stated that title passed to the customer at DCSLP's facility in Texas, even though DCSLP retained control and risk of loss of the goods until delivery to the customer's home state.

The sales agreement between DCSLP and its customers governs any dispute that might arise between the parties. It is clear, however, that the UCC is only intended to address rights of private parties and is not intended to override governmental or public determinations of what constitutes a sale. Official Comment 1 to § 55-2-401 states that:

> This article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed.... This section, however, *in no way intends to indicate which line of interpretation should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition*.... (emphasis added).

The fact that the UCC defines a sale as "the passing of title from the seller to the buyer for a price" and allows the parties to designate where such title passes, does not determine where a sale takes place for state tax purposes. In *Mossberg-Hubbard v. Norberg*, 432 A.2d 1176, 1179 (R.I. 1981), the Rhode Island court rejected the taxpayer's assertion that no sales tax was due on

its sale of equipment to Rhode Island customers because the parties had agreed that the transfer of goods was f.o.b. an out-of-state location:

> We hold, however, that Mossberg-Hubbard's contention that the Uniform Commercial Code is applicable is misplaced. As we have stated previously, "when an administrative agency has interpreted the parameters of particular statutory terms in a field over which it has been given authority, it is not bound by the meaning ascribed to similar concepts in the [Uniform Commercial] Code." *Rice Machinery, Inc. v. Norberg*, 120 R.I. 542, 391 A.2d 66, 74 n.12 (1978); G.L. 1956 (1969 Reenactment) § 6A-2-401, Comment 1.

The court further noted:

> For us to rule that when a transfer of possession is made in Rhode Island it is not subject to a sales tax, merely because the goods purchased are to be taken to another state in which title will pass according to the contract between the parties, would allow easy avoidance of a tax by a seller who would simply arrange for the buyer to take the goods elsewhere. Furthermore, to approve such a practice would give rise to untold chaos in the administration of the tax laws and to extensive losses of state sales-tax revenue.

Id. *See also, Sonic Industries, Inc. v. State*, 2000-NMCA-087, 129 N.M. 657, 11 P.3d 1219, *cert. granted, 129 N.M. 519, 10 P.3d 843* (2002) (parties to a sale in New Mexico cannot avoid gross receipts tax simply by stepping across the state line to sign the sales agreement). *Continental Inn v. New Mexico Taxation and Revenue Department*, 113 N.M. 588, 591, 829 P.2d 946, 949 (Ct. App. 1992) (private contracts regarding payment of tax on a sale cannot shift the legal incidence of tax as between the state and the taxpayer).

In this case, as in *Mossberg-Hubbard*, New Mexico has specific laws and regulations governing the application of state taxes. It is this legal framework—not the legal framework governing the rights and remedies of private parties under the UCC—that must be applied to determine DCSLP's liability for New Mexico gross receipts tax. *See also, Amoco Production Company v. New Mexico Taxation & Revenue Department*, 2003-NMCA-92, ¶ 13, 134 N.M. 162, 74 P.3d 96 (taxpayers' attempt to apply federal definition of processing "fails because we

must evaluate the definition of ‘processing’ in the context of the Act and not in the context of the calculation of mineral royalty payments”); *Rauscher, Pierce, Refsnes, Inc. v. Taxation & Revenue Department,* 2002-NMSC-13, ¶ 21, 132 N.M. 226, 46 P.3d 687 (taxpayer’s liability for gross receipts tax to be resolved “not by deciding whether Rauscher would be categorized as a dealer or broker under federal law, but by whether the term ‘broker’ as it appears in Section 7-9-3(F)(1)(b) encompasses Rauscher's role in the mutual fund transactions at issue”).

Application of New Mexico Tax Law. NMSA 1978, § 7-9-3(A) of New Mexico’s Gross Receipts and Compensating Tax Act defines the term “selling” as “a transfer of property for consideration.” Although DCSLP argues that this refers to a transfer of title and does not include a transfer of possession of the property being sold, there is nothing in the statute to support such a limited interpretation. When a statute does not define its terms, the rules of statutory construction require that those terms be interpreted in their common, ordinary sense. *Security Escrow Corp. v. Taxation and Revenue Department*, 107 N.M. 540, 543, 760 P.2d 1306, 1309 (Ct. App. 1988). *See also, State ex rel. Klineline v. Blackhurst*, 106 N.M. 732, 735, 749 P.2d 111, 1114 (1998) (courts are to give the words used in a statute their ordinary meaning unless the legislature indicates a different intent.). In *H-B-S Partnership v. Aircoa Hospitality Services, Inc*., 2005-NMCA-68, ¶ 22, 137 N.M. 626, 114 P.3d 306, the New Mexico Court of Appeals had occasion to interpret the term “transfer” in the context of a partnership agreement and found that:

> Black's Law Dictionary defines the verb "transfer" as, "1. To convey or remove from one place or one person to another; to pass or hand over from one to another, esp. to change over the possession or control of." Black's Law Dictionary 1536 (8th ed. 2004). Black's defines the noun "transfer" as "1. Any mode of disposing of or parting with an asset or an interest in an asset.... The term embraces every method—direct or indirect...of disposing of or parting with property or with an interest in property." *Id*. at 1535. Thus, the general legal definition of "transfer" is quite broad….

Giving the word its ordinary meaning, a "transfer" of property includes a transfer of physical possession of property, as well as a transfer of title to property. DCSLP's contention that "by every measure, a 'sale' takes place where title passes" is incorrect. Post-Hearing Brief at 7. In the area of state tax law—as opposed to commercial law—the majority of states define a "sale" as any transfer of title *or* possession, *or* both, for a consideration.[2] *See, e.g.*, Ark. Code Ann. § 26-52-103(9)(A) (sale means "the transfer of either the title or possession…for a valuable consideration of tangible personal property"); Fla. Stat. Ann. § 212.02(15) (sale includes any "transfer of title or possession, or both...of tangible personal property for a consideration"); La. R.S. § 47:301(12) (sale means any "transfer of title or possession, or both…of tangible personal property, for a consideration); N.J. Stat. Ann. § 54:32B-2(f) (sale means any "transfer of title or possession or both…for a consideration"); N.Y. Tax Law § 1101(b)(5) (sale includes any "transfer of title or possession or both...for a consideration"); Ohio Rev. Code Ann. § 5739.01(B)(1) (sale includes all "transactions by which title or possession, or both, of tangible personal property, is or is to be transferred"); 68 Okl. St. § 1352(21) (sale means "the transfer of either title or possession of tangible personal property for a valuable consideration"); Tex. Tax Code Ann. § 151.005 (sale means "any of the following when done or performed for consideration: (1) a transfer of title or possession of tangible personal property"). In Jerome R. Hellerstein and Walter Hellerstein, *State Taxation II*, ¶ 18.02[2][e] at 18-14 (3rd ed. 2003), the authors note that:

> As a matter of statutory construction, it is clear that the transfer-of-title-or-possession rule of taxability will subject to tax the transfer of possession to goods

[2] Although most states impose a sales tax rather than a gross receipts tax, the United States Supreme Court has made no distinction between such taxes when determining a state's right to tax sales in interstate commerce. *See*, *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 348 (1944) ("[I]t could hardly be held that Indiana lacked constitutional authority to impose a sales tax or a use tax on these transactions. But if that is true, a constitutional difference is not apparent when a 'gross receipts' tax is utilized instead.").

> within the state even though title to the property has not passed or title has passed elsewhere.

See also, Mossberg-Hubbard, supra; IBM v. Oklahoma Tax Commission, 853 P.2d 770, 772 (Okla. 1993) (although transfer of title passed outside Oklahoma, transfer of possession occurred within the state and the sale was subject to tax in Oklahoma).

The United States Supreme Court has consistently upheld the imposition of state sales taxes based on the place where consummation of a sale occurs. In *Oklahoma Tax Commission v. Jefferson Lines*, 514 U.S. 175, 184 (1995) the Court noted that: "It has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State." In support of this proposition, the Court cited to its earlier decision in *McGoldrick v. Berwind-White Coal Mining Co*., 309 U.S. 33, 49 (1940), which upheld New York's tax on the sale of coal shipped into New York from Pennsylvania, finding that the taxable event was the transfer of possession to the purchaser within the state, "regardless of the time and place of passing title...." In *International Harvester Co. v. Department of the Treasury*, 322 U.S. 340 (1944), the Court again held that a state may tax gross receipts from interstate transactions consummated within its borders:

> The fact that the sales in Class C are made by an out-of-state seller and that the contracts were made outside the State is not controlling. Here as in the *Wood Preserving Corp*. case, delivery of the goods in Indiana is an adequate taxable event. When Indiana lays hold of that transaction and levies a tax on receipts which accrue from it, Indiana is asserting authority over the fruits of a transaction consummated within its borders....

Id., 322 U.S. at 345.

In its Post-Hearing Reply Brief (page 3), DCSLP cites to *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327 (U.S. 1944) for the proposition that New Mexico's gross receipts tax cannot apply to a sale where title passes and goods are shipped from outside the state. DCSLP fails to

recognize that the Court's decision in *McLeod* was based on a finding that the sale in that case was consummated prior to shipment. The Court noted that this finding explained the difference between its decision in *McLeod*, which struck down Arkansas' sales tax on goods shipped into the state from Tennessee, and *Berwind-White, supra*, which upheld New York's sales tax on goods shipped into the state from Pennsylvania, stating: "In *Berwind-White* the Pennsylvania seller completed his sales in New York; in this case the Tennessee seller was through selling in Tennessee." *McLeod*, 322 U.S. at 330. In this case, as in *Berwind-White*, DCSLP's sales were consummated when merchandise was physically delivered to its customers. While title may have passed in Texas, DCSLP had not completed its bargain with its New Mexico customers and was not "through selling" until the customer received the goods within this state.

