

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

**IN THE MATTER OF THE PROTEST OF
HOME SECURITY SYSTEMS
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L1674614016**

AND

No. 12-26

**IN THE MATTER OF THE PROTEST OF
INDUSTRIAL & COMMERCIAL SECURITY SYSTEMS
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0774628608**

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on October 4, 2012 before Brian VanDenzen, Esq., Tax Hearing Officer, in Santa Fe. Attorneys Thomas Smidt II and Thomas Smidt III appeared representing Home Security Systems, Inc. (“HSS”) and Industrial & Commercial Security Systems, Inc. (“ICSS”), or known collectively as “Taxpayers”. Mr. Steven Berniklau, President of HSS & ICSS, testified on behalf of Taxpayers. Staff Attorney Ida M. Lujan appeared representing the Taxation and Revenue Department of the State of New Mexico (“Department”). Protest Auditor Sylvia Sena appeared as a witness for the Department. By stipulation, Department Exhibits A-T were admitted into the record. All exhibits are more thoroughly described in the Administrative Protest Hearing Exhibit Log. The parties also submitted a Joint Stipulations of Facts, numbered 1-31, which are adopted into the record. Both parties submitted closing arguments, proposed findings of fact, and conclusions of law, which are part of the record. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. HSS is a New Mexico corporation doing business in Albuquerque, New Mexico, and it has been registered for a Combined Reporting System number with the Department since July 30, 1979. [JSF #1].

2. HSS designs, pre-wires, installs, services and monitors 24-hour electronic security systems including intrusion alarms, door access control, video (visible and hidden camera) surveillance and computer-based integrated security systems. HSS sells and leases tangible personal property and sells installation and monitoring services. [JSF #2].

3. HSS owns the only alarm company owned central alarm monitoring station in New Mexico that provides alarm monitoring services to other alarm companies on a wholesale basis.

4. HSS sells and leases tangible personal property and sells installation and monitoring services.

5. ICSS is a New Mexico corporation doing business in Albuquerque, New Mexico, and it has been registered for a Combined Reporting System number with the Department since December 16, 1986. [JSF #3].

6. ICSS designs, pre-wires, installs, services and monitors 24-hour electronic security systems, including intrusion or burglar alarms, fire alarms, access control systems, video (visible and hidden camera) surveillance and computer-based integrated security systems on the industrial and large commercial level. [JSF #4].

7. ICSS sells and leases tangible personal property and sells installation and monitoring services.

8. Steve Berniklau is the president and owner of both HSS and ICSS, having purchased those companies from his parents on March 3, 2005.

9. Steve Berniklau worked for HSS and ICSS during the time that all transactions involved in these protests took place and is familiar with all of the transactions.

10. The Department audited both HSS and ICSS under various tax programs for a period beginning January 1, 2002 through March 31, 2005.

11. On May 23, 2005, the Department issued a 60-day notice letter to both HSS and ICSS requesting that Taxpayers possess New Mexico nontaxable transaction certificates (“NTTC or NTTCs”) or other documentation to support claimed deductions by July 22, 2005.

12. As part of the audit of both HSS and ICSS, the Department proposed using a sampling basis. Under that sampling method, the auditor selected invoices from the audit period and broke those invoices into two strata: the first strata (detailed selection) consisted of invoices of \$5,000 or greater, and the second strata (sample selection) consisted of invoices under \$5,000. HSS and ICSS agreed to the sampling method and do not contest that method as part of this protest.

13. The Department completed its audit of both HSS and ICSS sometime in February 2006. The Department disallowed numerous claimed deductions by both HSS and ICSS during the audit period.

14. At the protest hearing, the parties agreed that each respective protest was limited to nine disallowed HSS’ claimed deductions and seven disallowed ICSS’ claimed deductions (the claimed deductions at issue might have involved multiple invoices and/or transactions, but

all are categorized based on common customers). The findings of fact in this matter, therefore, are limited to these sixteen disputed disallowed deductions¹.

HSS Disputed Deductions

15. Rowland Electric, Inc. The Department disallowed three claimed deductions for the sale of wholesale monitoring services to Rowland Electric, Inc. on February 21, 2002, December 21, 2002, and December 22, 2003. [Department Exhibit B, pages C3.2-3].

- a. HSS timely provided an executed Type 7 NTTC to support the claimed deduction. [Department Exhibits B, pages C3.2-3 & B1a].
- b. Rowland Electric, Inc. installed home monitoring and fire alarm systems into buildings for its clients. Rowland Electric, Inc. then contracted with HSS to monitor those installed systems on behalf of their clients.

16. Powerline Technologies, Inc. The Department disallowed four claimed deductions for the sale of monitoring services to Powerline Technologies, Inc. on October 22, 2003, January 22, 2004, August 23, 2004, and November 20, 2004. [Department Exhibit B, page C3.3].

- a. HSS failed to timely provide an NTTC to the Department by July 22, 2005, 60-days after the Department's notice to do so. [Department Exhibit B, page C3.3].
- b. At the protest hearing, HSS presented a Type 7 NTTC, executed on April 10, 2002, to support these claimed deductions. [Department Exhibit B1b].
- c. Powerline Technologies, Inc. installed home monitoring systems into buildings for its clients. Powerline Technologies, Inc. then contracted with HSS to monitor those installed systems on behalf of their clients.

