STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
VIDEO FACTORY, **No. 16-10**
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L0257619264

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on January 15, 2016 before Hearing Officer Dee Dee Hoxie. The Taxation and Revenue Department (Department) was represented by Ms. Melinda Wolinsky, Staff Attorney. Ms. Sonya Varela, Auditor, also appeared on behalf of the Department. Ms. Lisa Benjamin, owner of Video Factory (Taxpayer), and Mr. David Newquist, a freelancer and former employee, appeared for the hearing. The Hearing Officer took notice of all documents in the administrative file. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On January 10, 2013, the Department assessed the Taxpayer for gross receipts tax, penalty, and interest for the tax period ending on December 31, 2008. The assessment was for $3,087.54 tax, $617.51 penalty, and $488.55 interest.
2. On February 8, 2013, the Taxpayer filed a formal protest letter.
3. On October 16, 2015, the Administrative Hearings Office first learned of the Taxpayer's protest when the Department filed a Request for Hearing asking that the Taxpayer's protest be scheduled for a formal administrative hearing.
4. On October 29, 2015, the Hearings Office issued a notice of hearing. As the protest was filed prior to the change in the statute, the hearing was not required to be set within 90 days of the receipt of the protest.

5. On February 12, 2016, the Hearing Officer issued an Order for Briefing and later an Order Extending Time.

6. Ultimately, the parties were given until March 11, 2016 to file a brief. Both parties timely filed a brief.

7. The Taxpayer is a video production company. It provides various services and products for its customers, including recording, editing, sound, and video duplication and production.

8. The bulk of the assessment relates to services and products that the Taxpayer provided for the State Bar of New Mexico, which had provided a nontaxable transaction certificate (NTTC). *See* NMSA 1978, § 7-9-60 (allowing for deductions with a NTTC for sale of tangible personal property to nonprofit organizations).

9. The Taxpayer recorded various live presentations, edited the recordings, and provided copies of the recordings on three DVDs to the State Bar.

10. The State Bar maintains copies in its library, distributes copies upon request, and allows viewing of the copies.

11. The Taxpayer did not receive any payment from the State Bar, and was not entitled to any payment from the State Bar, until the DVDs had been delivered.

12. If the Taxpayer spent time recording a presentation but was unable to deliver DVDs to the State Bar, the Taxpayer was responsible for its own lost time and effort.

13. The Taxpayer was deducting the sales of the DVDs to the State Bar as tangible personal property pursuant to the NTTC issued to the Taxpayer by the State Bar.

14. The Department audited the Taxpayer and determined that the Taxpayer was treating the DVDs that it provided to the State Bar solely as tangible personal property.

15. The Department concluded that the actual value of the DVDs was not as tangible personal property and was predominantly from the service of recording, editing, and transferring video files.

16. The Department allowed deductions for the cost of the DVDs as tangible personal property, but disallowed the bulk of the deductions as they were from services performed in recording, editing, and copying of the video files.

DISCUSSION

The issue to be decided is whether the Taxpayer is liable for the gross receipts taxes, penalty, and interest as assessed.

Burden of Proof.

Assessments by the Department are presumed to be correct. *See* NMSA 1978, § 7-1-17. Tax includes, by definition, the amount of tax principal imposed and, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." NMSA 1978, § 7-1-3. *See also El Centro Villa Nursing Ctr. v. Taxation and Revenue Department*, 1989-NMCA-070, 108 N.M. 795. Therefore, the assessment issued to the Taxpayer is presumed to be correct, and it is the Taxpayer's burden to present evidence and legal argument to show that it is entitled to an abatement of the assessment.

The burden is on the Taxpayer to prove that it is entitled to an exemption or deduction. *See Public Services Co. v. N.M. Taxation and Revenue Dep't.*, 2007-NMCA-050, ¶ 32, 141 N.M. 520. *See also Till v. Jones*, 1972-NMCA-046, 83 N.M. 743. "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." *Sec. Escrow Corp. v. State Taxation and Revenue Dep't.*, 1988-NMCA-068, ¶ 8, 107 N.M. 540. *See also Wing Pawn Shop v. Taxation and Revenue*

Dep't., 1991-NMCA-024, ¶ 16, 111 N.M. 735. *See also Chavez v. Commissioner of Revenue*, 1970-NMCA-116, ¶ 7, 82 N.M. 97.

