

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

**IN THE MATTER OF THE PROTEST OF
SOUTHWEST COPY SYSTEMS, Inc.
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L 1514601984**

No. 14-37

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on October 22, 2014, before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Elena Romero Morgan, Esq., attorney for the Department. Mr. Tom Dillon, Protest Office Supervisor from the Department, appeared as a witness for the Department, along with Shawn Marris, Senior Economist for the Department. Southwest Copy Systems, Inc. (“Taxpayer”) appeared at the appointed time and was represented by Clinton Marrs, Esq. The President of Southwest Copy Systems, Inc., Michael Contois, and the Vice President of Southwest Copy Systems, Inc., Dorothy Contois, appeared as witnesses for Taxpayer. Brian Rowe, certified public accountant, also appeared as a witness for Taxpayer.

Taxpayer introduced into the record Exhibits 1–16. Initially, the Department objected to Exhibits 1-14 based on relevancy; specifically that the exhibits were not based on source documents and not tied to the contracts. The objection was overruled because the workpapers deal with the receipts within the audit period and relate to the transactions at issue. The Department did not object to these same exhibits in the Joint Prehearing Statement. In addition, the Department argued that Mr. Rowe did not indicate on the workpapers who had prepared the documents. Exhibits 1-14 were initially prepared by the auditor, Ms. Cabrini Sanchez. Mr.

Rowe used the workpapers to arrive at his own calculations. The Department introduced into the record Exhibits B-E. The Hearing Officer would like to acknowledge the hard work and effort of both attorneys in this matter.

The record in this matter also contains the following filings: Notice of Telephonic Scheduling Conference issued on November 8, 2013; Scheduling Order and Notice of Administrative Hearing issued on November 21, 2013; Motion to Vacate Administrative Hearing and Pre-Hearing Deadlines filed on January 16, 2014 by Taxpayer; Department's Objection to Taxpayer's Motion to Vacate Administrative Hearing and Pre-Hearing Deadlines filed on January 17, 2014; Continuance Order, Amended Scheduling Order, and Amended Notice of Administrative Hearing issued on January 30, 2014; Joint Prehearing Statement filed by the Department on April 2, 2014 (mislabeled); Motion to Extend Deadline for Filing Prehearing Statement filed by Taxpayer on June 17, 2014; Order Extending Joint Prehearing Statement Deadline issued on June 17, 2014; Notice of Telephonic Prehearing Status Conference issued on June 27, 2014; Continuance Order, Amended Scheduling Order, and Amended Notice of Administrative Hearing issued on July 1, 2014; Amended Continuance Order, Amended Scheduling Order, and Amended Notice of Administrative Hearing issued on July 8, 2014; Department's Motion for Summary Judgment for the Denial of the Protest of Southwest Copy Systems, Inc. filed on August 15, 2014; Protestant's Motion for Summary Judgment filed on August 18, 2014; Department's Response to Taxpayer's Motion for Summary Judgment filed on August 27, 2014; Protestant's Opposition to Department's Motion for Summary Judgment filed on September 22, 2014; Continuance Order, Amended Notice of Summary Judgment Hearing, and Notice of Administrative Protest Hearing issued on September 24, 2014; Joint Prehearing Statement filed on October 2, 2014; Amendment to Joint Prehearing Statement filed on October

3, 2014; Order Denying Summary Judgment issued on October 8, 2014; and Notice of Reassignment of Hearing Officer for Administrative Hearing issued on October 20, 2014. There are also various e-mails contained in the administrative file.

There were three scheduling hearings that are also part of the record. Those hearings occurred on November 21, 2013, June 27, 2014 and July 1, 2014.

At the conclusion of the hearing, the Department was offered an opportunity to present legal argument, no more than five pages in length, responding to any issues raised at the hearing. The Department's legal counsel, Ms. Morgan, informed the Hearings Bureau that she intended to file legal argument. An Order was issued on October 29, 2014 setting out the deadlines for the legal argument. No legal argument was filed by the Department.

Based on the aforementioned pleadings, the testimony and evidence introduced at the hearing, and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On December 21, 2005, the Department assessed Taxpayer in the principal amount of gross receipts tax of \$127,787.54 and \$72,885.62 in interest for the tax period of January 31, 1998 through March 31, 2003. The relevant audit period for gross receipts tax is April 2001-March 2003. Exhibit D, page C2a. (The gross receipts tax audit period is from January 2000-March 2003; however, there were zero exceptions related to the issue in dispute for the time period of January 2000-March 2001 and so this time period is not included.) The Department also assessed Taxpayer \$1,866.10 in the principal amount of compensating tax and \$1,134.05 in interest. Letter Id No. L1514601984. Taxpayer is not contesting the compensating tax that is due.