¹ For organizational and efficiency purposes, and in order to reduce redundancies throughout the findings, each disputed disallowed deduction will be identified as a separate finding of fact, with sub-findings related to those transactions listed alphabetically below each respective numbered finding of fact.

17. Alarm Communications Svc. The Department disallowed three claimed deductions for the sale of monitoring services to Alarm Communications Svc. on July 17, 2003, September 17, 2003, and May 26, 2004. [Department Exhibit B, page C3.2-3].

- a. HSS timely provided an executed Type 7 NTTC to support the claimed deduction. [Department Exhibit B, page C3.2-3 & Department Exhibit B1c].
- b. Alarm Communications Svc. installed home monitoring systems into buildings for its clients. Alarm Communications Svc. then contracted with HSS to monitor those installed systems on behalf of their clients.

18. Alarm Control Technologies. The Department disallowed three claimed deductions for the sale of monitoring services to Alarm Control Technologies (noted as “ACT” on audit journal) on October 3, 2002, October 21, 2003, and September 4, 2004. [Department Exhibit B, page C3.2-3 & Department Exhibit B1d].

- a. HSS timely provided an executed Type 7 NTTC to support the claimed deduction. [Department Exhibit B, page C3.2-3 & Department Exhibit B1d].
- b. Alarm Control Technologies leased radios from HSS, which were connected into security systems that Alarm Control Technologies installed for its clients. Alarm Control Technologies then contracted with HSS to monitor those installed systems on behalf of their clients.

19. Assured Protection Service. The Department disallowed HSS’ claimed deduction for the sale of monitoring services to Assured Protection Service on February 15, 2004. [Department Exhibit B, page C3.2 & Department Exhibit B1e].

- a. HSS timely provided a Type 6 NTTC executed by Assured Protection Service during the audit. [Department Exhibit B, page C3.2 & Department Exhibit B1e].

- b. Assured Protection Service installed security systems into its customer's building. Assured Protection Service then contracted with HSS to monitor those installed systems on behalf of their clients.
20. Guardian Alarm Co. The Department disallowed three claimed deductions for the sale of monitoring services to Guardian Alarm Co. on July 25, 2003, October 2004, and December 27, 2005. [Department Exhibits B, page C3.2-3 and B1f].
 - a. HSS timely provided a Type 6 NTTC executed by Guardian Alarm Co. during the audit. [Department Exhibits B, page C3.2-3 and B1f].
 - b. Guardian Alarm Co. installed security systems into its customer's building. Guardian Alarm Co. then contracted with HSS to monitor those installed systems on behalf of their clients.
21. Southwest Fire and Sound. The Department disallowed one claimed deduction for the sale of monitoring services to Southwest Fire and Sound on May 21, 2004. [Department Exhibit B, page C3.3]
 - a. HSS failed to timely provide an NTTC to support this claimed deduction to the Department by July 22, 2005, 60-days after the Department's notice to do so. [Department Exhibit B, page C3.3].
 - b. At the protest hearing, HSS presented a Type 6 NTTC from Southwest Fire and Sound, executed on December 14, 1999, to support this claimed deductions. [Department Exhibit B1g].
 - c. Southwest Fire and Sound installed security systems into its customer's building. Southwest Fire and Sound then contracted with HSS to monitor those installed systems on behalf of their clients.

22. Professional Security Consultants, Inc. The Department disallowed one claimed deduction for the sale of monitoring services to Professional Security Consultants, Inc. in October 2004. [Department Exhibits B, page C3.3 & B1h].

- a. HSS timely provided a Type 6 NTTC executed by Professional Security Consultants, Inc. during the audit. [Department Exhibits B, page C3.3 and B1h].
- b. Professional Security Consultants, Inc. installed security systems into its customer's building. Professional Security Consultants, Inc. then contracted with HSS to monitor those installed systems on behalf of their clients.

23. T.C. Building & Realty, Inc. The Department disallowed one claimed deduction for the sale of pre-wiring services to T.C. Building & Realty, Inc. on September 8, 2004. [Department Exhibits B, page C3.3 & B1i].

- a. HSS timely provided a Type 7 NTTC executed by T.C. Building & Realty, Inc. on March 6, 2002 during the audit. [Department Exhibits B, page C3.3 and B1h].
- b. HSS pre-wired electrical, alarms, and audio visual equipment into homes being constructed by the building company, T.C. Building & Realty, Inc. T.C. Building & Realty, Inc. passed on the cost of this pre-wiring to the purchaser of the homes. T.C. Building & Realty, Inc.'s construction project was subject to gross receipts tax upon completion.
- c. The Department conceded in its closing argument, proposed findings of fact, and conclusions of law, that HSS is entitled to the disallowed deduction for T.C. Building & Realty, Inc under NMSA 1978, Section 7-9-52 (2000).