In *Proficient Food v. New Mexico Taxation and Revenue Department***,** 107 N.M. 392, 758 P.2d 806 (Ct. App.), *cert. denied*, 107 N.M. 308, 756 P.2d 1203 (1988), the New Mexico Court of Appeals recognized that the consummation of a sale in New Mexico supports the imposition of the gross receipts tax. The taxpayer was a California corporation which operated a restaurant supply business with a warehouse in Texas. The taxpayer had no place of business in New Mexico and had no employees, agents or salesmen residing in the state. Orders for food and supplies from New Mexico customers were taken by the taxpayer over the telephone, and all sales were invoiced to and paid by the customers' corporate headquarters located outside New Mexico. Once an order was accepted, the taxpayer used its own trucks to deliver the goods from its Texas warehouse to the New Mexico customer. Like DCSLP in this case, the taxpayer in *Proficient Food* argued that it was not subject to New Mexico gross receipts tax because it was not selling property in New Mexico. Instead, the taxpayer maintained that its selling activities

were concluded when the order was accepted and the goods were identified and placed in transit from its Texas warehouse. The court found otherwise, stating:

> The gross receipts tax assessed against PFC was limited to the receipts from the products sold by it to New Mexico restaurants. The Act defines gross receipts as the "total amount of money…received from selling property in New Mexico." NMSA 1978, § 7-9-3(F) (Repl.1986). The Act defines selling as "any transfer of property for consideration." § 7-9-3(B). Although not explicitly stated in the stipulated facts, the hearing officer determined it was reasonable to infer that the products delivered to the restaurants in New Mexico were sold in New Mexico, despite the fact that the invoices were handled by the corporate offices outside the state. *See Pittsburgh & Midway Coal Mining Co. v. Revenue Div., Taxation & Revenue Dep't.,* 99 N.M. 545, 660 P.2d 1027 (Ct. App. 1983) (sale occurred in New Mexico when title and risk of loss pass to purchaser in New Mexico and tax may be imposed on those sales). We agree.

Proficient Food, supra, 107 N.M. at 395, 758 P.2d at 809.

A similar result was reached in *Siemens Energy & Automation, Inc. v. Taxation & Revenue Department*, 119 N.M. 316, 889 P.2d 1238 (Ct. App. 1994), which involved the gross receipts tax liability of an out-of-state manufacturer with a sales office in Albuquerque but no manufacturing facilities within the state. A high percentage of Siemens' sales were to national distributors who asked Siemens to ship equipment directly to their customers. The court of appeals held that when three-party interstate transactions "involve a New Mexico shipping destination," the seller is entitled to accept a Multistate Tax Commission certificate from its purchaser to establish that the sale is exempt from New Mexico gross receipts tax. *Siemens*, 119 N.M. at 317, 889 P.2d at 1239. Despite the fact that many of Siemens' customers had voluntarily paid compensating tax on the value of the goods ordered, the court held that the gross receipts tax—not the compensating tax—applied to the sale of equipment delivered to customers in New Mexico.

A third New Mexico case supporting the conclusion that a "sale" for state tax purposes depends on where risk of loss passes, as well as where title passes, is *Pittsburgh & Midway Coal*

Mining Co. v. Revenue Division, Taxation & Revenue Department, 99 N.M. 545, 660 P.2d 1027 (Ct. App. 1983), *cert. quashed*, 99 N.M. 644, 662 P.2d 645 (1983). In that case, the taxpayer challenged the imposition of gross receipts tax on its sale of coal to an out-of-state buyer. Based on its finding that both title and risk of loss passed to the buyer in New Mexico when the coal was loaded onto railroad cars for transportation outside the state, the court held that the sale was subject to tax in New Mexico, stating: "We conclude that the question of title *and delivery of coal in New Mexico* is a positive factor upon which to determine that the tax does not interfere with the Commerce Clause of the U.S. Constitution." *Id.*, 99 N.M. at 555, 660 P.2d at 1037 (emphasis added). In reaching its conclusion, the court also relied on a Department regulation (now codified at 3.2.213.12 NMAC) which provided that "receipts of New Mexico sellers from sales of property to nonresidents of New Mexico who accept delivery of the property in New Mexico are not transactions in interstate commerce, and are subject to Gross Receipts Tax." *Id.*, 99 N.M. at 552, 660 P.2d at 1034. This regulation and the holdings in *Proficient Food, Siemens,* and *Pittsburgh & Midway* establish that—subject to the constitutional limitations discussed in the next section—New Mexico follows the approach of most other states in imposing tax on sales where transfer of possession of tangible personal property occurs within the state.

In arguing that transfer of title alone establishes the location of a sale, DCSLP ignores the New Mexico cases dealing with sales of goods and relies on the New Mexico Supreme Court's decisions in *Kmart Corporation, supra*, and *TPL, Inc. v. New Mexico Taxation & Revenue Department*, 2003-NMSC-7, 133 N.M. 447, 64 P.3d 474, neither of which involved the sale of tangible personal property. In *Kmart*, the supreme court held that the transfer of a license to use intangible personal property in New Mexico was not subject to New Mexico gross receipts tax because both parties to the license agreement were located in Michigan and all activity related to the

license agreement took place in Michigan. Based on these facts, the court concluded that "[w]ith all critical elements and parties being in Michigan, it cannot be said that this transaction involved the sale of property within the borders of New Mexico." 2006-NMSC-006, ¶ 18. The facts of this case are quite different. Each sales transaction was initiated when a buyer located in New Mexico mailed an order form, picked up a telephone, or turned on a computer in New Mexico and placed an order for DCSLP's products. Each transaction was consummated when DCSLP completed physical delivery of the ordered products to the customer in New Mexico. In contrast to the facts in *Kmart*, one of the two parties and many of the critical elements involved in DCSLP's sales of tangible goods were located in New Mexico.

With regard to *TPL, supra*, DCSLP relies on the following sentence taken from the New Mexico Supreme Court's opinion: "In cases involving the sale of goods, the place of transfer of title determines where the transaction is taxable." 2003-NMSC-7, ¶ 26. In order to understand the import of this sentence, however, it must be read in context, which DCSLP has failed to do:

> Transfer of title occurred in New Mexico because the inert munitions were in New Mexico at the time the transfer of title took place. *See Pittsburgh & Midway Coal Mining Co. v. Revenue Div., Taxation & Revenue Dep't*, 99 N.M. 545, 554, 660 P.2d 1027, 1036 (Ct. App. 1983) (citing *State Tax Comm'n v. Pac. States Gas Iron Co*., 372 U.S. 605, 10 L. Ed. 2d 8, 83 S. Ct. 925 (1963)). In cases involving the sale of goods, the place of transfer of title determines where the transaction is taxable. *Id*. ("Where a vendor sells property, and passage of title and delivery occurs in the vendor state, that state can levy and collect the sales tax on that transaction."). Thus, if this case involved the sale of goods, New Mexico would have taxing authority.

2003-NMSC-7, ¶ 26. The first sentence of this passage sets out the court's conclusion that title to the munitions transferred to TPL in New Mexico *because the munitions were already in TPL's possession within the state*. This does not support DCSLP's assertion that transfer of title, by itself, determines the place of sale.

As the Department points out in its Post-Hearing Response Brief (pages 6-7), the discussion in *TPL* concerning title to the demilitarized munitions was *dicta*. The holding of the case was that the *intangible* product of a service performed on property shipped into New Mexico by an out-of-state buyer was not initially used by or delivered to the buyer in New Mexico when the buyer had no employees, agents, or other physical presence in the state. This holding does not support DCSLP's argument that its sales of tangible personal property to New Mexico buyers who had no employees, agents, or other physical presence in Texas should be treated as Texas sales. Although DCSLP's terms and conditions of sale provided for passage of title at its Texas facility, the buyer acquired no control over the property at that point. To the contrary, there were "no procedures whereby customers who desired to pick up their merchandise or have other carriers pick up their merchandise at Dell warehouses or other shipping locations out of state could do so." Stip. Ex. S-8 at 7. Because DCSLP retained both risk of loss and control over its products until they were physically delivered to its customers in New Mexico, DCSLP had gross receipts from "selling property in New Mexico" under NMSA 1978, § 7-9-3.5(A).

Issue II. Whether imposition of New Mexico gross receipts tax on DCSLP's sales to New Mexico customers violates the Commerce Clause of the United States Constitution.

DCSLP argues that even if the Department had the requisite statutory authority to tax DCSLP's sales to New Mexico customers, the limitations imposed by the Commerce Clause of the federal constitution bars taxation in this case.[3] In *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977), the United States Supreme Court held that a state tax on foreign corporations performing exclusively interstate business will not violate the protections of the Commerce Clause if the tax meets the following four-part test: (1) a sufficient nexus exists between the

[3] DCSLP has not challenged the Department's assessment on due process grounds.

activity being taxed and the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to services provided by the state.

A. Fair Apportionment. A state tax on interstate commercial activity is "fairly apportioned" if it is both internally and externally consistent. *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989). *See also, Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983); *Jefferson Lines, supra,* 514 U.S. 175, 185. A tax is internally consistent if "the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." *Id.* The internal consistency test "simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Id.* The external consistency test looks at the in-state business activity on which the tax is imposed and the practical or economic effect of the tax to determine "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg, supra*, 488 U.S. at 262.