2. Taxpayer filed a protest in this matter on January 18, 2006.

3. On January 25, 2006, the Department acknowledged the protest filed by Taxpayer.

4. The Department requested a hearing in this matter with the Hearings Bureau on November 4, 2013.

5. The Department conducted an audit of Taxpayer beginning on October 23, 2002 and concluding on August 11, 2004. Exhibit D, page GN 1.

6. The auditor, Cabrini Sanchez, used the sampling method of audit even though Taxpayer's records were available to her. Exhibit D, page GN 3. Ms. Sanchez stated in the audit that she used the sampling method because there was a high number of daily transactions. Exhibit D, pages GN 3 and DN1.2. Ms. Sanchez derived the disallowed deductions by multiplying a percentage of error of 34.1527% (old OMD system), 19.3824% (new OMD system) and 76.5719% (disallowed deductions) against the total deductions per the filed returns to arrive at a disallowed deduction amount. Exhibit D, pages DN1.3, DN2.2 and DN3.3.

7. The Department's on-line Audit Manual provides that the sampling method is used to review "less than 100% of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of all the items within the balance or class of transactions." Department's Audit Manual, page 26. The purpose of audit sampling is to allow the Department's employees to be more efficient and to save time and money. Department's Audit Manual, page 26. The sampling method is an alternate method of sampling. [CD 2, 10/22/14, 4:50]. (At the hearing during the testimony of the Department's witness, Shawn Marris, he discussed the Department's on-line Audit Manual. The Audit Manual can be found at <http://realfile.tax.newmexico.gov/general-audit-manual.pdf>.) [CD 2, 10/22/14, 18:11-18:56].

8. The Department's Audit Manual states that "when sampling procedures have been challenged by a taxpayer, we have allowed the taxpayer to present detailed information to refute the results of the sample." Department's Audit Manual, page 26.

9. Taxpayer's representatives provided detailed information to the Department during the course of the Department's audit, but the Department did not conduct a more detailed audit. Exhibit D, pages DN.1.1-DN 1.3.

10. Taxpayer was incorporated in New Mexico in 1992. Its President is Michael Contois, and its Vice President is Dorothy Contois. [CD 1, 10/22/14, 55:43-55:57].

11. Mr. Contois has been in the copier business since 1968. [CD 1, 10/22/14, 55:00-57:00].

12. During the audit period, Taxpayer was in the business of selling, leasing and servicing photocopier, printer and fax equipment to other businesses located in New Mexico. [CD 1, 10/22/14, 57:00 and 1:16:15-1:16:30].

13. As part of its business practice, Taxpayer sold photocopier, printer and fax parts and supplies (collectively known as "supplies") to its customers. It also sold services to repair and maintain the photocopiers, printers and fax machines (collectively known as "machines"). [CD 1, 10/22/14, 1:16:53-1:17:04]. The charges for the supplies and the charges for the services were included in a monthly fee charged to Taxpayer's customers. Exhibit 15, pages 1-4.

14. Customers entered into Maintenance Agreements (Agreement) with Taxpayer for the servicing of the machines and for providing supplies. The Agreement was a form contract that all nonprofits and governmental agencies used during the audit period. [CD 1, 10/22/14, 2:08:46-57]. The Agreement provided that for a monthly fee, the fee changed depending on several factors, Taxpayer provided unlimited service, drum and parts, and supplies: Toner,

Developer, Waste Container. [CD 1, 10/22/14, 1:36:00-1:39:42]; Exhibit 15, pages 1-4. The fee for the Agreement included a set number of copies, e.g., 15,000 copies per month. [CD 1, 10/22/14, 1:36:00-1:43:00]; Exhibit 15, page 1. The pricing cost of the Agreement was derived by knowing the yields of copies per type of machine. [CD 1, 10/22/14, 1:38:00-1:39:58].

15. The customer could order and use as many supplies (drum and parts, and supplies: Toner, Developer, Waste Container) so long as it did not exceed the per month number of copies agreed upon. [CD 1, 10/22/14, 2:09:42-2:10:45]. If the number of agreed upon copies were made, then there was an additional fee or overage charge was applied to the customer's account. Exhibit 15, pages 1-4.

