

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

**IN THE MATTER OF THE PROTEST OF  
DIAMOND “G” HOME CENTER  
ID NO. 01-815838-00 2; TO AUDIT  
ASSESSMENT NOS. 4048374-4048436**

**No. 07-18**

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held on October 18, 2007, before Margaret B. Alcock, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Jeffrey W. Loubet, Special Assistant Attorney General. Diamond “G” Home Center (“Taxpayer”) was represented by its controller, Eugene L. Gutierrez. At the close of the hearing, the record was left open for 10 days to give the Taxpayer time to present additional documentary evidence in support of its protest to the assessment of compensating tax. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

**FINDINGS OF FACT**

1. The Taxpayer operates a retail business in Grants, New Mexico, selling building materials, hardware, and homeware. The Taxpayer also has some rental business.
2. The Taxpayer’s customers include commercial customers, government agencies, nonprofit organizations, and individuals purchasing items for personal use.
3. The Taxpayer maintains a file of Type 6 nontaxable transaction certificates (“NTTCs”) issued by the Department and executed to the Taxpayer by construction contractors, as well as Type 9 NTTCs executed by government and nonprofit customers.

4. The back of each NTTC issued by the Department lists the different types of NTTCs the Department issues and provides an explanation as to the proper use of each NTTC.

5. The same explanation concerning the proper use of NTTCs is contained in the CRS Filer's Kit the Department mails to the state's gross receipts taxpayers every six months.

6. During the audit period, taxpayers were advised that Type 6 NTTCs could be used for the following purpose (Department Exhibit C):

Type 6 certificates may be executed by a CONSTRUCTION CONTRACTOR for the purchase of CONSTRUCTION MATERIALS which will be incorporated as an ingredient or component part of a construction project which is subject to gross receipts tax....

7. During the audit period, taxpayers were advised that Type 9 NTTCs could be used for the following purpose (Department Exhibit C):

Type 9 certificates may be executed by GOVERNMENTAL AGENCIES and 501(c)(3) ORGANIZATIONS for the purchase of TANGIBLE PERSONAL PROPERTY ONLY. These certificates may not be used for the purchase of services or for the lease of property. Neither governmental agencies nor 501(c)(3) organizations may use these certificates to purchase construction materials to be used in construction projects....

8. Most of the Taxpayer's employees were not aware of the legal limitations on the use of Type 6 and Type 9 NTTCs and believed that the NTTCs covered all sales of tangible personal property, including tools purchased by contractors and construction materials purchased by governments and nonprofit organizations.

9. For this reason, the Taxpayer's employees never questioned its customers as to how they intended to use the materials purchased and generally did not charge gross receipts tax to customers who had provided the Taxpayer with an NTTC.

10. On the few occasions when an employee added gross receipts tax to charges made to government or nonprofit customers, the customers refused to pay the tax, claiming that they were tax exempt.

11. The Taxpayer believed it was not good policy to argue with its customers and never required customers to pay gross receipts tax as a condition of sale.

12. In May 2002, the Department began a field audit of the Taxpayer's books and records for the period January 1997 through March 2002.

13. The auditor found that the Taxpayer was liable for additional gross receipts tax on receipts from the sale of construction materials to governments and nonprofit organizations that provided the Taxpayer with Type 9 NTTCs and the sale of tools and supplies to contractors that provided the Taxpayer with Type 6 NTTCs.

14. The auditor also found that the Taxpayer was liable for compensating tax on certain supplies and fixed assets purchased outside the state.

15. On April 9, 2003, the Department assessed the Taxpayer for \$29,777.24 of gross receipts tax and \$1,931.08 of compensating tax, plus penalty and interest, for reporting periods January 1997 through March 2002.

16. On May 3, 2003, the Taxpayer filed a written protest to the Department's assessment.

17. After the protest was filed, the Department conducted a detailed review of the audit and abated \$8,498.06 of the gross receipts tax assessed, plus related penalty and interest.

18. At the administrative hearing on the Taxpayer's protest, evidence was introduced indicating that the Taxpayer paid compensating tax on the purchase of supplies from CCI Triad

(listed on Exhibit B, page D4.0), and the Department agreed to abate the compensating tax on these purchases.