(1) Internal Consistency. As discussed in the previous section, most states define a "sale" for purposes of state taxation as any transfer of title or possession, or both, for a consideration. On its face, such a statutory scheme appears to violate the fair apportionment test because it could result in multiple taxation in cases where transfer of title takes place in one state and transfer of possession takes place in another. The possibility of double taxation is obviated, however, by the exemption (or deduction) states routinely provide for sales of property shipped outside the state. As discussed in Walter Hellerstein, Michael J. McIntyre and Richard D. Pomp,

Commerce Clause Restraints on State Taxation After Jefferson Lines, 51 Tax L. Rev. 47, n. 63 (Fall 1995):

> Despite the theoretical risk of multiple taxation to which interstate commerce could be exposed under many state sales taxes, *see* note 62, most states, in fact, exempt from tax sales of goods for out-of-state delivery, even when title passes within the state.... As a practical matter, then, a purchaser in State A who purchases goods from a seller in State B ordinarily will not be subject to State B's sales tax, unless the purchaser comes into State B to pick up the goods. *See id*. In that event, of course, State A has no power to impose a tax on the sale, because transfer of neither ownership nor possession occurs in State A.

In this case, the taxation of DCSLP's sales to out-of-state customers illustrates the way in which existing state tax schemes operate to avoid the danger of multiple taxation on interstate sales. Under Tex. Tax Code § 151.005, a "sale" is defined to include the "transfer of title or possession of tangible personal property" for consideration. Based on this definition, DCSLP should have been liable for Texas sales tax on its sales to New Mexico customers because title to the goods transferred in Texas. DCSLP acknowledges, however, that it never paid tax to Texas on these sales because they "constituted sales in interstate commerce" and "DCSLP had no obligation to pay and the State of Texas did not impose any sales tax on such transactions." Stip. Ex. S-8 at 8. This exemption for interstate sales is found in Tex. Tax Code § 151.330(a), which provides that the "sale of tangible personal property that under the sales contract is shipped to a point outside this state is exempted from the sales tax…."

New Mexico's gross receipts tax follows the same pattern. DCSLP is liable for gross receipts tax on its sales into New Mexico because those sales are consummated when DCSLP transfers physical possession of the goods to its customers within the state. Had the location of the parties been reversed, DCSLP's receipts on the sale of property shipped from New Mexico to customers in Texas would have escaped tax under NMSA 1978, § 7-9-55, which provides a deduction for receipts from transactions in interstate commerce. *See also*, *Al Zuni Traders v.*

Bureau of Revenue, 90 N.M. 258, 259-260, 561 P.2d 1351, 1352-1353 (Ct. App. 1977) (rejecting the taxpayer's Commerce Clause argument and noting that a deduction from gross receipts tax was allowed for all of the taxpayer's sales delivered out of state).

As this analysis demonstrates, the structure of New Mexico's gross receipts tax meets the internal consistency test. If every state taxed the sale of goods shipped into the state and exempted the sale of goods shipped out of the state (except where the sale is completed prior to shipment), no more than 100 percent of a vendor's receipts would be subject to tax, regardless of the vendor's location. In Walter Hellerstein, *Is "Internal Consistency" Foolish?: Reflection on an Emerging Commerce Clause Restraint on State Taxation*, 87 Mich. L. Rev. 138, 173-174 (1998), Professor Hellerstein notes that the United States Supreme Court has consistently approved this method of taxing interstate sales:

> First, with respect to gross receipts taxes on interstate sales activity, the Court has analogized gross receipts taxes to retail sales and use taxes. Because retail sales and use taxes are consumer taxes which are separately stated, collected from purchasers, and imposed on a transaction-by-transaction basis, apportionment of such levies—in the sense of division of the tax base—has never been viewed as a practicable solution to the multiple taxation issues that such taxes raise. Instead, the Court in effect has had to decide whether the state from which the goods were sent, the state to which the goods were shipped, or both, or neither would be permitted to tax retail interstate sales. In fact, the Court has generally allowed the state of destination to tax retail sales transactions while forbidding the state of origin from doing so. By analogy, the Court has generally sustained gross receipts taxes on interstate sales activity when imposed by the state to which the goods were shipped while prohibiting such taxes when imposed by the state from which the goods were sent. (footnotes omitted).

Finally, it should be noted that the Supreme Court has held that the mere possibility of multiple taxation is not sufficient to defeat a state tax. In *Goldberg, supra*, the Court held that a State in which an interstate telephone call originates or terminates has the requisite Commerce Clause nexus to tax a customer's purchase of that call. Although the Court acknowledged the

possibility that more than one state could impose such a tax, it determined that this was not sufficient to invalidate the tax imposed by the State of Illinois:

> We recognize that, if the service address and billing location of a taxpayer are in different States, some interstate telephone calls could be subject to multiple taxation. n13 This limited possibility of multiple taxation, however, is not sufficient to invalidate the Illinois statutory scheme. *See Container Corp.*, 463 U.S., at 171; *Moorman*, 437 U.S., at 272-273. To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation. *D. H. Holmes, supra*, at 31 ("The ... taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States"); *see also Tyler Pipe, supra*, at 245, n. 13.

Id., 488 U.S. at 263-264. *See also, Proficient Food, supra*, 107 N.M. 392, 395, 758 P.2d 806, 809 (rejecting taxpayer's theoretical argument that it could be subject to tax by Texas and California as well as by New Mexico); *Mossberg-Hubbard, supra*, 432 A.2d 1176, 1180 (finding that imposition of Rhode Island sales tax did not violate the Commerce Clause absent a showing that the taxpayer was actually subject to multiple taxation on its interstate business). In this case, the exemption from tax provided by both Texas and New Mexico on sales consummated by the transfer of goods outside the state prevents any danger of multiple taxation and provides the internal consistency required by the *Complete Auto* test.

(2) External Consistency. New Mexico's gross receipts tax scheme also meets the requirement for external consistency. In this case, DCSLP has not completed its bargain with its customer and has not earned the receipts subject to tax until the goods being sold are physically delivered to the customer in New Mexico. Taxing DCSLP's receipts at the place where the sale is consummated reflects the economic reality of this transaction. As the United States Supreme Court explained in *Jefferson Lines, supra*, 514 U.S. at 186:

> A sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale.... We have therefore consistently approved taxation of sales without any division of the tax base among different States, and

> have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future. *See, e. g., McGoldrick v. Berwind-White Coal Mining Co., supra*.

B. Discrimination. NMSA 1978 § 7-9-4 imposes an excise tax of five percent of a vendor's gross receipts from selling property in this state, regardless of the location of the vendor. DCSLP pays gross receipts tax on its sale of computers to New Mexico customers at exactly the same rate paid by in-state vendors of computers. *See also, Proficient Food, supra*, 107 N.M. 392, 396, 758 P.2d 806, 810 (gross receipts tax applies equally to in-state and out-of-state sellers). New Mexico's gross receipts tax does not discriminate against interstate commerce.

C. Relation to Services Provided. The fourth prong of the *Complete Auto* test asks whether the state tax is fairly related to the presence and activities of the taxpayer within the state and "focuses on the wide range of benefits provided to the taxpayer, not just the precise activity connected to the interstate activity at issue." *Goldberg, supra,* 488 U.S. at 267. In reviewing state transaction taxes, the Supreme Court has held that the benefits of fire and police protection, the use of public roads and utilities, and the other advantages of a civilized society are sufficient to justify the imposition of tax. *See, e.g., Goldberg*, 488 U.S. 252, 267; *Jefferson Lines*, 514 U.S. 175, 200; *D. H. Holmes Co. v. McNamara*, 486 U.S. 24, 32 (1988). Similar benefits were extended to DCSLP in this case. Without fire and police protection, as well as public roads by which to effect delivery to its customers, DCSLP would have had no way to carry out its sales activity. Without electricity, telephone lines, and the other benefits of modern society, DCSLP would have had absolutely no market for its computers within New Mexico. For this reason, the fourth prong of the *Complete Auto* test is met.

D. Substantial Nexus. The final question to be determined is whether DCSLP has sufficient nexus with New Mexico to support New Mexico's imposition of gross receipts tax. Under the analysis in *Complete Auto*, a state must demonstrate that the tax at issue "is applied to an activity with a substantial nexus with the taxing State." 430 U.S. at 279. In the later case of *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992), the United States Supreme Court held that for purposes of imposing sales and use taxes, the Commerce Clause requires that the taxpayer have a physical presence in the taxing state. Since *Quill*, states have struggled, with varying results, to define the parameters of the physical presence overlay to the substantial nexus requirement set out in *Complete Auto*.

Some guidance is provided by the Supreme Court's decisions in *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977), which upheld a finding of nexus based on the taxpayer's maintenance of two in-state offices unconnected with the sales transactions at issue, and *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987) and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1992), which upheld a finding of nexus based on the presence of independent representatives of the taxpayer within the taxing state. Although these decisions predated *Quill*, the Court reconfirmed their holdings, finding that the taxpayer operating through independent contractors in *Tyler Pipe* "had a physical presence in the taxing State," *Quill*, 504 U.S. at 314, and citing *National Geographic* and *Scripto* for the proposition that nexus "may turn on the presence in the taxing State of a small sales force, plant, or office." *Quill*, 504 U.S. at 315.

In this case, the Department maintains that the in-home repair services BancTec USA, Inc. ("BancTec") performed in New Mexico established DCSLP's physical presence in the state under *Scripto* and *Tyler Pipe* because DCSLP exercised a substantial degree of control over

BancTec's activities and those activities served to further the market for DCSLP's products in New Mexico. The Department argues that a physical presence also exists as a result of Dell Products L.P.'s ownership of replacement parts, mailing boxes and technical manuals provided to BancTec service technicians operating in New Mexico. Finally, the Department asserts that DCSLP engaged in "joint solicitation activities" with Dell Financial Services, L.P., an affiliated company which leased Dell computers to New Mexico customers. DCSLP rejects all of these arguments, maintaining that it did not have sufficient contacts with New Mexico to meet the physical presence requirement established in *Quill*.