16. The Agreement, however, also specifies that "(p)arts are included in your Maintenance Agreement, excluding consumables such as toner, dispersant, and developer...". Exhibit 15, pages 1-4.

17. Taxpayer's customers included 501(c)(3) organizations ("nonprofits") and governmental units or subdivisions, agencies, departments or instrumentalities ("entities"). Exhibits 4 and 5.

18. Taxpayer's business model was to sell business-to-business. [CD 1, 10/22/14, 1:04:30-1:04:40]. Taxpayer's business slogan or motto was "to be responsive to the customer's needs quickly" and "to be competitive you need to supply the customer's needs." [CD 1, 10/22/14, 1:01-1:04:40]. The business model included not being a retail business for walk in customers to purchase supplies. [CD 1, 10/22/14, 1:03:52]. Taxpayer's business model included being the "total solutions" for every business. [CD 1, 10/22/14, 1:51].

19. During the audit period, Mr. Contois testified that Taxpayer had approximately 40 employees. [CD 1, 10/22/14, 59:21-59:27]. (The Department's audit stated that there were 28

employees employed during the audit period. Neither party explained the discrepancy.) Exhibit D, page GN 1. The company was divided into administrative, service and sales departments. [CD 1, 10/22/14, 59:27-59:39].

20. The supplies were kept on-site in Taxpayer's warehouse. [CD 1, 10/22/14, 1:00:46-1:01:11].

21. The supplies included PM kits, rollers, computer boards, display panels, drums, cleaning blades, developer and toner. [CD 1, 10/22/14, 1:06:11-1:07:02].

22. The photocopier machines serviced were high speed large copy machines costing anywhere from \$5,000 to \$50,000. [CD 1, 10/22/14, 1:10:53-1:13:38].

23. The sales representatives for the company responded to sales calls outside of the office. The sales representatives were not qualified to service the machines. [CD 1, 10/22/14, 1:05:00-1:30:00].

24. The service technicians were dispatched from the company's main office to service machines. [CD 1, 10/22/14, 1:05:00-1:30:00].

25. Prior to the audit period, the cost for servicing a machine was around 66% percent of the pricing cost of the Agreement, with the remaining 34% of the pricing cost of the Agreement attributable to supplies for the machine. [CD 1, 10/22/14, 1:48:50-1:49:40]. Prior to audit period, Taxpayer employed one service technician for every 76-100 machines. [CD 1, 10/22/14, 1:22:47-1:24:12].

26. During the audit period, Taxpayer employed one technician for every 400 machines. [CD 1, 10/22/14, 1:24:15-1:24:17].

27. The computer program used to track supplies and service hours was referred to as the “OMD” system. [CD 2, 10/22/14, 30:43-33:48].

28. The OMD system kept track of the number of service calls per customer, the number of hours a technician serviced a machine and the hourly fee for each technician servicing a machine. [CD 2, 10/22/14, 26:30-30:27].

29. When a service technician was dispatched to a customer’s office, a service ticket and if necessary, a supply ticket were created. [CD 1, 10/22/14, 1:39:20-1:43:00; CD 2, 10/22/14, 30:43-32:43]. When the technician returned from a customer’s office, he added the number of service hours to the ticket and the name and number of supplies. [CD 2, 10/22/14, 28:29-30:27].

30. A data entry clerk would, then, enter the information into the OMD system and the OMD system would fill in the cost of the supply item to the customer’s contract number and remove the item from inventory. [CD 1, 10/22/14, 1:39:20-1:43:00; CD 2, 10/22/14, 27:00-30:03].

31. The service ticket indicated how many hours the technician worked on the equipment and the cost per hour for his/her time. [CD 1, 10/22/14, 1:39:20-1:43:00; CD 2, 10/22/14, 27:00-30:03]. The OMD system would, then, calculate the service charge and charge the customer’s contract number with the service fee. [CD 2, 10/22/14, 30:01-30:08].

32. The OMD system kept track of the inventory and charged each customer’s contract number with the cost of each supply charged to the customer’s contract number. [CD 1, 10/22/14, 1:39:50-1:43; CD 2, 10/22/14, 26:30-30:27; CD 2, 10/22/14, 30:43-33:48].

33. The amount of service ticket was not combined in any way with the cost of supplies listed on the supply ticket. [CD 2, 10/22/14, 31:52-32:18].