ICSS Disputed Deductions

24. Marlin Leasing Co. The Department disallowed a claimed deduction for the March 1, 2002 sale of alarm equipment and cameras totaling \$16,018.00 to the financing company Marlin Leasing Co., who provided the financing to ICSS' actual customer LGM Trucking Services. [Department Exhibit P, pages C3.3 & Department Exhibit Q.1B].

- a. ICSS provided to the Department a Multi-jurisdiction Uniform Sales and Use Tax Certificate, dated March 29, 2005 and listing Marlin Leasing Co.'s New Mexico tax identification number, to support the claimed deduction. [Department Exhibit Q.1].
- b. ICSS installed alarms systems and cameras into LGM Travel Plaza in Wagon Mound. LGM financed the purchase through Marlin Leasing Co., who provided a lump payment to ICSS minus gross receipts tax. Marlin Leasing Co. then leased the alarm system back to LGM.

25. Northrop Grumman. The Department disallowed claimed deductions for the November 27, 2002 sale of security access control systems to Northrop Grumman under two invoices totaling \$13,934.00 and \$16,473.00 respectively. [Department Exhibit P, pages C3.3, Department Exhibit Q.2 & Department Exhibit Q.3].

- a. ICSS is a distributor of a DSX security access control systems manufactured in Dallas, TX.
- b. ICSS sold DSX security access control systems to Northrop Grumman for installation on the Island of Don Diego in the Atlantic Ocean. The entire transaction occurred by telephone or email with Northrop Grumman's Colorado

Springs office, and the product itself was drop-shipped from Dallas, Texas directly to Northrop-Grumman in either Colorado Springs or Don Diego Island.

- c. One of the invoices totaling \$16,473.00 had a billing service address in Colorado Springs, CO. [Department Exhibit Q.3]. The Department concedes that Taxpayer is entitled to a deduction on this invoice.
- d. The other invoice totaling \$13,934.00 listed Northrop Grumman's Colorado Springs office for billing purposes, but also listed a service address in Socorro, NM. However, there is no evidence that any portion of the transaction involved Northrop Grumman's New Mexico office. The product sold in this transaction was drop-shipped from Dallas, TX to Don Diego Island in the same manner as the other invoice. [Department Exhibit Q.2].

26. Napa Auto Parts/Sun Trust Leasing/Genuine Parts Co. The Department disallowed a claimed deduction for the October 7, 2003 survey and sale of alarm equipment totaling \$7,053.00 to Napa Auto Parts/Sun Trust Leasing. [Department Exhibit P, page C3.4 & Department Exhibit Q.4].

- a. ICSS surveyed and installed security and alarm systems into a Napa Auto Parts store.
- b. The Department initially disallowed the claimed deduction for the absence of an NTTC to support the deduction. [Department Exhibit P, page C3.4].
- c. Genuine Parts Co. is a holding company for Napa Auto Parts.
- d. ICSS provided to the Department a Type 5 NTTC for the service of sale for resale, executed date of October 9, 2003, from Genuine Parts Co. to support the claimed deduction. [Department Exhibit Q.5].

- e. While ICSS in fact did possess an NTTC related to this disallowed deduction, ICSS did not demonstrate how it was providing a sale of a service for resale under NMSA 1978, Section 7-9-48 (2000).
27. West Mesa Autocraft. The Department disallowed a claimed deduction for the November 25, 2003 sale of alarm system equipment totaling \$14,754.00 to West Mesa Autocraft. [Department Exhibit P, page C3.5 & Department Exhibit Q.6].
- a. ICSS timely provided a Type 5 NTTC, service for resale, executed by West Mesa Autocraft, to the Department during the audit. [Department Exhibit P, page C3.5 & Department Exhibit Q.7].
 - b. ICSS sold and installed a fire and burglar alarm into the building occupied by West Mesa Autocraft. West Mesa bought the system, leased it to the building's owner, and the building's owner leased the system back to West Mesa with the rented space.
 - c. A Type 5 NTTC, service for resale, is not the appropriate NTTC to support a deduction under NMSA 1978, Section 7-9-49 (1992), sale of tangible personal property for leasing.
 - d. On May 12, 2006, after the expiration of the 60-day deadline on July 22, 2005 to present NTTCs to the Department, ICSS untimely presented the Department a Type 2 NTTC executed by West Mesa Autocraft. [Department Exhibit Q.8]. Because this Type 2 NTTC was untimely, the Department continued to disallow the claimed deduction.

28. Jaycor and L-3 Services. The Department disallowed a claimed deduction for three invoices in August 2004 for the sale of services totaling \$1070.00 to JayCor/L3 Services. [Department Exhibit P, page C3.1, C3.2 & Department Exhibit Q.9-11].

- a. ICSS timely provided a Type 5 NTTC, service for resale, executed by Jaycor, to the Department during the audit. [Department Exhibit Q.12].
- b. ICSS sold Jaycor radio alarm monitoring equipment and wireless monitoring services.
- c. Jaycor resold these monitoring services to the Federal government, which was subject to a gross receipts tax.