(1) DCSLP's Relationship With BancTec. The parties have stipulated that DCSLP did not own or lease any real property, did not maintain any office or other place of business, did not operate any retail stores, and did not have any employees or independent sales agents located in New Mexico during the audit period. The issue to be decided is whether the repair services BancTec performed in New Mexico under the terms of three Service Contract Sales Brokerage Agreements ("Brokerage Agreements") gave DCSLP a physical presence in the state for purposes of New Mexico gross receipts tax.

Each of the Brokerage Agreements was entered into between BancTec and a different Dell entity: the 1991 agreement was with Dell USA Corporation, the 1995 agreement was with Dell Products L.P., and the 1998 agreement was with Dell USA L.P. The references to "Dell" in the agreements are generic, however, and are not limited to the contracting entity. For example, the 1995 Brokerage Agreement provides that "Dell shall render sales and marketing assistance to BancTec for the sale of Service Contracts." Stip. Ex. S-2 at 1. Dell Products L.P.—the contracting entity—was the limited partnership responsible for manufacturing Dell products and did not engage in sales activity. Sales and marketing were handled by Dell Marketing L.P. (large

corporate, governmental and institutional customers), Dell Direct Sales L.P. (small and medium-sized business customers) and DCSLP (individual home consumers). With regard to the transactions at issue in this case, DCSLP was the Dell entity responsible for marketing, selling, and overseeing BancTec service contracts sold to DSCLP customers under the terms of the Brokerage Agreements.

It is DCSLP's position that BancTec was an unrelated company doing business on its own behalf and not on behalf of DCSLP. While there is no question that BancTec performed computer repair services and received payment on its own behalf, that is true of any independent contractor and does not preclude a finding that BancTec was also performing those services at the direction and for the benefit of DCSLP. As set out in some detail in the Findings of Fact, *supra*, the parties' Brokerage Agreements strictly regulated the sale and the manner of execution of BancTec's service contracts with DCSLP customers. A brief review recap of just some of those facts illustrates the degree of control exercised by DCSLP:

— A New Mexico customer who wished to purchase a service contract for a Dell computer could not call BancTec directly, but had to purchase the contract through DCSLP.

— The service contracts between BancTec and DCSLP customers had to follow the form set out in the Brokerage Agreements. DCSLP had the right to revise the contract from time to time "to facilitate ease of understanding by Customer."

— DCSLP set the price for BancTec service contracts. As a marketing tool, DCSLP often "bundled" the cost of BancTec's service contract into a single package price charged for a complete computer setup, including such components as the monitor, processor and hard drive.

— During the audit period, 75 percent of DCSLP's New Mexico customers purchased a service contract. BancTec was required to accept all service contracts sold by DCSLP.

— When a New Mexico customer who had purchased a BancTec service contract had a problem, the customer could not contact BancTec directly. Instead, the customer was required to call Dell Customer Technical Support ("Dell Tech Support"), which provided technical services to DCSLP for a fee.

— Only after Dell Tech Support had diagnosed the problem and determined that it could not be corrected over the telephone would it authorize BancTec to dispatch a technician to the New Mexico customer's address for service.

— During the audit period, Dell Tech Support dispatched BancTec technicians on 1,273 service calls and installation visits to DCSLP's customers in New Mexico.

— BancTec was required to follow detailed "Service Call Procedures" when performing services for DCSLP's New Mexico customers, which included a requirement that BancTec contact DCSLP customers within a specified period of time after receipt of a dispatch notice from Dell Tech Support.

— BancTec was required to track every service call against targeted arrival times and to cooperate with DCSLP "to establish and implement effective escalation or remedial procedures to produce optimum customer satisfaction."

— At the time of dispatch, Dell Tech Support delivered the parts required for resolution of the customer's problem to BancTec. BancTec was prohibited from using parts other than the parts supplied by Dell Tech Support. If the technician ran into a problem at the customer's site in New Mexico, he was required to call Dell Tech Support for additional assistance.

— BancTec's service technicians had to meet specific skill levels set out in the Brokerage Agreements and were trained to "professionally and positively" represent "Dell Computer Corporation and other partners" during on-site service calls.

— BancTec warranted its repair services to DCSLP, but disclaimed all warranties in its contracts with DCSLP customers.

— In the event a New Mexico customer was not satisfied with the services performed by BancTec, the customer registered a complaint with Dell Tech Support and not with BancTec. Dell Tech Support then acted as an intermediary, reporting the problem to BancTec management for resolution.

— If BancTec's "service level performance" as set out in the Brokerage Agreement fell below 95% for two consecutive months, DCSLP had the exclusive right to take over the service obligations under all of BancTec's existing service contracts with DCSLP's New Mexico customers, or to assign BancTec's service obligations to a third party chosen by DCSLP.

The record in this case provides overwhelming evidence that DCSLP controlled and directed BancTec's performance of repair services for DCSLP customers. DCSLP's characterization of BancTec as an independent service provider acting solely on its own behalf simply does not correspond to the facts. In carrying out the terms of its service contracts with

DCSLP's New Mexico customers, BancTec was also carrying out the terms of its Brokerage Agreements with Dell, and its activities were performed on behalf of and for the benefit of both parties. Nonetheless, DCSLP argues that BancTec's activities in New Mexico cannot be attributed to DCSLP because (a) BancTec did not solicit sales on DCSLP's behalf, and (b) BancTec did not meet the legal definition of an agent under New Mexico law.

(a) Solicitation of Sales. DCSLP maintains that an independent contractor's in-state activities may be attributed to an out-of-state vendor only when the contractor is soliciting sales on behalf of the vendor. As support for its argument, DCSLP points out that the independent contractors in both *Scripto* and *Tyler Pipe* were involved in soliciting sales. Nothing in those decisions indicates, however, that the Supreme Court intended to limit its nexus analysis to identical fact situations. To the contrary, the Court concluded that the "crucial factor" governing a determination of nexus is "whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe, supra*, 483 U.S. at 251 (quoting from the decision of the Washington Supreme Court). There is nothing to suggest that the only activity that can meet this criteria is the solicitation of sales.

In December 1995, the Multistate Tax Commission ("MTC") issued Nexus Program Bulletin 95-1, which concludes that an out-of-state computer company providing in-state repair services to its customers through a third-party contractor has nexus with the state.[4] Ex. A at B12.3. Although the fact scenario used in the bulletin refers to services performed under a warranty, the MTC notes that this example "is for illustrative purposes and should not be

[4] The MTC is "the organization primarily responsible for promoting uniformity of taxation in member states." *Kmart Properties, Inc. v. Taxation & Revenue Department*, 2006-NMCA-26, ¶ 52, quoting from *Twentieth Century-Fox Film Corp v. Department of Revenue*, 700 P.2d 1035, 1041 (Or. 1985). The MTC was established through the Multistate Tax Compact, which was adopted by New Mexico in 1967. NMSA 1978, § 7-5-1.

interpreted to exclude other instances involving similar, but not identical, fact patterns." *Id*. *See also*, Richard D. Pomp & Michael J. McIntyre, *State Taxation of Mail-Order Sales of Computers After Quill; An Evaluation of MTC Bulletin 95-1*, 11 State Tax Notes 177 (1996) (describing the bulletin as a refinement of the MTC's long-standing conviction that a mail-order seller has nexus with a state if it has an in-state service representative who regularly acts on its behalf). Bulletin 95-1 takes the position that representatives other than salesmen may establish nexus for out-of-state vendors and lists 26 states, including New Mexico, that "have indicated that their law is consistent with the constitutional and federal statutory nexus principles described in this Bulletin." Ex. A at B12.5. *See also, Borders Online LLC v. State Board of Equalization*, 29 Cal. Rptr.3d 176, 190 (Cal. App. 2005) (there is no requirement that an out-of-state retailer's in-state representative be engaged in the solicitation of sales to satisfy the substantial nexus required by the Commerce Clause).

In *Kmart Properties, Inc. v. Taxation & Revenue Department*, 2006-NMCA-26 (Ct. App. 2001), *reversed in part on other grounds, Kmart Corporation v. Taxation and Revenue Department*, 2006-NMSC-006, the New Mexico Court of Appeals determined that the in-state activities of Kmart employees, which served to protect and promote the trademarks of Kmart's out-of-state subsidiary, were sufficient to establish the subsidiary's nexus with New Mexico for gross receipts tax purposes. While noting that the subsidiary was not engaged in retail sales, the court concluded that this did not change the Commerce Clause analysis to be applied in determining nexus:

> Unlike *Tyler Pipe* and *Scripto*, KPI is not engaged in the retail sales of a product. Its sole function is to hold title to marks and associated goodwill that are under license to Kmart Corporation. The question is whether this distinction, with respect to the kind of business and the nature of the intangible property interests being promoted, requires any different result. We think not.

Id., 2006-NMCA-26, ¶ 34.

Louisiana courts have also rejected the argument that solicitation of sales is the only type of third-party activity that can create nexus for an out-of-state vendor. In *Louisiana Department of Revenue and Taxation v. Quantex Microsystems, Inc.*, 809 So. 2d 246 (La. Ct. App. 2001), the Louisiana Court of Appeals concluded that an out-of-state corporation's use of independent contractors to provide on-site computer repair services in Louisiana could establish substantial nexus under *Quill*. The court of appeals reversed the trial court's grant of summary judgment and remanded the case for further development of the facts, including the extent of the on-site repair services performed by the contractor and whether those services were significantly associated with Quantex's ability to establish and maintain a market in Louisiana.