34. The Department's audit acknowledges that in Taxpayer's computer software system, Taxpayer separated the sale invoices by taxable sales and deductions. Exhibit D, page DN 1.2.

35. Mrs. Contois was responsible for the administration of the office, of all the internal financial and accounting functions. [CD 2, 10/22/14, 25:36-26:01].

36. The OMD system was a software system specifically designed for Taxpayer's copier business. [CD 2, 10/22/14, 30:51-31:18].

37. During the course of the audit, the computer program was changed, and the new program worked almost identically to the old program. Exhibit D, pages GN3 and D2.2.

38. Taxpayer's computer program was reliable and was able to keep track of the cost of supplies charged to each customer's contract number.

39. The Department's audit states that "(t)he taxpayer said that to calculate deductions an internal company specific formula of 64% taxable / 36% was invented and used since the business start date." Exhibit D, page DN2.2.

40. There is no evidence that either Taxpayer's representative made this statement or that the President or the Vice President invented the formula. Exhibit D, page DN 1.2.

41. Taxpayer does not dispute all of the audit exceptions in the audit. Taxpayer is only protesting the audit findings that pertain to the sale of tangible personal property sold to nonprofits and governmental agencies.

42. Mr. Dillon testified that he did not doubt that Taxpayer sold tangible personal property as part of the Agreement. [CD 2, 10/22/14, 2:45:03-2:45:10]. Mr. Dillon testified that the audit exceptions being disputed by Taxpayer are only being disallowed because there is no

separate invoice detailing the price of the supplies. [CD 2, 10/22/14, 2:18:30 and 2:43:30-2:43:37].

43. Ms. Sanchez did not testify in this matter even though she is still employed by the Department.

44. Prior to the conclusion of the audit, Taxpayer's representative, Brian Rowe, CPA, disputed the audit findings and disputed the disallowance of the deductions as it applied to nonprofits and governmental agencies. [CD 2, 10/22/14, 59:21-1:00:22].

45. Taxpayer was allowed a deduction for the sale of the supplies (i.e., toner) to nonprofits or governmental agencies if the supply was separately invoiced. Exhibits 4 and 5.

46. The disallowed deductions in dispute relate to nonprofits and governmental agencies who issued a timely Type 9 nontaxable transaction certificate ("nttc") to Taxpayer.

47. The nonprofits and governmental agencies in dispute are: Albuquerque Indian Center, Albuquerque Little Theatre, Albuquerque Public Schools, Berean Baptist Church, Catching the Dream, Catholic Social Services, Children Youth and Families, Christian Fellowship Church, City of Albuquerque, Cornucopia, Inc., County of Valencia, EV Lutheran Good Samaritan, Federal Aviation Administration Government Letter, Frederick H. Leonhard Foundation, Immanuel Baptist Church, Los Lunas Schools, March of Dimes Birth Fund, National Indian Youth Council, New Mexico Educational Assistance Foundation, New Mexico Environment Department, New Mexico Coalition Against Domestic Violence, New Mexico State Highway and Transportation Department, Office of the Special Trustee, Presbyterian Medical Services, Pueblo of Laguna, City of Rio Rancho, Rio Rancho United Methodist, Sandia View Elementary, Taxation and Revenue Department, Town of Edgewood, Tramway

Community Church, University of New Mexico, Us District Court, US Postal Service, YMCA of Albuquerque. Exhibit D, page C11.0.

48. The Department determined that from April 2001 through March 2003, \$101,510.44 in gross receipts were disallowed because the Agreement included a service component. Exhibit D, pages C2a and C3.20a.

49. Mr. Rowe derived a percentage of the total receipts by reviewing the total receipts received by Taxpayer from nonprofits and governmental agencies for the period of April 1, 2001 and ending March 2003 and, then, dividing the dollar amount or the “retail” price of the supplies sold to the nonprofits and governmental agencies. Exhibit 3 and Exhibit 16, pages 3-4.

50. By accessing the old and new OMD systems, Mr. Rowe determined and provided the retail price of all the supplies sold to nonprofits and governmental agencies during the audit period. Exhibits 7-14.

51. Mr. Rowe calculated that the receipts for supplies were: 79.3731% for 2001; 83.4010% for 2002; and 70.4652%. Exhibits 3 and 16, page 4.; [CD 2, 10/22/14, 1:00:00-1:44:00].