29. Bernalillo County Sheriff's Office. The Department partially disallowed a claimed deduction for the June 22, 2004 invoice amount related to the sale of a service (the Department did allow the portion of the claimed deduction related to the sale of tangible personal property). [Department Exhibit P, page C3.2 & Department Exhibit Q.13-14].

30. Four Suns Builders, Inc. The Department disallowed a claimed deduction for the October 22, 2003 sale of services totaling \$51.00 to Four Suns Building, Inc. [Department Exhibit P, page C3.1].

- a. ICSS timely provided a Type 7 NTTC, construction contractor purchaser of services, executed by Four Suns Builders, Inc., to the Department during the audit. [Department Exhibit Q.15].
- b. ICSS sold Four Suns Builders, Inc. alarms systems into property under construction in order to avoid thefts at the construction sites.
- c. Four Suns Builders, Inc. incorporated the costs of the alarms systems into the closing costs on the property.

- d. There is insufficient evidence as to whether Four Suns Builders, Inc. actually incorporated the security systems into the construction project, or removed the systems upon completion of the project.

Procedural History

31. On August 31, 2006, the Department issued a Notice of Assessment, Letter ID L1674614016, to HSS for \$25,511.58 in gross receipts tax, and \$9,459.96 in interest, for a total gross receipts assessment of \$34,972.54. HSS was assessed compensating tax of \$2,163.20 and \$879.74 in interest. [Department C].

32. HSS does not protest the assessment of compensating tax in this matter.

33. On August 31, 2006, the Department issued a Notice of Assessment, Letter ID L0774628608, to ICSS for \$54,420.53 in gross receipts tax, and \$20,346.19 in interest, for a total gross receipts assessment of \$74,766.72. [Department K].

34. On September 21, 2006 HSS and ICSS timely requested an extension of time to file their protests. [Department Exhibits D & L].

35. On October 3, 2006, the Department granted HSS and ICSS an extension of time to file protests. [Department Exhibits E & M].

36. On November 29, 2006, HSS and ICSS filed their respective protests to the Department's assessments. [Department Exhibit F & N].

37. On January 29, 2007, the Department acknowledged both HSS' and ICSS' protests. [Department Exhibit G & O].

38. On August 5, 2011, the Department filed its Requests for Hearing on the HSS and ICSS protests.

39. On August 8, 2011, the Department's Hearing Bureau sent notice of administrative hearing, scheduling this matter for February 21, 2012.

40. On February 2, 2012, the Hearing Bureau sent amended notice of administrative hearing, rescheduling this matter for May 8, 2012.

41. On May 4, 2012, the parties submitted a stipulated motion to consolidate HSS' and ICSS' protests given the common ownership of the companies, the common issues at protest, and the common witnesses between the two proceedings.

42. On May 4, 2012, HSS and ICSS submitted an unopposed motion to continue the May 8, 2012 protest hearing.

43. On May 7, 2012, the Hearing Bureau granted the stipulated motion to consolidate the HSS and ICSS protest hearings.

44. On May 7, 2012, the Hearing Bureau continued the May 8, 2012 hearing and sent notice of administrative hearing scheduling this matter for October 4, 2012.

45. On June 1, 2012, the Department's protest bureau revised portions of the original ICSS' audit, made adjustments and/or abatements, and allowed some of ICSS' previously disallowed deductions. [JSF #20].

46. Reflecting the Department's adjustments, as of the date of hearing, October 4, 2012, ICSS owed \$37,531.43 in total gross receipts tax and accrued interest.

47. As of the date of hearing, October 4, 2012, HSS owed \$51,139.63 in total gross receipts tax, compensating tax, and respective accrued interest.

DISCUSSION

The main issue at protest is whether HSS and ICSS were entitled to an additional nine and seven respective claimed deductions disallowed by the Department during the audit. In short

answer, HSS is entitled to one additional deduction and ICSS is entitled to two additional claimed deductions. Otherwise, HSS and ICSS are liable for the remaining disallowed deductions at issue in the protest.

Presumption of Correctness and Burden of Proof.

Under NMSA 1978, Section 7-1-17(C) (2007), the assessment issued in this case is presumed to be correct. Consequently, the Taxpayer has the burden to overcome the assessment and establish that it was entitled to the claimed deductions during the sample audit period. *See Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (NM Ct. App. 1972). Moreover, this case involves Taxpayer's protest over disallowed claims for deductions. "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). However, once a taxpayer rebuts the presumption of correctness, the burden shifts to the Department to show the correctness of the assessed tax. *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 133 N.M. 217, 220, 2003 NMCA 21, ¶13, 62 P.3d 308, 311 (N.M. Ct. App. 2002).

Overview of Deduction, NTTCs, and Multistate Certificates

The Gross Receipts and Compensating Tax Act provides numerous deductions from gross receipts for taxpayers who meet the statutory requirements set by the legislature. In order to qualify for the claimed deductions, many of the deductions require a taxpayer to obtain a supporting NTTC. Almost all of Taxpayer's claimed deductions in this protest require a supporting NTTC.