The holding in *Quantex* was reconfirmed in *Louisiana Department of Revenue and Taxation v. Dell International, Inc.*, 922 So.2d 1257, 2006 La. App. LEXIS 280 (La. Ct. App. 2006), *rehearing denied*, 2006 La. App. LEXIS 867 (March 30, 2006), which presented issues identical to the issues in this case. Once again, the court reversed the trial court's grant of summary judgment, finding that the trial court erred in concluding that BancTec's computer repair services for Dell customers located in Louisiana could not provide Dell with the substantial nexus required for state taxation:

> Both the extent and the nature of the services provided by BancTec to Dell's Louisiana customers as well as the impact of this service on Dell's ability to establish and maintain a lucrative market in this state are clearly presented as evidence in this record. Applying the well-settled law to the facts of this case, we can not conclude that Dell established an absence of factual support for the claim by LDL that BancTec provided computer repair services in Louisiana to Dell customers on behalf of Dell and thus, that Dell's activities in this state constituted a sufficient nexus to create the physical presence constitutionally required for the imposition of a use tax herein. Thus, Dell failed to establish its entitlement to judgment in its favor as a matter of law.

Id., 2006 La. App. LEXIS 280, 24-25.

As the above cases demonstrate, in-state representatives may establish nexus for an out-of-state vendor through activities other than sales. The "crucial factor" is not the nature of the in-state activities, but whether those activities are "significantly associated with the taxpayer's ability to establish and maintain a market" for sales. *Tyler Pipe, supra*, 483 U.S. at 251.

(b) Agency. DCSLP also argues that BancTec's activities in New Mexico are "immaterial for purposes of establishing nexus" because BancTec did not have the legal authority to bind DCSLP and was not an "agent" as defined in New Mexico law. Post-Hearing Brief at 16-17. This argument ignores the United States Supreme Court's decisions in both *Tyler Pipe* and *Scripto*, which concluded that a formal agency relationship is not required in order for the activities of an in-state representative to establish nexus for an out-of-state vendor. In *Tyler Pipe*, *supra*, 483 U.S. at 250, the Court found that:

> As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor *instead of as an agent*. We agree with this analysis. (emphasis added).

In *Scripto,* the Supreme Court upheld a finding of nexus despite the fact that the out-of-state vendor did not have "any regular employee *or agent*" in the state. *Id.,* 362 U.S. at 209 (emphasis added). The ten wholesalers operating in Florida solicited orders for Scripto's products, which were then forwarded to Georgia for acceptance or refusal. The wholesalers themselves had no authority to accept or reject orders, to accept payments, or to incur debts on behalf of the vendor. The Supreme Court nonetheless held that the wholesalers' activities established a sufficient nexus between the vendor and the State of Florida to subject to the vendor to tax:

> True, the "salesmen" are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. The formal shift in the contractual tagging of the salesman as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into Florida….

> To permit such formal "contractual shifts" to make a constitutional difference would open the gates to a stampede of tax avoidance.

Id., 362 U.S. at 211. State courts have also held that the activities of independent contractors who do not meet the legal definition of an "agent" may be sufficient to subject an out-of-state vendor to state tax. *See, Commissioner of Revenue v. Jafra Cosmetics, Inc*., 742 N.E.2d 54, 59 (Mass. 2001) (an out-of-state vendor was subject to sales and use tax based on activities of in-state consultants without power to bind the vendor: "the lack of contractual authority was legally insignificant"); *Amway Corp., Inc. v. Director of Revenue*, 794 S.W.2d 666, 671 (Mo. 1990) (independent distributors were acting "on behalf" of Amway even though they lacked legal authority to enter into contracts); *Ex parte Newbern*, 239 So.2d 792, 796-798 (Ala. 1970), *appeal dismissed*, 409 U.S. 813 (1972) (in-state salesmen need not have a legal relationship with an out-of-state vendor in order to subject the vendor to tax).

The only authority DCSLP cites in support of its argument that a formal agency relationship is required for a finding of nexus is the Connecticut Superior Court's decision in *Dell Catalog Sales, L.P. v. Commissioner of Revenue Services*, 834 A.2d 812 (Conn. Super. Ct. 2003), which considered the same issues raised in this protest. There, the court noted that "*[a]lthough it appears that BancTec was operating in Connecticut on Dell's behalf*," the state tax commissioner had stipulated that Dell had no right to direct and control the work of BancTec and that BancTec was not an agent for Dell. *Id.*, 834 A.2d at 819 (emphasis added). Contrary to DCSLP's assertions, however, the absence of an agency relationship was not the basis for the Connecticut court's holding that BancTec's activities did not establish nexus for DCSLP. Even after determining that the tax commissioner's stipulations negated a finding of agency, the court went on to find as follows:

> One cannot escape the fact, however, that BancTec served an important need of Dell Catalog Sales to service the Dell customers in Connecticut. Dell Catalog Sales benefitted financially from the sales of the service contracts as well as the ability to have an outsourced repair service attend to the needs of its customers in Connecticut. *See* 2 R. Pomp & O. Oldman, *supra*, p. 9-63. The missing ingredient in determining whether BancTec's on-site service established nexus in Connecticut as a representative of Dell would be the frequency, if any, of the number of on-site service calls.
>
> .... For the most part, the facts in the present case were developed by a stipulation of the parties. The stipulation of facts contains no information regarding the extent of BancTec's activities in Connecticut….

Id., 834 A.2d at 822. The court concluded that because there were "no facts to support the commissioner's claim that BancTec had sufficient, substantive physical presence in the state of Connecticut, the plaintiffs appeal must be sustained." *Id*., 834 A.2d at 823.

In contrast to the Connecticut case, the Department in this case has not stipulated that DCSLP lacked the right to direct and control the work of BancTec, and the facts presented at the administrative hearing support exactly the opposite conclusion. Under the terms of the three Brokerage Agreements, DCSLP exercised extensive control over BancTec's service activities in New Mexico. DCSLP determined whether BancTec would be permitted to make an on-site service call; the time frame within which BancTec was required to respond to DCSLP's dispatch notices; the training and skill level of each BancTec technician assigned to a particular type of service call; and the extent of the service provided to the customer, including the specific parts to be replaced. The record also establishes that BancTec had a substantial presence in New Mexico during the audit period, making more than 1,200 service calls on DCSLP customers within the state.

In *Dell International, supra*, the Louisiana Court of Appeals relied on these same facts to reject the trial court's conclusion that BancTec's status as an independent contractor precluded a finding that BancTec was performing repair services on behalf of Dell:

> Our *de novo* review of this matter reveals that the trial court erred as a matter of law in concluding based on those facts no issue of material fact existed that BancTec was not acting on behalf of Dell. On appeal, Dell maintains the trial court was correct in finding BancTec was not its contractual "agent," rather it was a "broker" and therefore, was not acting "on its behalf." Dell argues semantics, rather than law, and as noted by the Court in *Scripto*, these are fine distinctions without constitutional significance. Moreover, the trial court and Dell both ignore the Supreme Court's admonition in *Scripto*, that the "contractual tagging" of a third party as an independent contractor or salesman is simply insufficient to change the function of the third party "nor bears on its effectiveness in securing a substantial flow of goods into [the state]." 362 U.S. at 211. The nature and extent of the activities (*Scripto*, 362 U.S. at 211) and whether those activities are significantly associated with the taxpayer's ability to establish and maintain a market in this state (*Tyler Pipe Industries, Inc*., 483 U.S. at p. 250; *Quantex*, 809 So.2d 252) are the determinative factors of whether Dell's contractual dealings with BancTec constitute a sufficient physical nexus for the purpose of justifying the imposition of a use tax.

Dell International, Inc., supra, 922 So.2d 1257, 2006 La. App. LEXIS 280, 18-19.

Based on the facts presented in this protest, BancTec was acting at DCSLP's direction and on its behalf in performing services under the contracts DCSLP sold to its customers in New Mexico. The question that remains is whether BancTec's activities were significantly associated with DCSLP's ability to establish and maintain a market for its computer products. A review of the facts presented at the administrative hearing show that they were.

Richard Salwen, former legal counsel for Dell Computer Corporation, explained the genesis of Dell's decision to seek out a company to provide repair services to Dell customers:

> Well, as Dell was growing, and this was really in the 1985, '86, '87 time frame…we started having customers, and many of them were small business customers, who said, well, if my computer breaks, I don't want to have to send it back to the factory and I don't have the expertise to go inside the box and I don't really want or need the hassle of going and finding the computer geek service organization here in my town that will come and fix my computer for me. So I need something different. Dell, can't you provide me some service?

Tr. 87. Initially, Dell entered into an agreement with Honeywell Bull "as the partner for a service alliance to provide—to have Honeywell Bull provide repair service to the owners of Dell

computers." Tr. 90. That relationship ended when Dell began receiving complaints from customers. As Mr. Salwen explained: "Dell computer owners didn't like who was providing them their service and they were calling Dell and blaming us because we had sold the contracts to them." Tr. 92. Xerox was subsequently selected by Dell to provide repair service to its customers. Tr. 94. That relationship ended when Xerox wanted more money on each of the service contracts sold by Dell. Dell declined to increase the price because a higher price would result in fewer sales of service contracts "and people are going to be unhappy again and the whole reason that we were interested in doing this in the first place was because it was what our customers wanted. Certainly we make money at it and we want to, but we want first of all to make sure that customers are served properly." Tr. 97. After the agreement with Xerox expired, Dell entered into the Brokerage Agreements with BancTec, under which BancTec acted as the exclusive provider of on-site repair services for Dell computer products.

Brian Wood, who is a vice president of Dell Marketing L.P., testified concerning the interplay between the manufacturer's warranty provided on Dell products and the BancTec service contract:

> [W]hen a consumer buys a service contract, what they're essentially buying is a contract with BancTec that allows them to have an alternative vehicle to get a warranty claim dealt with. In the standard warranty model and there is no service contract in place, if you have a problem, you have to send it back to us, we'll repair it, and we'll send it back to you…. All the BancTec contract is a way to say, I don't really want to do that because that's hard and it's expensive, and BancTec will say, we'll handle that for you.