19. The Taxpayer also provided invoices showing payment of compensating tax on two items identified on the audit's fixed asset list as the Hyster Forklift and PDS Inventory Management (Exhibit B, page D3.0). Although the record was left open for an additional 10 days, the Taxpayer did not provide any other invoices relating to the Department's assessment of compensating tax.

### **DISCUSSION**

The Taxpayer protests the Department's disallowance of deductions taken on sales of construction materials to government agencies and nonprofit organizations that provided Type 9 NTTCs to the Taxpayer. The Taxpayer concedes its liability for gross receipts tax on the sale of tools to contractors who provided Type 6 NTTCs, but questions why tax was assessed on certain items that are usually consumed during the construction process. Finally, the Taxpayer protests the assessment of compensating tax based on its assertion that it paid tax on all of its purchases.

**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); *MPC Ltd. v. New Mexico Taxation & Revenue Department*, 2003 NMCA 21, ¶ 13, 133 N.M. 217, 62 P.3d 308. There is also a presumption that all receipts of a person engaging in business in New Mexico are subject to gross receipts tax. NMSA 1978, § 7-9-5; *Grogan v. New Mexico Taxation and Revenue Department*, 2003-NMCA-033, ¶ 11, 133 N.M. 354, 62 P.3d 1236, *cert. denied*, 133 N.M. 413, 63 P.3d 516 (2003). Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and

unambiguously expressed in the statute, and the right must be clearly established by the taxpayer. *Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991). Accordingly, it is the Taxpayer's burden to come forward with evidence or legal argument to show that it is entitled to the deductions claimed and that the Department's assessment is incorrect.

### **Sale of Construction Materials to Governments and Nonprofit Organizations.**

NMSA 1978, § 7-9-54 provides a deduction for receipts from selling tangible personal property to "the United States or New Mexico or any governmental unit or subdivision, agency, department or instrumentality thereof." Similarly, NMSA 1978, § 7-9-60 provides a deduction for receipts from selling tangible personal property to certain tax exempt organizations if the organization provides the seller with a nontaxable transaction certificate ("NTTC"). Both statutes specifically state, however, that the deduction does not apply to receipts from selling construction material.<sup>1</sup>

Based on the express language in the statutes disallowing a deduction for the sale of tangible personal property constituting construction material, the Department disallowed deductions the Taxpayer had taken on such sales. Although the Taxpayer maintains that the meaning of construction is too vague to allow a seller to determine what is and is not taxable, the term "construction" has been broadly defined by the legislature and further explained in Department regulations. *See*, NMSA 1978, § 7-9-3.4; Regulations 3.2.1.11; 3.2.209.7 through 3.2.209.22 NMAC. Pursuant to the statutory definition, construction includes, among other

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<sup>1</sup> During reporting periods January 1997 through June 2001, §§ 7-9-54 and 7-9-60 stated that the deduction for sales of tangible personal property did not apply to "receipts from selling tangible personal property that will become an ingredient or component part of a construction project." Effective July 1, 2001, both statutes were amended to state that the deduction does not apply to "receipts from selling construction material."

things, the building, altering, repairing or demolishing of any building, stadium or other structure; construction material means any tangible personal property that becomes or is intended to become an ingredient or component part of a construction project. § 7-9-3.4. A review of the audit shows that the tangible personal property the Department determined to be construction material included such items as roofing nails, roofing felt, caulk, 2x4s, sheetrock, paint, ceiling tiles, pipes, stucco and cement. *See*, revised pages C3.2 through C3.47 of Exhibit B. The Taxpayer did not challenge any specific deduction disallowed by the Department on the ground that the property sold was not construction material.

**Sale of Tools and Supplies to Contractors.** NMSA 1978, § 7-9-51 provides a deduction for receipts from selling construction material to a contractor who delivers an NTTC to the seller, provided that the buyer incorporates the construction material as an ingredient or component part of a construction project.<sup>2</sup> During the audit period, a substantial number of transactions involved the Taxpayer's sale of tools and supplies to contractors, including chisels, screwdrivers, extension cords, mops, drill bits and paint rollers. *See*, revised pages C3.2 through C3.47 of Exhibit B. The Taxpayer concedes its liability for tax on the sale of tools, but questions why a deduction was disallowed for such items as drill bits and paint rollers, which are normally consumed or thrown away after use. The answer to the Taxpayer's question can be found in the language of § 7-9-51, which limits the deduction on sales to contractors to items that are incorporated as "an ingredient or component part of a construction project...." Although drill bits and paint rollers have a short useful life and may not be used on more than one project, those