NMSA 1978, Section 7-9-43 (2005) articulates the requirements for obtaining NTTCs:

All nontaxable transaction certificates...should be in the possession of the seller or lessor for nontaxable transactions at the time the

return is due for receipts from the transactions. If the seller or lessor is not in possession of the required nontaxable transaction certificates within sixty days from the date that the notice requiring possession of these nontaxable transaction certificates is given the seller or lessor by the department, deductions claimed by the seller or lessor that require delivery of these nontaxable transaction certificates shall be disallowed.

Regulation 3.2.201.8(A)(1) NMAC (05/31/01) further indicates that a taxpayer “should be in possession of all (NTTCs) at the time the deductible transaction occurs.” While taxpayers “should” have possession of required NTTCs at the time the return is due from the receipts at issue under the statute, NMSA 1978, §7-9-43 (2005) gives taxpayers audited by the Department a second chance to obtain the required NTTCs. *See also* Regulation 3.2.201.8(A)(2) NMAC (05/31/01).

Regardless of the reason for failing to obtain a requisite NTTC, taxpayers who rely on the statute’s second chance provision run the risk of having their deductions disallowed if they are unable to meet the 60-day deadline set by the legislature. The language of the statute is mandatory: if a seller is not in possession of required NTTCs within 60 days from the date of the Department's notice, "deductions claimed by the seller ... that require delivery of these nontaxable transaction certificates *shall be disallowed.*" (emphasis added). NMSA 1978, §7-9-43 (2005).

Under certain circumstances, the Department can accept a Multistate Tax Commission Multi-jurisdiction Uniform Sales and Use Tax Certificate (“MTC certificate”) in lieu of NTTCs. Under NMSA 1978, §7-9-43 (2005), the Department is authorized, through promulgation of regulation, to accept as a valid NTTC “documents issued by other states or the multistate tax commission to taxpayers not required to be registered in New Mexico.”

As directed by NMSA 1978, §7-9-43 (2011), the Department has in fact promulgated a regulation regarding the acceptance of MTC certificates. Under Regulation 3.2.201.13 (A) NMAC (3/15/10), the Department will accept a MTC certificate issued by another state or the multistate tax commission “to a taxpayer not required to be registered in New Mexico” as equivalent to NTTCs

types issued in New Mexico for claimed deductions under NMSA 1978, Sections 7-9-46, 7-9-47, and 7-9-75.

Application of Law to the Deductions at Issue.

a. Allowable Deductions.

In its proposed findings of fact, conclusions of law, and closing argument, the Department rightfully conceded that HSS was entitled to one previously disallowed deduction for its September 8, 2004 sale to T.C. Building and Realty, Inc. under NMSA 1978, Section 7-9-52 (2000). In light of that concession, no further discussion of that deduction is necessary.

The Department also conceded in its proposed findings of fact, conclusions of law, and closing argument, that ICSS was partially entitled to a previously disallowed deduction for its sales to Northrop Grumman. Specifically, the Department conceded that the invoice totaling \$16,473.00, Department Exhibit Q.3, was a transaction in interstate commerce subject to a deduction under NMSA 1978, §7-9-55 (1993).

The Department continues to challenge the claimed deduction as it relates to the Northrop Grumman invoice totaling \$13,934.00, Department Exhibit Q.2, because in addition to listing Northrop Grumman's Colorado Springs address, the invoice provides a service address in Socorro, NM. However, given the testimony of Mr. Berniklau that the transaction represented in Department Exhibit Q.2 involved the same sale of drop-shipped product from Dallas to Don Diego Island without any connection to New Mexico, Taxpayer overcame the presumption of correctness on the second invoice as well. The Department presented no countervailing evidence to meet the shifted burden of correctness under *MPC Ltd.* Therefore, ICSS is also entitled to a deduction under NMSA 1978, §7-9-55 (1993) of \$13,934.00 for the other Northrop Grumman invoice found at Department Exhibit Q.2.

Finally, ICSS is entitled to its claimed deduction for three invoices to Jaycor/L3 Services under NMSA 1978, Section 7-9-48 (2000), sale of a service for resale. Under NMSA 1978, § 7-9-48 (2000), a seller may claim a deduction for the sale of a service for resale if the buyer delivers an applicable NTTC. In this case, ICSS timely provided the Department with a Type 5 NTTC, the correct type of NTTC for the sale of a service for resale. Based on the credible testimony of Mr. Berniklau, ICSS sold Jaycor/L3 Services radio alarm monitoring equipment and wireless monitoring services, which Jaycor/L3 Services in turn resold to the Federal government in transactions subject to gross receipts tax. Thus, ICSS was entitled to its claimed deductions on these three invoices.

b. *Properly Disallowed HSS' Claimed Deductions.*

Aside from the deductions addressed in the previous discussion section, neither HSS nor ICSS are entitled to any additional claimed deductions for the disputed invoices at issue in this protest.

HSS failed to timely provide the requisite NTTC (or equivalent MTC Certificate) by the statutory 60-day deadline for the claimed deductions for Powerline Technologies and Southwest Fire and Sound. Regardless of the merits of the claimed Powerline Technologies and Southwest Fire and Sound deductions, HSS was not entitled to those two claimed deductions under the mandatory disallowed language of NMSA 1978, §7-9-43 (2005).