Tr. 164-165. Mr. Wood explained that if a customer whose computer was still under warranty had a BancTec service contract, then "BancTec would handle that warranty repair for them and they would do it on site so no need to box the computer and send it back to us. BancTec would get the spare part, effect the repair, and return the part." Tr. 169. Mr. Wood acknowledged that

the availability of in-home service was an important factor in establishing Dell's market for sales. Tr. 165.

Based on the testimony of Mr. Salwen and Mr. Wood, there is no question that the in-home repair services provided by BancTec significantly enhanced DCSLP's ability to establish and maintain its market for Dell computers in New Mexico and elsewhere. For many customers, the prospect of having to pack up and mail a Dell computer back to Texas—at the customer's expense—and then wait for its return, was simply not acceptable. In order to make Dell computers attractive to potential customers, DCSLP had to provide those customers with a convenient method to have their Dell computers repaired on site. This is confirmed by the fact that approximately 75 percent of DCSLP's customers purchased a service contract for their Dell computers.

In light of Dell's negative experience with Honeywell Bull, it was also important to insure that the quality of the service provided to DCSLP customers met certain standards. For this reason, the Brokerage Agreements gave DCSLP a significant amount of control over the manner in which BancTec carried out its service obligations to DCSLP customers. While this control and attention to detail made good business sense and resulted in an enhanced market for Dell computers, it also resulted in DCSLP's loss of the constitutional protections afforded to retailers "whose only connection with customers in the [taxing] State is by common carrier or the United States mail." *Quill, supra*, 504 U.S. at 315, quoting from *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967). Once an out-of-state retailer ventures beyond this safe harbor, whether through the activities of its own employees or through the activities of independent contractors acting on its behalf, the retailer has the same obligation for payment of sales and use taxes as do retailers operating within the state. In this case, DCSLP's

relationship with BancTec, which provided in-home repair services to DCSLP's New Mexico customers, was sufficient to meet the physical presence requirement under *Scripto* and *Tyler Pipe* and to subject DCSLP to New Mexico gross receipts tax on its sales to New Mexico customers.

(2) Alternative Nexus Theories. The Department raises two alternative nexus arguments based on its contention that DCSLP and Dell Financial Services L.P. ("Dell Financial") engaged in "joint solicitation activities" in New Mexico and that Dell Products L.P. ("Dell Products") owned mailing boxes, replacement parts and technical manuals in the state.

In *Quill, supra*, 504 U.S. at 315, the United States Supreme Court confirmed that nexus "may turn on the presence in the taxing State of a small sales force, plant, or office." One of the cases cited for this proposition was *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977), which held that the presence of two corporate offices was sufficient to establish National Geographic's nexus with California, even though the activities performed by those offices were unrelated to the sales transactions California sought to tax. As a result of the holding in *National Geographic* and similar cases, many businesses have adopted a practice known as "entity isolation." This involves creating affiliated companies to operate different aspects of a unitary business that formerly would have operated as a single company. By dividing the business into separate legal entities, it is possible to avoid having the physical presence of one entity operating within a state attributed to the activities of another entity operating outside the state.

Although the practice of entity isolation has engendered much discussion and some criticism, it has so far withstood the attempts of state tax authorities to extend the analysis employed in *National Geographic* to allow a finding of nexus based solely on the presence of an

affiliated entity within the state.[5] Instead, courts have applied the same analysis used to determine whether the presence of an unrelated third party can be attributed to an out-of-state vendor, *i.e.*, to what extent does the activity of the in-state affiliate further the interests of the entity the state is seeking to tax? *See, e.g*., *Borders Online LLC v. State Board of Equalization*, 29 Cal. Rptr.3d 176, 190 (Cal. App. 2005) (policy allowing customers to return goods ordered online to the brick-and-mortar stores of an in-state affiliate was significantly associated with the online retailer's ability to establish and maintain a market for sales in the state); *Reader's Digest Association, Inc. v. Mahin*, 255 N.E.2d 458 (Ill. 1970), *cert. denied*, 399 U.S. 919 (1970) (subsidiaries' active solicitation of sales in the state supported a finding of nexus for the parent corporation). *Cf.*, *Current, Inc. v. California State Board of Equalization*, 29 Cal.Rptr.2d 407 (Cal. App. 1994) (in-state presence of an affiliated manufacturer and wholesaler of goods did not create nexus for an out-of-state mail order company with a different product line and customer base); *SFA Folio Collections Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991), *cert. denied*, 501 U.S. 1223 (1991) (in-state retailer and out-of-state mail order company linked by a common parent and sharing a corporate name and logo could not be treated as a single entity for purposes of establishing a nexus); *Bloomingdale's by Mail v. Department of Revenue*, 567 A.2d 773, (Pa. Commw. Ct. 1989), *aff'd*, 591 A.2d 1047 (Pa. 1991), *cert. denied*, 504 U.S. 955 (1992) (presence of in-state retailer did not create nexus for its out-of-state mail order subsidiary).

In this case, the Department's theory of affiliate nexus appears to resurrect the "common enterprise" theory rejected in *SFA Folio, supra*. The current state of the law of nexus, as well as New Mexico's history of honoring the distinction between separately incorporated entities, does not support the Department's position. *See, Scott v. AZL Resources, Inc.,* 107 N.M. 118, 753

[5] *See,* John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S.Cal. L. Rev. 419 (2002); Michael J. McIntyre, *Commentary on McLure and Hellerstein: Taxing Electronic Commerce Fairly and Efficiently*, 52 Tax. L. Rev. 625 (1997).

P.2d 897 (1988) (only under special circumstances will the courts disregard a corporate entity to create liability for individual shareholders or a parent corporation); *Cruttenden v. Mantura*, 97 N.M. 432, 640 P.2d 932 (1982) (creditor could not garnish wages payable by a subsidiary to its employee by serving writ of garnishment on the parent corporation). There is no question that the Dell limited partnerships cooperated with each other in carrying out their day-to-day business and, in some cases, performed procurement and other services for one another. The evidence does not establish, however, that the operation of the separate partnerships was so intertwined that they constituted sham entities. In order to establish its theory of affiliate nexus, therefore, the Department must show that the in-state activity of a particular Dell limited partnership was significantly associated with DCSLP's ability to market and sell computers to customers located in New Mexico.

(a) Leasing Computers in New Mexico. The Department contends that Dell Financial had nexus with New Mexico and that this nexus can be attributed to DCSLP. Post-Hearing Response Brief at 15-16. The Department bases its argument on the fact that Dell Financial purchased advertising space in DCSLP's catalogs and DCSLP informed its customers that they could lease—rather than buy—a Dell computer. There are several problems with the Department's reasoning. First, Dell Financial did not begin leasing computers until April 1997—no lease option was offered to DCSLP customers during the first four years of the audit period. Second, there is no evidence that any computers were leased to customers located in New Mexico during the remaining two years of the audit period. Finally, the Department's assertion that DCSLP and Dell Financial were "engaged in a joint venture to further the overall sales of the entity which owns and controls both of their activities, Dell Computer Corporation," is irrelevant to DCSLP's gross receipts tax liability. Post-Hearing Response Brief at 16-17. The

matter at issue is whether Dell Financial was engaged in activities in New Mexico that were significantly associated with DCSLP's ability to establish and maintain a market for sales in New Mexico, not whether the activities of the two Dell affiliates furthered the "overall sales" of their parent corporation. The evidence does not support the Department's arguments concerning Dell Financial's activities in New Mexico or its relationship with DCSLP.

(b) Presence of Mailing Boxes in New Mexico. When a DCSLP customer had a problem with a defective computer part, Dell Products mailed a replacement part to the customer in a box that could be re-used to return the original part to the factory as required by Dell Products' warranty. Despite the Department's arguments to the contrary, the fact that Dell Products included a prepaid return shipping label in boxes used to mail replacement parts does not establish that Dell Products "owned" the mailing boxes after their receipt by DCSLP's customers. Under the terms of the warranty, customers "must ship the products back to Dell in their original *or equivalent* packaging...." Ex. F, last tab (emphasis added). Clearly, customers were free to throw the original mailing boxes away or use them for another purpose and substitute their own boxes to ship defective parts back to the factory. While it may have been convenient to do so, nothing in the record suggests that New Mexico customers were required to use Dell Products' packaging material or that Dell Products retained ownership of this material.

(c) Presence of Technical Manuals in New Mexico. The Department also failed to establish that Dell Products (or any other Dell entity) owned technical manuals located in New Mexico. DCSLP acknowledged that training manuals were provided to BancTec in Texas. There is no evidence, however, that those manuals were ever present in New Mexico. The audit report states that the auditor was unable to determine whether BancTec's service technicians "carry any type of Dell manuals." Ex. A at GNN1.6. The fact that the auditor

ultimately concluded "that Dell may have had training materials and technical manuals in the state" (Post-Hearing Response Brief at 15) carries little weight without some evidentiary basis for that conclusion. Even if technical manuals for Dell computers were present in New Mexico, it is far from clear that the manuals belonged to Dell. The section titled "Service Materials" in the Brokerage Agreements states that "Dell will own all copyright and other rights to documentation prepared by Dell." Stip. Ex. S-2 at 33. Owning a copyright is not equivalent to owning every technical manual or other document produced under the copyright.