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<sup>2</sup> During reporting periods January 1997 through June 2001, § 7-9-51 provided a deduction for the sale of "tangible personal property" that was incorporated as an ingredient or component part of a construction project. Effective July 1, 2001, the statute was amended to substitute "construction material" for "tangible personal property."

items are not incorporated as part of the final house, office building or other structure in the same way as nails, lumber or stucco. Unless the item sold will become a physical part of the final project, it does not qualify as construction material. For this reason, the Department correctly disallowed the Taxpayer's deduction of receipts from the sale of drill bits, paint rollers and similar items to contractors.

**Taxpayer's Acceptance of NTTCs.** The Taxpayer maintains that it should not be required to determine whether an NTTC actually covers the transaction at issue, but should be able to accept whatever NTTC its customer provides. NMSA 1978, § 7-9-43 does give a safe harbor to sellers who accept an NTTC in good faith that the buyer "will employ the property or service transferred in a nontaxable manner." The purpose of this provision is to protect a seller who has no way of verifying whether a customer's subsequent use of goods or services purchased with a valid NTTC complies with the requirements of that certificate. For example, a tool manufacturer is entitled to accept a Type 2 NTTC (sale of tangible personal property for resale) from a hardware store in good faith that the hardware store will use the tools in a nontaxable manner, *i.e.*, will resell the tools in the ordinary course of business. The seller is not required to check on its customer during the following months to be sure the tools were actually resold.

A different scenario is presented, however, when the NTTC tendered by the customer does not apply to the transaction at issue. New Mexico law provides that taxpayers have a continuing duty to assess the validity of deductions taken in reliance on NTTCs. *Arco Materials, Inc. v. New Mexico Taxation and Revenue Department*, 118 N.M. 12, 16, 878 P.2d 330, 334 (Ct. App.) (because Type 9 NTTCs no longer applied to the sale of construction materials to government agencies, they could not be used to support the deductions claimed, "regardless of

what the NTTCs represented on their face”), *rev’d on other grounds*, 118 N.M. 647, 884 P.2d 803 (1994); *See also*, Department Regulation 3.2.201.14(A) NMAC. Unless the NTTC covers the transaction at issue, the seller is not entitled to a deduction. *Gas Co. v. O’Cheskey*, 94 N.M. 630, 632, 614 P.2d 547, 549 (Ct. App.1980) (issuance of NTTC does not transform an otherwise taxable transaction into a nontaxable one); *McKinley Ambulance Service v. Bureau of Revenue*, 92 N.M. 599, 601-602, 592 P.2d 515, 517-518 (Ct. App. 1979) (because there was no NTTC applicable to the transaction at issue, Department’s refusal to approve a deduction based on taxpayer’s acceptance of an NTTC was not error). In this case, the Taxpayer acknowledges that it deducted receipts from the sale of all property purchased by customers who provided Type 9 NTTCs, including construction material. Because New Mexico law does not provide a deduction for receipts from the sale of construction material to governments and nonprofit entities, these deductions were properly disallowed.

At the administrative hearing, the Taxpayer’s controller argued that the Taxpayer is doing the state a service by collecting the gross receipts tax and should not have to police its customers’ use of NTTCs. This argument is based on a misunderstanding of New Mexico law. Unlike other states, New Mexico does not have a sales tax that is charged to and collected from the buyer. New Mexico has a gross receipts tax that is imposed directly on the seller of goods and services. NMSA 1978, § 7-9-4; *Tiffany Construction Company v. Bureau of Revenue*, 96 N.M. 296, 300, 629 P.2d 1225, 1229 (1981). Although it is common practice for sellers to pass the cost of the gross receipts tax on to their buyers, a seller’s inability to separately charge or obtain reimbursement of the tax does not affect the seller’s legal obligation to report and pay tax to the state. *Grogan v. New Mexico Taxation and Revenue Department*, 2003-NMCA-033, ¶ 24, 133



N.M. 354, 62 P.3d 1236, *cert. denied*, 133 N.M. 413, 63 P.3d 516 (2003) (while retailers may almost universally pass the tax on to consumers, the law clearly imposes the tax on the retailer, and it remains the retailer's business decision as to how to compensate for that tax expense).