HSS claimed numerous deductions either under NMSA 1978, Section 7-9-51 (2001), sale of construction material to persons engaged in the construction business, or under NMSA 1978, §7-9-52 (2000), sale of construction services to persons engaged in the construction business.

NMSA 1978, §7-9-51 (2001) reads in pertinent part “(r)ceipts from selling construction material may be deducted from gross receipts if the sale is made to *a person engaged in the*

construction business who delivers a nontaxable transaction certificate to the seller.” (italics for emphasis). Construction materials is defined under that statute as “tangible personal property that becomes or is intended to become an ingredient or component part of a construction project.” NMSA 1978, §7-9-3.4 (B) (2003).

Similarly, under NMSA 1978, §7-9-52 (2000), “receipts from selling a construction service may be deducted from gross receipts if the sale is made to *a person engaged in the construction business* who delivers a nontaxable transaction certificate... (italics for emphasis). NMSA 1978, Section 7-9-3.4 (A) (2003) defines construction for gross receipt tax purposes as the “building, altering, repairing or demolishing” any of the 18-listed items under the statute. Regulation 3.2.1.11(A) (1) NMAC (12/30/2003) limits construction services to the 18 items/activities listed under NMSA 1978, Section 7-9-3.4 (A) (2003).

Under Regulation 3.2.1.11(A) (2) NMAC (12/30/2003), not all services related to a construction project are considered construction services. As Regulation 3.2.1.11(A) (2) NMAC (12/30/2003) indicates,

“Construction” does not include services that do not physically change the land or physically create, change or demolish a building, structure, or other facility as part of a construction project, even though they may be related to a construction project. That fact that a service may be a necessary prerequisite or ancillary to construction or a construction project does not itself make the service a construction service.

Finally, Regulation 3.2.1.11(A) (3) NMAC (12/30/2003) excludes leasing equipment from the definition of construction.

In light of these statutory and regulatory requirements, there are two main problems with almost all of HSS’ claimed deductions under either NMSA 1978, §7-9-51 (2001) or NMSA 1978, §7-9-52 (2000). First, HSS did not present sufficient evidence that Rowland Electric, Inc.,

Alarm Communication Svc., Alarm Control Technologies, Assured Protection Service, Guardian Alarm Co., and Professional Security Consultants, Inc. are companies engaged in the construction business based on the statutory definition of “construction.” Mr. Berniklau indicated generally that everyone associated with the installation of security/alarm systems must be a licensed general contractor by the New Mexico Regulation and Licensing Department. However, that fact alone does not establish that those companies were performing any of the 18- enumerated activities under the statutory definition of construction, NMSA 1978, Section 7-9-3.4 (A) (2003) at the time of the HSS’ invoices.

The second main problem is that even if those companies were engaged in the construction business for the purposes of NMSA 1978, Section 7-9-3.4 (A) (2003) at the time of the HSS’ invoices, there is insufficient evidence that HSS was providing either a qualifying construction service under NMSA 1978, §7-9-52 (2000) or tangible personal property that became an ingredient or component part of the construction project under NMSA 1978, §7-9-51 (2001). By regulation leasing and other ancillary services like “maintenance work, landscape upkeep, repair of equipment or appliances, architectural, engineering, surveying, traffic safety or legal services” do not qualify as construction services. Regulation 3.2.1.11(A) (2-3) NMAC (12/30/2003). Without more detailed information about the nature of each transaction, HSS’ leasing of alarm systems and monitoring services do not qualify as construction under Regulation 3.2.1.11(A) (2-3) NMAC (12/30/2003). And with the exception of the allowable deduction to T.C. Building and Reality, Inc., there is little evidence that any of the HSS’ security systems were an ingredient or component part of a construction project under NMSA 1978, §7-9-3.4 (B) (2003).

Further, HSS cannot avail itself to the good-faith/safe harbor provision of NMSA 1978, §7-9-43 (2005). Under NMSA 1978, §7-9-43 (2005), a seller who accepts a timely NTTC “in good

faith that the buyer... will employ the property... transferred in a nontaxable manner,” may rely on that NTTC as “conclusive evidence” that the receipts from that transaction “are deductible.”

Regulation 3.2.201.14 NMAC (05/31/01) indicates that the statutes “good faith” provision will be determined at the time of each transaction, and that a taxpayer claiming protection of an NTTC “continues to be responsible that the goods delivered... are of the type covered by the certificate.”

By Regulation 3.2.201.14 NMAC (05/31/01) and by case law, a taxpayer may only rely on an NTTC if the goods delivered during the transaction are the correct type given the NTTC issued and the deduction at issue. *See 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); *see also McKinley Ambulance Service v. Bureau of Revenue*, 92 N.M. 599, 601-602, 592 P.2d 515, 517-518 (Ct. App. 1979) (the "conclusive evidence" provision of § 7-9-43(A) does not apply when there is no NTTC applicable to the transaction at issue); *see also 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).