(d) Presence of Computer Parts in New Mexico. There is evidence that Dell Products retained ownership of computer parts removed from Dell computers located in New Mexico. The terms and conditions governing DCSLP's sales to New Mexico customers stated that "Dell owns all parts removed from repaired products" and required customers to "pay Dell for replacement parts when the replaced part is not returned to Dell…." Stip. Ex. S-5, second page. *See also*, Ex. F, last tab. With regard to the replacement parts that Dell Products provided to BancTec, the Brokerage Agreements state that title and possession transferred to BancTec in Texas. In reality, BancTec never acquired true ownership of these parts. BancTec was prohibited from using the replacement parts for any purpose other than servicing the computers of Dell customers and could not "repair, scrap or sell any faulty System parts or any spare parts acquired from Dell to any party other than Dell or Customers." Stip. Ex. S-2 at 29. As Michael Burns, BancTec's former vice president, described the situation, BancTec was merely a bailee of spare parts and was liable to Dell for any loss or damage to those parts while they were in BancTec's possession. Tr. 213-215.

As discussed under Issue II D(1), *supra*, the BancTec service contracts DCSLP sold to its customers significantly enhanced DCSLP's ability to establish and maintain its market for Dell

computers in New Mexico and elsewhere. Dell Products' ownership and control of replacement parts was an important factor in BancTec's ability to provide service under the contracts. As Dell vice president Brian Wood testified, BancTec provided an "alternative vehicle to get a warranty claim dealt with." Tr. 164. If a customer whose computer was still under Dell Products' warranty had a BancTec service contract, then "BancTec would handle that warranty repair for them and they would do it on site…. *BancTec would get the spare part, effect the repair, and return the part*." Tr. 169 (emphasis added). This procedure confirms that, at least for parts under warranty, BancTec was not buying replacement parts from Dell Products and reselling them to DCSLP customers. Dell Products was required to provide those parts to the customer free of charge. BancTec merely served as the delivery agent, shipping the part from Texas into New Mexico and installing it in the customer's computer pursuant to instructions BancTec received from DCSLP through Dell Tech Support. BancTec then took possession of the defective part, which was the property of Dell Products under the terms of its warranty, and delivered the part to Dell's facility in Texas.

Dell Products played an integral role in DCSLP's efforts to provide its customers with a fast and convenient method of obtaining on-site repair of their Dell computers. By insuring that BancTec received the correct part to service DCSLP customers in a timely manner, Dell Products helped to insure customers' satisfaction with the service contract and with their Dell computers. This, in turn, enhanced DCSLP's ability to establish and maintain its market for sales in New Mexico. Placed in this context, Dell Products' ownership and control of computer parts located in New Mexico is a contributing factor in establishing that DCSLP had nexus with New Mexico for purposes of the New Mexico gross receipts tax.

Issue III. Whether DCSLP is liable for compensating tax on catalogs mailed into New Mexico.

The Department assessed DCSLP for $31,908.69 of compensating tax for the period January 1993 through June 1997. The basis for the assessment was that DCSLP "used catalogs shipped into New Mexico to promote the sales of their computers." Ex. A at CN1.1. DCSLP challenges the assessment on the following grounds: DCSLP lacks constitutional nexus with New Mexico; DCSLP does not "use" the catalogs in New Mexico within the meaning of the compensating tax statutes; and the amount of tax is inflated because DCSLP did not begin mailing catalogs into New Mexico until June 1997, more than four years into the audit period. Post-Hearing Brief at 25.

A. Nexus. DCSLP first argues that it cannot be subject to tax in New Mexico because it does not have the physical presence required for a finding of substantial nexus under the Commerce Clause. This argument has already been addressed under Issue II D(1), *supra*. DCSLP further argues that constitutional nexus does not exist for compensating tax purposes because DCSLP "does not control the production or distribution of the catalogs from within New Mexico." Post-Hearing Brief at 27. This same argument was rejected by the United States Supreme Court in *D. H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988), which upheld Louisiana's imposition of use tax on mail order catalogs printed outside the state and mailed by the printer directly to prospective customers in Louisiana. In a unanimous decision, the Court rejected the taxpayer's argument that it did not "use" the catalogs in Louisiana because it did not control distribution of the catalogs within the state:

> Holmes' contention that it lacked sufficient control over the catalogs' distribution in Louisiana to be subject to the use tax verges on the nonsensical. Holmes ordered and paid for the catalogs and supplied the list of customers to whom the catalogs were sent; any catalogs that could not be delivered were returned to it.

> Holmes admits that it initiated the distribution to improve its sales and name recognition among Louisiana residents.

Id., 486 U.S. at 32. In this case, DCSLP operated as a direct catalog sales company and the distribution of catalogs to potential customers was essential to establishing and maintaining its market for sales in New Mexico and elsewhere. As the Court found in *D. H. Holmes, supra*, the fact that DCSLP contracted with a third party to produce and mail its catalogs does not support the conclusion that DCSLP had no control over distribution of those catalogs within New Mexico. DCSLP had nexus with New Mexico for purposes of the compensating tax.

B. Meaning of "Use" under New Mexico's Compensating Tax Statutes. NMSA 1978, § 7-9-7 imposes a compensating tax on "the privilege of using tangible property in New Mexico." The term "use" is defined to mean "use, consumption or storage other than storage for subsequent sale in the ordinary course of business or for use solely outside this state." NMSA 1978, § 7-9-3.1(N). The issue to be decided is whether DCSLP's distribution of catalogs to potential customers in New Mexico was a taxable "use" of those catalogs. The only New Mexico case addressing the application of compensating tax to advertising materials is *Phillips Mercantile Co. v. Taxation and Revenue Department*, 109 N.M. 487, 786 P.2d 1221 (Ct. App. 1990). There, Phillips contracted with an out-of-state "coordinator" to produce catalogs and newspaper inserts. The coordinator then shipped these items to an Albuquerque mailing service, which addressed and mailed the catalogs to New Mexico residents, and to two New Mexico newspapers, which included the advertising inserts in newspapers distributed within the state. The court upheld the Department's assessment of compensating tax against Phillips on the value of the catalogs and inserts purchased from the out-of-state coordinator:

> Phillips contends it did not use the remaining catalogs or inserts because it never had physical possession of those printed materials. Phillips offers no New Mexico authority for the proposition that "use" requires actual physical possession

> and control of the property. Further, the cases Phillips relies on are distinguishable because in those cases, the in-state retailer had the advertising material shipped directly from the out-of-state seller or printer to the in-state recipient, and those materials were never in possession, in the taxing state, of a third party having a contractual relationship with the retailer. *See District of Columbia v. W. Bell & Co.*, 420 A.2d 1208 (D.C. App. 1980); *Bennett Bros., Inc. v. State Tax Comm'n*, 62 A.D.2d 614, 405 N.Y.S.2d 803 (1978); *Modern Merchandising, Inc. v. Department of Revenue*, 397 N.W.2d 470 (S.D. 1986).

Id., 109 N.M. at 488-489, 786 P.2d at 1222-1223. Although DCSLP cites *Phillips Mercantile* for the proposition that there can be no taxable use of DCSLP catalogs in the absence of an in-state distributor, the court of appeals never reached this issue. In addition, the cases cited in *Phillips Mercantile*—which are also cited in DCSLP's brief—were decided prior to the United States Supreme Court's decision in *D. H. Holmes, supra*. As noted in Hellerstein, *supra*, ¶16.03[3][a] at 16-20, *D. H. Holmes* called earlier state court decisions annulling taxes on promotional materials sent into the state "into serious question." As the authors explain:

> When the printer mailed the catalogs to residents of Louisiana from other states, it did so as agent for DH Holmes. That the printer or the U.S. mails, or a common carrier delivering catalogs, were independent contractors would not affect the result. They were agents of the taxpayer or its agent, the printer, whose acts were attributable to the retailer. Getting the catalogs and fliers into the hands of the prospective customers was the business reason the mail order house had them produced. Consequently, the delivery of the articles to the prospects in the taxing state by the taxpayer's agents should properly be treated as a "use" of the articles in the state by the taxpayer.

Id. at 16-21 to 16-22 (footnote omitted). The same conclusion was reached by the Connecticut Supreme Court in *Sharper Image Corp. v. Miller*, 692 A.2d 774, 779-780 (Conn. 1997):

> Even though the distribution was accomplished by having the catalogs placed in the hands of the postal service in Nebraska, the delivery was not at the discretion of the postal service. Rather, the delivery was directed by Sharper Image to specific residents in this state. Sharper Image contracted with Foote & Davies to print and label the catalogs based on a mailing list it provided to them, and Sharper Image also directed that they be delivered by the postal service. Simply put, the catalogs entered the state at the command and direction of Sharper Image. We see no distinction between this arrangement and one in which the employees of Sharper Image themselves deliver the catalogs door to door in Connecticut.

In *Sharper Image Corp. v. Arizona Department of Revenue*, 957 P.2d 1369, 1371-1372 (Ariz. Ct. App. 1998), the Arizona Court of Appeals also upheld the imposition of use tax on Sharper Image catalogs, reconfirming its decision in the earlier case of *Service Merchandise Co., Inc. v. Arizona Department of Revenue*, 937 P.2d 336 (Ariz. App. 1996):

> One cannot reasonably dispute the use-tax liability of a hypothetical taxpayer in the position of Service Merchandise or Sharper Image who has its own employees truck its advertising materials to Arizona and deliver them to Arizona addressees. As we intimated in *Service Merchandise*, no sensible rationale can be offered for holding that a taxpayer who does exactly the same thing through private or quasi-public independent contractors does not use its property in Arizona to precisely the same extent.

See also, Associated Petroleum Transport, Ltd. v. Shepard, 53 N.M. 52, 55, 201 P.2d 772, 774 (1949) (plaintiffs having selected the United States mail as the means of delivering their protest, it became their agent).