When customers refuse to pay the gross receipts tax added to their invoices, the Taxpayer must decide whether to: (1) attempt to educate its customers by showing them a copy of the pertinent statute or the language appearing on the back of NTTCs and in the CRS Filer's Kit; (2) absorb the cost of the tax and build it into the price charged for the merchandise it sells; or (3) stop doing business with customers who refuse to pay the tax.

With regard to the sale of construction material to state entities, NMSA 1978, § 7-9-54(C) offers the Taxpayer a fourth option:

C. When a seller, in good faith, deducts receipts for tangible personal property sold to the state or any governmental unit, subdivision, agency, department or instrumentality thereof, after receiving written assurances from the buyer's representative that the property sold is not construction material, the department shall not assert in a later assessment or audit of the seller that the receipts are not deductible pursuant to Paragraph (3) of Subsection A of this section.

This subsection, which was effective July 1, 2001, allows the Taxpayer to protect itself from New Mexico counties, municipalities and state agencies that refuse to pay gross receipts tax by obtaining the buyer's written statement that the particular items being purchased do not qualify as construction material because those items will not become an ingredient or component part of a construction project. While the Department could assess the government entity for compensating tax if its written statement is found to be erroneous, the Department could not assess the Taxpayer for gross receipts tax. It should be noted, however, that this protection has not been extended to transactions with federal agencies or nonprofit organizations.

**Assessment of Compensating Tax.** The Taxpayer protested the Department's assessment of compensating tax on property the Taxpayer purchased from out-of-state vendors, arguing that it paid tax on all of its purchases. At the administrative hearing, evidence was introduced indicating that the Taxpayer paid compensating tax on the purchase of supplies from CCI Triad (which are listed on Exhibit B, page D4.0), and the Department agreed to abate the compensating tax on these purchases. The Taxpayer also provided invoices showing payment of compensating tax on two items which were identified on the auditor's fixed asset list as the Hyster Forklift and PDS Inventory Management. A review of the audit workpapers shows, however, that these two items are not listed in the column of exceptions and no compensating tax was assessed on their purchase. *See*, Exhibit B, p. D3.0.

Although the evidentiary record was left open for 10 days following the administrative hearing, the Taxpayer was unable to locate invoices showing payment of compensating tax on the remaining supplies and fixed assets listed in the audit. NMSA 1978, § 7-1-10(A) requires every person to "maintain books of account or other records in a manner that will permit the accurate computation of state taxes...." Unsubstantiated statements that an assessment is incorrect cannot overcome the presumption of correctness. Department Regulation 3.1.6.12(A) NMAC 2001; *Grogan, supra*, 2003-NMCA-033, ¶ 12. In the absence of invoices or other documentary evidence showing that compensating tax was paid on its purchases from out-of-state vendors, the Taxpayer failed to meet its burden of proving that the Department's assessment was incorrect.

### **CONCLUSIONS OF LAW**

A. The Taxpayer filed a timely, written protest to Assessment Nos. 4048374-4048436, and jurisdiction lies over the parties and the subject matter of this protest.

B. There is no deduction applicable to receipts from selling construction material to government agencies and nonprofit organizations, and the Taxpayer could not deduct those receipts based on the Type 9 NTTCs provided by its customers.

C. There is no deduction applicable to receipts from selling tools and other items to contractors when those items are not incorporated as an ingredient or component part of a construction project, and the Taxpayer could not deduct those receipts based on the Type 6 NTTCs provided by its customers.

D. The Taxpayer is entitled to an abatement of compensating tax imposed on its purchase of supplies for CCI Triad, but failed to meet its burden of proving that compensating tax was not due on its other purchases of supplies and fixed assets listed in the audit workpapers.

For the foregoing reasons, the Taxpayer's protest IS GRANTED IN PART AND DENIED IN PART. The Department is ordered to abate the compensating tax, plus related penalty and interest, assessed on the Taxpayer's purchase of supplies from CCI Triad as listed on page D4.0 of the audit report (Exhibit B). The Taxpayer is liable for the balance of gross receipts and compensating taxes, plus penalty and interest, assessed against it for reporting periods January 1997 through March 2002.

Dated October 30, 2007.