Here, without establishing that it was either selling qualifying construction materials or providing a construction service, HSS had no basis to accept the NTTCs in good faith because the transactions could never satisfy the statutory deductions absent such proof from HSS. The NTTCs HSS did possess were insufficient to shield HSS from tax liability for an otherwise taxable transaction. *See Gas Co. v. O'Cheskey*, 94 N.M. 630, 632, 614 P.2d 547, 549 (Ct. App. 1980).

c. Properly Disallowed ICSS' Claimed Deductions.

ICSS challenged the Department's decision to disallow the deduction for the \$16,018.00 invoice to Marlin Leasing Company, for which ICSS provided a timely executed MTC certificate. In this invoice, ICSS sold tangible personal property to Marlin Leasing Company, which leased the property to LGM Travel Plaza. The nature of this transaction otherwise qualifies for a deduction under NMSA 1978, Section 7-9-49 (1992), sale of tangible personal property and licenses for leasing, assuming it is supported by a requisite NTTC. Marlin is a financing company that purchases tangible personal property with a lump payment in order to lease the tangible personal property to the end user. The problem is that by regulation, a taxpayer may not use an MTC certificate as a substitute for an NTTC for any claimed deductions other than deductions under NMSA 1978, Section 7-9-46, NMSA 1978, Section 7-9-47, and NMSA 1978, Section 7-9-75. *See* Regulation 3.2.201.13 NMAC (5/31/01). Since ICSS seeks a deduction under NMSA 1978, Section 7-9-49 (1992), the MTC certificate is insufficient to support the claimed deduction.

ICSS claimed a deduction for the sale and installation of alarm systems to Four Suns Builders, Inc. under NMSA 1978, § 7-9-52 (2000). Four Suns Builders used the alarm systems to monitor property under construction in order to avoid theft at construction sites. Four Suns Builders then billed the costs of the alarm systems into the closing costs of the properties. This is an ancillary service akin to traffic safety monitoring, which is excluded from the definition of construction under Regulation 3.2.1.11(A) (2) NMAC (12/30/2003). Therefore, ICSS was not entitled to the claimed deduction under NMSA 1978, § 7-9-52 (2000). The record is unclear whether Four Suns Builders incorporated the alarms systems into the finished construction product (like T.C. Building and Realty, Inc. did for the HSS' alarm system) or simply removed them from the construction site.

Without this additional information, it is not possible to determine whether ICSS sold “construction materials” under the statutory definition that might qualify for a deduction under NMSA 1978, Section 7-9-51 (2001).

ICSS also claimed a deduction for the sale of monitoring services to the Bernalillo County Sheriff’s Office. ICSS based its claim for a deduction on NMSA 1978, §7-9-54 (2003), which allows a deduction for the sale tangible personal property to a governmental agency. However, the language of NMSA 1978, §7-9-54 (2003) does not authorize a similar deduction for the sale of a service to a governmental agency. In fact, under Regulation 3.212.9 (A) NMAC (5/31/01), the sale of a service to a governmental agency is not deductible under the statute. Therefore, the Department properly allowed the portion of the invoice related to the sale of the security system, but properly disallowed the portion of the invoice related to the sale of a service.

ICSS claimed a deduction for its sale and installation of a fire and burglar alarm into a building occupied by West Mesa Autocraft. West Mesa Autocraft leased the fire and burglar alarm to the building’s owner (their landlord), who in turn leased it back to West Mesa Autocraft. ICSS did timely possess a Type 5 NTTC, sale of a service for resale, related to this invoice. However, that type of NTTC is not the correct type for the sale of tangible personal property for leasing deduction covered by NMSA 1978, §7-9-42 (1992) and the Department properly disallowed the claimed deduction during the audit. After the 60-day NTTC deadline, ICSS presented the correct type of NTTC, a Type 2, to cover its transaction with West Mesa Autocraft. However, under the mandatory disallowed language of NMSA 1978, §7-9-43 (2005), the Department could not allow ICSS’s claimed deduction.

ICSS is not entitled to the good-faith/safe harbor protection under NMSA 1978, §7-9-43 (2005) for the Type 5 NTTC it timely received from West Mesa Autocraft because the NTTC it

received was the wrong type for the kind of transaction at issue. *See* Regulation 3.2.201.14 NMAC (05/31/01); *See also Gas Co. v. O'Cheskey*, 94 N.M. 630, 632, 614 P.2d 547, 549 (Ct. App. 1980); *see also McKinley Ambulance Service v. Bureau of Revenue*, 92 N.M. 599, 601-602, 592 P.2d 515, 517-518 (Ct. App. 1979); *see also Arco Materials, Inc. v. New Mexico Taxation and Revenue Department*, 118 N.M. 12, 16, 878 P.2d 330, 334 (Ct. App.), *rev'd on other grounds*, 118 N.M. 647, 884 P.2d 803 (1994).

For the claimed Napa Auto Parts deduction, ICSS presented no evidence to show how it was providing a sale of a service for resale to Napa under NMSA 1978, §7-9-48 (2000). There is no information on the record as to what Napa did with the security system and monitoring services ICSS provided to Napa. ICSS simply failed to meet its burden to establish it was entitled to the claimed deductions and failed to overcome the presumption of correctness that attached to the assessment.