52. Based on the percentages, Mr. Rowe revised the workpapers provided to him by Ms. Sanchez. Exhibits 1, 2, 4 and 5. (Mr. Rowe omitted his initials from his revised workpapers.)

53. There were deductions that were disallowed by the Department, other than the ones described herein. Taxpayer does not dispute the disallowance of these deductions.

54. Mr. Rowe determined that the allowable deductions based on sale of tangible personal property sold under the Agreements was \$374,172.63 with amount of tax due of

\$62,449.74. Exhibit 1, page C2a and Exhibit 16, pages 7-8. (Mr. Rowe used the auditor's work papers and carried over the headings into his workpapers.)

55. Taxpayer does not dispute that a portion of the receipts from the Agreements that are services and therefore not deductible.

56. Taxpayer does not dispute the interest on the amount of tax it claims is due.

57. Mr. and Mrs. Contois were credible witnesses because they both had extensive knowledge of the manner in which their business operated both structurally and financially. They both exhibited ease in describing the details of the OMD system and how it operated which was crucial in determining whether the OMD system was reliable and whether the cost of the tangible personal property was entered into the system. In addition, they both seemed very truthful.

DISCUSSION

The issue to be determined is whether Taxpayer is able to substantiate its sales of tangible personal property if the sale included a service and the personal property was not invoiced separately.

The Department contends that to substantiate the sale of tangible personal property at the same time a service is provided by the same taxpayer, an invoice must be prepared indicating the cost of the tangible personal property item to the customer. (The Department argued that in the Agreement there was no "allocation" between the price of the tangible personal property and the cost of the service.) [CD 1, 10/22/14, 29:00-35:33]. Taxpayer argued that there is no statutory obligation that a taxpayer prepare an invoice detailing the sale of tangible personal property, so long as there is sufficient record keeping and proof of the cost of the item.

Burden of Proof and Standard of Review.

NMSA 1978, Section 7-1-17(C) (2007) provides that any assessment of taxes made by the Department is presumed to be correct. *See, TPL, Inc. v. Taxation and Revenue Dep't*, 2000-NMCA-083, ¶8, 129 N.M. 539, 542, 10 P.2d 3d 863, 866, *cert. granted*, 129 N.M. 519, 10 P.3d 843, *rev'd on other grounds*, 2003-NMSC-7, 133 N.M. 447, 64 P.3d, 474. Accordingly, it is Taxpayer'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. When a taxpayer presents sufficient evidence to rebut the presumption, the burden shifts to the Department to show that the assessment is correct. *See, MPC LTD. v. N.M. Taxation and Revenue Dep't.*, 2003-NMCA-021, ¶ 13, 133 N.M. 217, 219-220, 62 P.3d 308, 310-311; *Grogan v. New Mexico Taxation and Revenue Department*, 2003-NMCA-033, ¶11, 133 N.M. 354, 357-58, 62 P.3d 1236, 1239-40. Consequently, Taxpayer has the burden to show that the Department's assessment is incorrect and establish that it was entitled to the deduction for tangibles. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶7, 84 N.M. 428, 431, 504 P.2d 638, 641. The courts have held that "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*, 1991-NMCA-024, ¶16, 111 N.M. 735, 740, 809 P.2d 649, 654.

In addition thereto, it is presumed that "all receipts of a person engaging in business are subject to the gross receipts tax." NMSA 1978, Section 7-9-5 (2002). Therefore, the notice of assessment is not only presumed to be correct, but all of Taxpayer's receipts are presumed to be taxable. It is Taxpayer's burden to rebut the presumptions.

Taxpayer's Business.

Taxpayer was in the business of selling, leasing and servicing machines to other businesses located in New Mexico. Mr. Contois and his wife, Mrs. Contois, have owned and operated the company since 1992. Both Mr. and Mrs. Contois were credible witnesses and both witnesses spoke at length about the specific nature of the copier business. Mr. Contois articulated that the business plan and model for his business was to meet the needs of New Mexico businesses and to sell business-to-business in both the servicing and repairing of the machines. Taxpayer's business slogan or motto was "to be responsive to the customer's needs quickly" and "to be competitive you need to supply the customer's needs." The business model included not being a retail business for walk in customers but to provide the necessary supplies for each customer at the time the machines were serviced so that each customer could print and make copies without much interruption. To accomplish this, Taxpayer sold or leased machines to customers and then entered into formal written Agreements with customers wherein the customer was charged a per copy fee per month, which included a service component to the contract and a supply component. The agreed upon monthly fee was priced to include both service charges and charges for supplies. Taxpayer used form contracts that were modified for use with each individual customer. There is no issue that the service component of the Agreement constituted gross receipts for which no deduction applies.