Since the Supreme Court's decision in *D. H. Holmes*, virtually every state court that has addressed the issue has held that retailers are liable for use tax on catalogs and other promotional material mailed into the state. *Commissioner of Revenue v. J.C. Penney Co., Inc.*, 730 N.E.2d 266 (Mass. 2000); *J.C. Penney Co., Inc. v. Balka*, 577 N.W.2d 283 (Neb. 1998); *Sharper Image Corp. v. Arizona Department of Revenue, supra; Sharper Image Corp. v. Miller, supra*; *Sharper Image Corp. v. Department of Revenue of State of Florida*, 704 So.2d 657 (1st Dist. Ct. App. 1997), *review denied*, 722 So.2d 195 (1998), *cert. denied*, 526 U.S. 1016 (1999); *Service Merchandise Co., Inc. v. Schwartzberg*, 971 P.2d 654 (Colo. App. 1997); *American Express Travel Related Services Co., Inc. v. Tax Commission of State of Idaho*, 920 P.2d 921 (Idaho 1996); *Service Merchandise Co., Inc. v. Arizona Department of Revenue*, *supra*; *Talbots, Inc. v. Schwartzberg*, 928 P.2d 822 (Colo. App. 1996); *Collins v. J. C. Penney Co.*, 461 S.E.2d 582 (Ga.

App. 1995); *Comfortably Yours, Inc. v. Director, Division of Taxation*, 640 A.2d 862 (N.J. Super, App. Div. 1994); *J. C. Penney Co., Inc. v. Olsen*, 796 S.W.2d 943 (Tenn. 1990).

The only case with a contrary result cited in DCSLP's brief is *Sharper Image Corp. v. Michigan Department of Treasury*, 550 N.W.2d 596 (Mich App. 1996), *app. denied*, 560 N.W.2d 636 (1997), where the court found that because the state statute did not define the term "use" to include the distribution of material, the use tax did not apply to the distribution of catalogs to Michigan residents. In New Mexico, the legislature has not attempted to list every activity that will constitute a taxable "use" of property. It is clear, however, that the legislature intended the term to be interpreted broadly. NMSA 1978, § 7-9-8(A) provides a presumption of taxability and states that "it is presumed that property bought or sold by any person *for delivery into this state* is bought or sold for a taxable use in this state." (emphasis added). This presumption, and the overwhelming weight of authority from other jurisdictions, supports the conclusion that DCSLP is liable for compensating tax on the value of catalogs distributed in New Mexico.

C. Factual Basis for Assessment. The Department's assessment of compensating tax covers the entire six-year audit period. DCSLP contends that the tax is overstated because DCSLP did not begin mailing catalogs into New Mexico until July 1997. Emily Parrino, senior state tax manager for Dell USA L.P., testified that she recalled the date because "[w]e moved into a new building in January of 1996 and I remember that it was shortly after that that they started sending catalogs outs. They started developing a catalog and it was around the middle of 1997 that they actually started mailing catalogs." Tr. 300. Ms. Parrino also testified that she checked with Dell USA L.P.'s procurement division and the only contract in its records concerning DCSLP catalogs was an Advertising Agency Master Services Agreement dated July 29, 1997. Tr. 301. Although the contract was entered into between Rapp Collins Worldwide and

Dell Products L.P., the opening paragraph states that Dell Computer Corporation "and any of its corporate subsidiaries or affiliates may purchase Services...and enjoy the benefits of this Agreement." Exhibit 17. The attached schedule of deliverables makes specific reference to "DCS" catalogs to be ready by "drop dates" beginning in July 7, 1997. Ms. Parrino testified that her job duties included reviewing catalogs and that the first catalogs she saw for DCSLP were in the time frame of June or July of 1997. Tr. 304.

Although the Department's assessment of tax has a statutory presumption of correctness, that presumption is overcome when the taxpayer comes forward "with some countervailing evidence tending to dispute the factual correctness of the assessment...." Regulation 3.1.6.12(A) NMAC; *MPC Ltd. v. New Mexico Taxation & Revenue Department*, 2003-NMCA-21, ¶ 13, 133 N.M. 217, 62 P.3d 308. Once the presumption is rebutted, the burden shifts to the Department to establish the basis for its assessment. *New Mexico Taxation & Revenue Department v. Whitener*, 117 N.M. 130, 133, 869 P.2d 829, 832 (Ct. App. 1993). In this case, Ms. Parrino's testimony and the copy of the Master Services Agreement constitute evidence "tending to dispute the factual correctness" of the assessment of compensating tax for periods prior to July 1997. This shifts the burden to the Department to establish that DCSLP was engaged in mailing catalogs into New Mexico between January 1993 and June 1997.

In support of its assessment, the Department references the business activity questionnaire Emily Parrino completed at the beginning of the audit, which stated that DCSLP began mailing catalogs into New Mexico in November 1993. Ms. Parrino subsequently testified that this statement was an error on her part and that catalogs were first mailed out in 1997. Tr. 303. During the deposition of the Department's auditor in November 2005, the auditor stated that she had no reason to disagree with Ms. Parrino's corrected statement. Ex. 1 at 191-192. The

auditor could only testify "without a doubt," that catalogs were being mailed into New Mexico by February of 1998. *Id*. The DCSLP catalog attached as an exhibit to the Department's audit is dated July 1999; the catalog admitted as Exhibit K at the administrative hearing is dated February 1999. Although there is some conflict in the evidence, I accept Ms. Parrino's testimony on this issue and find that DCSLP did not begin mailing catalogs into New Mexico until July 1997.

Finally, the Department's introduction of evidence that Dell Direct Sales L.P. (the Dell sales entity targeting small to medium-sized business customers) mailed catalogs into New Mexico between January 1993 and June 1997 does not support the assessment of compensating tax against DCSLP. While Dell Direct's catalogs may have generated some calls from individual customers who were then transferred to DCSLP for service, there is no evidence that DCSLP exercised any control over the production and distribution of Dell Direct catalogs or that these catalogs targeted DCSLP's customer base of individual home consumers. The proper entity to have assessed for compensating tax on the value of catalogs Dell Direct mailed into New Mexico between 1993 and 1997 was Dell Direct, not DCSLP.

Issue IV: Whether DCSLP is liable for the ten percent negligence penalty on its failure to report and pay New Mexico gross receipts and compensating taxes during the audit period.

NMSA 1978, § 7-1-69(A) 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" to pay taxes due to the state. Regulation 3.1.11.11 NMAC sets out several situations that may indicate a taxpayer has not been negligent, including "reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts." In this case, the testimony of Richard Salwen, who was legal counsel for Dell Computer

Corporation, establishes that the company used separate legal entities as part of a tax planning strategy designed to shelter certain activities from state tax. Mr. Salwen explained the company's analysis of state tax issues as follows:

> *Ms. Gall*: In terms of structure...as the business changed in the ways you have described, what happened to the structure and specifically what happened with respect to tax registration and collection?
>
> *Mr. Salwen*: Well, we saw that some of the activities that these large companies wanted were going to put us in a position where those activities would subject us to the laws of the various states where they were located., And so we said, okay, we need to start paying tax, and we started a program to get registered and start collecting and paying tax to the different states. But at the same time, we had lots of other business that didn't—that wasn't done that way. We were adjusting the business for these large customers, and we said, let's set up an entity to serve them and then that entity will get to pay the tax and we'll be in good shape.

Tr. 61. And later in his testimony:

> *Mr. Fort*: In 1991, at the time this [BancTec] contract was negotiated, in fact Dell Direct L.P. was not paying gross receipts or compensating tax to New Mexico because it took the position it did not have nexus. Is that correct?
>
> *Mr. Salwen*: ... I think that at that point we still were not paying any tax and were conducting our business so as to avoid nexus with New Mexico.
>
> ***
>
> *Mr. Fort*: And so it is correct to assume that when you were negotiating this contract in December of 1991, that you were concerned about avoiding nexus for Dell Direct Sales L.P., isn't that correct?
>
> *Mr. Salwen*: Concerned is probably too strong a word.
>
> *Mr. Fort*: How would you describe it?
>
> Mr. Salwen: I would describe it as saying that we were aware of the situation and understood that there were activities that might—that we could undertake that might establish nexus and that we needed to measure the value to our customers and ourselves versus the cost of establishing nexus....

Tr. 105-106. Based on Mr. Salwen's testimony, there is no question that Dell's legal and accounting staff were making the determination as to which Dell entities, including DCSLP,

were required to register and pay tax to New Mexico and other states. Whether the advice DCSLP received was correct is not relevant for purposes of the negligence exception provided in Regulation 3.1.11.11. Because DCSLP reasonably relied on the advice of its legal staff and accountants, penalty is not due.

CONCLUSIONS OF LAW

A. DCSLP filed a timely, written protest to Assessment No. 2549063, and jurisdiction lies over the parties and the subject matter of this protest.

B. DCSLP was selling property in New Mexico and is subject to gross receipts tax on its sales of tangible personal property delivered to New Mexico customers during the audit period.

C. DCSLP is subject to New Mexico compensating tax on the value of DCSLP catalogs mailed into New Mexico during the period July 1997 through June 1999.

D. DCSLP had substantial nexus with New Mexico under the standard set out in the United States Supreme Court's decision in *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

E. Imposition of New Mexico gross receipts and compensating taxes meets the constitutional requirements set out in the United States Supreme Court's decision in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

F. DCSLP relied on the advice of its accounting and legal staff and was not negligent in failing to pay New Mexico gross receipts and compensating taxes during the audit period.

IT IS THEREFORE ORDERED:

That the Department abate the penalty assessed against DCSLP in its entirety;

That the Department abate the compensating tax and related interest assessed against DCSLP for the period January 1993 through June 1997;

That DCSLP pay the compensating tax assessed against it for the period July 1997 through June 1999, plus interest accrued to the date of payment; and

That DCSLP pay the gross receipts tax assessed against it for the period January 1993 through June 1999, plus interest accrued to the date of payment.

DATED June 22, 2006.