CONCLUSIONS OF LAW

A. After the Department granted HSS an extension of time in which to file a protest, HSS filed a timely, written protest to the gross receipts portion of assessment L1674614016.

Jurisdiction lies over the parties and the subject matter of this protest.

B. After the Department granted ICSS an extension of time in which to file a protest, ICSS filed a timely, written protest to the gross receipts portion of assessment L0774628608.

Jurisdiction lies over the parties and the subject matter of this protest.

C. HSS was entitled to its claimed T.C. Building and Realty, Inc. deduction under NMSA 1978, Section 7-9-52 (2000).

D. Under NMSA 1978, §7-9-43 (2005), HSS was not entitled to its claimed deductions for Powerline Technologies and Southwest Fire and Sound deductions because it did not timely

present the requisite supporting NTTCs to the Department before the expiration of that statute's 60-day deadline.

E. HSS was not entitled to its claimed deductions for the Rowland Electric, Inc., Alarm Communication Svc., Alarm Control Technologies, Assured Protection Service, Guardian Alarm Co., and Professional Security Consultants invoices for two legal reasons. First, there is insufficient evidence that any of those companies are engaged in the construction business, as required for a deduction under either NMSA 1978, §7-9-51 (2001) or NMSA 1978, Section 7-9-52(A) (2000). Second, there is insufficient evidence that HSS was providing either a qualifying construction service under NMSA 1978, §7-9-52 (2000) or tangible personal property that became an ingredient or component part of the construction project under NMSA 1978, §7-9-51 (2001) to any of these companies.

F. HSS is not entitled to NMSA 1978, §7-9-43 (2005)'s good-faith/safe harbor protection for its disallowed deductions pursuant to Regulation 3.2.201.14 NMAC (05/31/01), *Gas Co. v. O'Cheskey*, 94 N.M. 630, 632, 614 P.2d 547, 549 (Ct. App. 1980), *McKinley Ambulance Service v. Bureau of Revenue*, 92 N.M. 599, 601-602, 592 P.2d 515, 517-518 (Ct. App. 1979), and *Arco Materials, Inc. v. New Mexico Taxation and Revenue Department*, 118 N.M. 12, 16, 878 P.2d 330, 334 (Ct. App.), *rev'd on other grounds*, 118 N.M. 647, 884 P.2d 803 (1994).

G. ICSS was entitled to deduct both Northrop Grumman invoices pursuant to NMSA 1978, §7-9-55 (1993).

H. ICSS was entitled to its claimed deductions for the three Jaycor/L3 Services pursuant to NMSA 1978, § 7-9-48 (2000).

I. ICSS was not entitled to its claimed deduction for the Marlin Leasing Company invoice under NMSA 1978, §7-9-49 (1992) because a MTC certificate is not an adequate substitute for an NTTC under that specific deduction. *See* Regulation 3.2.201.13 NMAC (5/31/01).

J. ICSS was not entitled to its claimed deduction for the Four Suns Builders, Inc. invoices under NMSA 1978, §7-9-52 (2000) because it was providing an ancillary service outside of the definition of construction under Regulation 3.2.1.11 (A) (2) NMAC (12/30/2003). Further, there is insufficient evidence that ICSS qualified for this deduction under NMSA 1978, §7-9-51 (2001). *See Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991).

K. ICSS was not entitled to a deduction under NMSA 1978, §7-9-54 (2003) for its sale of a service to the Bernalillo County Sheriff's Office. *See* Regulation 3.212.9 (A) NMAC (5/31/01).

L. ICSS did not timely possess the correct type of NTTC necessary to support its claimed deduction under NMSA 1978, §7-9-42 (1992) for the West Mesa Autocraft invoices. A Type 5 NTTC, service for resale, is not the appropriate NTTC to support a deduction under NMSA 1978, Section 7-9-49 (1992), sale of tangible personal property for leasing. Under NMSA 1978, §7-9-43 (2005), the Department could not accept the correct NTTC that ICSS presented after the expiration of the 60-day deadline to support the West Mesa deduction.

M. ICSS presented insufficient evidence that it was providing a sale of a service for resale to Napa Auto Parts and therefore was not entitled to the claimed deduction under NMSA 1978, §7-9-48 (2000). *See Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991).

For the foregoing reasons, the HSS' and ICSS' protests **ARE GRANTED IN PART AND DENIED IN PART**. The Department is ordered to allow HSS' claimed T.C. Building & Realty, Inc. deduction, and recalculate that assessment accordingly. HSS is then ordered to pay the newly calculated assessment and any accrued interest, as required under NMSA 1978, §7-1-67 (2007). The Department is ordered to allow ICSS' claimed deductions for both Northrop Grumman invoices and Jaycor/L3 Services invoices, and recalculate that assessment accordingly. ICSS is then ordered to pay the newly calculated assessment and any accrued interest, as required under NMSA 1978, §7-1-67 (2007).

DATED: December 31, 2012.

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