Sale of Tangible Personal Property.

The only inquiry is whether certain receipts from the supplies or the tangible personal property when sold with the service component are deductible either pursuant to the deduction for sales of tangible personal property to a governmental agency or the sales of tangible personal property to a nonprofit. The applicable deductions at issue are Section 7-9-54 and Section 7-9-60. Section 7-9-54(A) which provides that:

(r)ceipts from selling tangible personal property to the United States or New Mexico, or any governmental unit or subdivision, agency, department or instrumentality thereof may be deducted from gross receipts or from governmental gross receipts.

NMSA 1978, Section 7-9-54(A) (2001). The other germane deduction is Section 7-9-60(A) and it provides that:

A.(r)ceipts from selling tangible personal property to organizations that have been granted exemption from the federal income tax by the United States commissioner of internal revenue as organizations described in Section 501(c)(3) of the United States Internal Revenue Code of 1986, as amended for renumbered, may be deducted from gross receipts...

NMSA 1978, Section 7-9-60(A) (2001).

In addition thereto, there are specific regulations providing instruction when there is a sale of both a service and tangible personal property in a single transaction. The regulations provide the use of either a “predominate” test, wherein the transaction is predominately a service, or a test when neither the service or the sale of tangible personal property “predominate.”

In regulation 3.2.1.29(E)(1) NMAC (2001)¹, the Department contemplates the possibility that there are some transactions wherein either the performance of a service or the sale of tangible personal property may not predominate but both the service and sale of property occur in a transaction. The regulation provides that if the receipts attributable to each constitutes more than 40% of the total receipts, then the receipts may be apportioned accordingly. However, the market value or the cost of the tangible personal property or services must be “readily ascertainable” and the taxpayer’s records must “adequately reflect” the portion of the receipts derived from the sale of tangible personal property. The regulation goes on to provide that the

¹It should be noted that the example under regulation 3.2.1.29(E) NMAC (2001) is identical to Taxpayer’s situation but for the manner in which Taxpayer X bills the customer. In the example, Taxpayer X bills the customer with an invoice for the sale of the tangible personal property.

taxpayer is responsible for providing the information and to justify the portion of the receipts attributable to the sale of tangible personal property. Finally, the regulation provides that “(t)he clearest way of carrying that burden is to *specify separately* on the invoice the charges for the property and the charges for the services, and to retain sufficient records to allow a determination that the relative value of either the property or the services is not overstated.” (Emphasis added).

The Department argued that the language in the regulation providing that the clearest way to prove the cost of tangible personal property is to separately state on the invoice the charges for the tangible personal property is a mandatory requirement. In reviewing both statutory deductions, Section 7-9-54 and 7-9-60, there is no mandatory requirement that the invoice **must** separately state the charges for the property and the charges for the services. Likewise, in reviewing the regulation, there is no mandatory requirement that the taxpayer **must** separately state the charges for the property and the charges for the services. The language in the regulation only provides that “the clearest” manner in which the taxpayer, whose burden it is, may prove the charges for the property and the charges for the services is to separately state those charges. There is no doubt that the clearest and surest manner in which to prove the cost of tangible personal property when there is a sale of both a service and property is to separately state the cost of the property. There are going to be some businesses for which separately stating the cost of the property is not in keeping with the type of business. Mr. Contois testified that the customers would have been confused if they had received an invoice for the cost of supplies; especially considering that the supplies were included within the per month fee.

Therefore, since the regulation does not require that the charges for the property be separately stated, the inquiry then shifts focus to whether Taxpayer met its burden by showing there were sufficient records to show the cost of the property and whether Taxpayer charged its

customers that cost. There are four components to this inquiry. One component is whether the record keeping is generally reliable. Another component is whether the record keeping adequately reflects the charges. The third is whether Taxpayer charged its customers the cost of the property. And finally, a taxpayer must show that charges are not “overstated.”

As for whether Taxpayer’s record keeping was reliable, Mr. Contois testified in great detail about the operational nature of Taxpayer’s business. He testified that the machines that were serviced under an Agreement were not desk top printers, but rather high speed large machines costing anywhere from \$5,000 to \$50,000. Each machine was highly sophisticated and if you compared the machines that were in use prior to the audit period to the machines used during the audit period, the machines in use prior to the audit period needed more servicing than the newer more efficient machines. He testified that there was a formula of one service technician for every 76-100 machine prior to the audit period as compared to during the audit period wherein the Taxpayer only needed one technician for every 400 machines. This is evidence that the servicing part of the pricing of the Agreement was not as important as the supply part of the pricing of the Agreement. It was the supplies that were more costly than the servicing of a machine. The newer machines simply did not need to be serviced like the older machines.

It was Mr. Contois' belief that to have a successful business, Taxpayer needed to be readily available to service any machine at any time and provide the necessary supplies when servicing the machines. Part of servicing the machines included routine service calls, which included charging supplies, including PM kits, rollers, computer boards, display panels, drums, cleaning blades, developer and toner to the customer’s contract.

The sale of the supplies was accounted for on a daily basis in the OMD system. Mr. and Mrs. Contois both testified that there was a software program, the OMD system, which kept track of the inventory and charged each customer's contract with the cost of each supply and the number of service hours a technician work on a machine. The Agreements were priced to include both the service and supply costs.

Mrs. Contois testified at length about how the cost of the supplies were tracked in the OMD system. During the audit period, Mrs. Contois was responsible for the administration of the office, of all the internal financial and accounting functions. The OMD system was a software system specifically designed for the copier business. Mrs. Contois described in great detail how the OMD kept track of the number of service calls per customer contract, the number of hours a technician serviced a machine and the hourly fee for each technician servicing a machine. Generally, when a service technician was dispatched to a customer's office a service ticket was created. When the technician returned from a customer's office, the technician completed the number of hours he serviced a machine and the supplies he used. The clerk would, then, input the data into the OMD system, and the OMD system would populate the cost of the supply item to the customer's contract number and the per hour rate for the technician. The OMD system would, then, tie the charges to the customer's contract number. The charge for the service ticket was not combined in any way with the cost of supplies listed on the supply ticket. Taxpayer's OMD system also kept track of the inventory and charged each customer's contract number with the cost of each supply item charged to a customer's account.

Taxpayer disputes the sampling method as it was applied to the receipts and disallowed deductions from nonprofits and governmental agencies. The Department used a percentage of error of 34.1527% (old OMD system), 19.3824% (new OMD system) and 76.5719% (disallowed

deductions) multiplied against the total deductions per the filed returns to arrive at a disallowed deduction amount. Instead, Mr. Rowe gathered the cost of the supplies from the OMD systems, which contain all of the original cost amounts, and prepared a spreadsheet indicating the cost of all the items *charged* during the audit period to nonprofits and governmental agencies. Exhibits 7-14 and 16. The listing is detailed and there is no evidence to prove that any of the costs were overstated. The auditor, Ms. Sanchez, noted in her audit that Taxpayer's computer software system separated the sale invoices by taxable sales and deductions. Exhibit D, page DN 1.2. It is not clear if this is an acknowledgment that Taxpayer charged its customers the cost of the supplies or if she meant something entirely different. Thus, since she was not available to testify, this statement is not helpful. Ms. Sanchez also stated in the audit that "(t)he taxpayer said that to calculate deductions an internal company specific formula of 64% taxable / 36% was invented and used since the business start date." There is no evidence that Taxpayer "invented" a formula and since the auditor was unavailable to testify as to this statement, this statement is not given any weight. Both Mr. Contois and Mrs. Contois were credible witnesses and did not give any evidence that they would decide the pricing cost of an Agreement based on an invented formula. Taxpayer has met its burden that the record keeping was reliable, that it accurately reflected the charges, that the customers were charged the cost of the property and that the charges were not overstated.

Sampling Method.

The Department argued that the method of sampling was accurate, so therefore, the assessment should be upheld. Taxpayer argues that the sampling method is not the only method for deriving the exceptions or the disallowed deductions. The Department's own Audit Manual provides that the sample method reviews "less than 100% of the items within an account balance

or class of transactions for the purpose of evaluating some characteristic of all the items within the balance or class of transactions.” Department’s Audit Manual, page 26. In fact, a more accurate rendition of a taxpayer’s disallowed deductions is to review each transaction. In this case, Taxpayer has provided the cost of each sale of tangible personal property sold to a nonprofit or governmental agency. Exhibits 7-14. The Department’s Audit Manual states that “when sampling procedures have been challenged by a taxpayer, we have allowed the taxpayer to present detailed information to refute the results of the sample.” Department’s Audit Manual, page 26. Therefore the sampling method as applied to the disallowed deductions (the portion related to supplies under the Agreement) is set aside because Taxpayer met its burden to overcome the presumption of correctness with detailed and credible evidence of the cost of each sale of tangibles sold to nonprofits and governmental agencies.

Contradictory Language in Agreement.

There is the issue of the contradicting language in the Agreement concerning whether the supplies, like toner, were included in the monthly fee. There is no question that the contract is ambiguous since there are terms that contradict each other. The “Special Terms” language contradicts the language in the Agreement. In *C.R. Anthony Co. v. Loretto Mall Partners, 1991-NMSC-070*, ¶¶12-19, 112 N.M. 504, 508-509, 817 P.2d 238, 242-243, the Court abandoned the “plain-meaning” or “four-corners” standard to determine whether the context of the contract was ambiguous. The Court went on to adopt the contextual approach to contract interpretation, in recognition of the “difficulty of ascribing meaning and content to terms and expressions in the absence of contextual understanding.” *C.R. Anthony Co., 1991-NMSC-070*, ¶14. See also, *Mark V, Inc. v. Mellekas, 1993-NMSC-001*, 114 N.M. 778, 845 P.2d 1232. Thus, parol evidence is admissible to explain or clarify an ambiguous term. *C.R. Anthony Co., 1991-NMSC-070*, ¶18.

Mr. Contois testified that Taxpayer used a standard form agreement and amended the Agreement with the notations under the section of the Agreement entitled “Special Terms.” Exhibit 15, pages 1-4. Each example of an Agreement indicates that supplies included both the parts and supplies like toner. The testimony is credible that the standard Agreement was amended by the “Special Terms” section and that, not only were the parts included in the monthly fee, but the supplies like toner were also included. Therefore, the standard form section related to supplies of the Agreements is modified by the “Special Terms” section of the Agreement.

CONCLUSIONS OF LAW

A. Southwest Copy Systems, Inc. filed a timely written protest to the Department’s Assessment issued under Letter Id No. L1514601984.

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

C. The amount of assessed gross receipts tax is \$127,787.54 in principal and \$72,885.62 in interest for the tax period of January 31, 1998 through March 31, 2003. The Department also assessed Taxpayer \$1,866.10 in the principal amount of compensating tax and \$1,134.05 in interest. Letter Id No. L1514601984.

D. Taxpayer owes the assessed compensating tax, including principal and interest.

E. Southwest Copy Systems, Inc. kept reliable records and its record keeping adequately related the cost of the supplies charged to its customers.

F. Southwest Copy Systems, Inc. charged its customers the cost of the tangible personal property and those costs were not overstated.

G. Southwest Copy Systems, Inc. was not legally required to separately state on an invoice the charges to its customers for costs allocated to the sale of tangible personal property because it utilized a record keeping system that was reliable; the record keeping adequately

elected the charges; the pricing cost of the contract included the cost of the supplies; and the charges were not overstated.

H. The receipts from the sale of tangible personal property to nonprofit organizations and governmental agencies are deductible but the services are not.

I. Southwest Copy Systems, Inc., Inc. proved by a preponderance of the evidence that it owes in gross receipts tax \$62,449.74, plus interest.

J. Southwest Copy Systems, Inc., Inc. was able to rebut the presumption of correctness as it applied only to the receipts set forth herein.

K. Interest should be applied to the principal amount of tax due in accordance with NMSA 1978, Section 7-1-67 (2007).

For the foregoing reasons, the Taxpayer' protest **IS GRANTED IN PART AND DENIED IN PART.**

DATED: November 20, 2014.

Monica Ontiveros
Hearing Officer
Taxation & Revenue Department
Post Office Box 630
Santa Fe, NM 87504-0630

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, §7-1-25 (1989), the Taxpayer have the right to appeal this decision by filing a notice of appeal with the New Mexico Court of Appeals within 30 days of the date shown above. *See* NMRA, 12-601 of the Rules of Appellate Procedure. If an appeal is not filed within 30 days, this Decision and Order will become final. A party filing an appeal shall file a courtesy copy of the appeal with the Hearings Bureau contemporaneously with the

filing of the Notice with the Court of Appeals so that the Hearings Bureau may prepare the record proper.