Gross Receipts Tax.

Anyone engaging in business in New Mexico is subject to the gross receipts tax. *See* NMSA 1978, § 7-9-4. Gross receipts tax applies to the total amount of money received from selling property or services. *See* NMSA 1978, § 7-9-3.5. It was undisputed that the Taxpayer was engaging in business and generally subject to the gross receipts tax.

Assessed transactions.

There was some dispute about what transactions were related to the assessment. Ms. Benjamin indicated that her understanding was that the assessment related to gross receipts from the Taxpayer's transactions with the State Bar. Ms. Varela indicated that her research indicated that the assessment was also related to other nonprofit businesses and some government entities that had transactions with the Taxpayer. However, Ms. Varela was unable to identify all of the other entities and was unable to specify what amount of gross receipts taxes would have applied to these other transactions. Ms. Benjamin reiterated her understanding and explained that the amount of the assessment corresponded with the amount of business that the Taxpayer did with the State Bar. Based upon the totality of the evidence, the assessment is likely related to the Taxpayer's gross receipts from its transactions with the State Bar and will be treated as such.

Tangible personal property.

Most of the arguments centered on whether the DVDs constituted "tangible personal property" that would be subject to the deduction *per se*. *See* NMSA 1978, § 7-9-60. The parties agree that the primary product for which the State Bar was paying was the video files on the DVDs (movies). "Tangible personal property" is not defined by the statutes. *See* NMSA 1978, §§ 7-1-3 and 7-9-3. Generally, "tangible personal property" is "corporeal personal property of any kind;

personal property that can be seen, weighted, measured, felt, or touched, or is in any other way perceptible to the senses". *Black's Law Dictionary*, 1337-8 (9th ed. 2009). "Tangible personal property" is included in the definition of "property". *See* NMSA 1978, § 7-9-3 (J). "Tangible personal property" is also included in the definition of "service" when it is included as part of a construction project. *See* NMSA 1978, § 7-9-3 (M). "Service" also includes "activities [that] involve predominantly the performance of a service as distinguished from selling or leasing property." *Id.*

The Department argues that the Taxpayer's production of the DVDs is predominantly the performance of service. The Department has promulgated a regulation in relation to determining if a transaction is predominantly a service. *See* 3.2.1.29 NMAC. The Department argues that the Taxpayer is not engaged in selling DVDs except in conjunction with the service of producing the movies and that the DVDs are incidental to the service and that the service is of greater value than the DVDs. *See id.*

The Taxpayer argues that the State Bar is paying for the movies, and that the movies are impossible to produce without a physical medium, like the DVDs. The Taxpayer analogizes its production of the movies to a dressmaker's production of a dress. The dress is the product of intensive labor by the dressmaker, from choosing fabric, making patterns, cutting fabric, piecing it together, and finally, sewing, but the end product that is the subject of the transaction is the dress, a piece of tangible personal property.

There do not seem to be any New Mexico cases that deal with this particular type of transaction, involving movies and tangible personal property. However, federal tax cases have long considered movies to be tangible personal property for purposes of taxation and applications of credit against taxes. *See Walt Disney Productions v. U.S.*, 480 F.2d 66 (9th Cir. 1973); *Walt Disney Productions v. U.S.*, 549 F.2d 576 (9th Cir. 1976); *Texas Instruments, Inc. v. U.S.*, 551 F.2d 599 (5th

Cir. 1977); and *Bing Crosby Productions, Inc. v. U.S.*, 588 F.2d 1293 (9th Cir.1979). Cases in other jurisdictions have also routinely found that movies are tangible personal property for tax purposes. *See Fla. Ass'n of Broadcasters v. Kirk*, 264 So.2d 437 (Fla. Dist. Ct. App. 1972); *Boswell v. Paramount Television Sales, Inc.*, 291 Ala. 490, 282 So.2d 892 (Sup. Ct. Ala. 1973); *Cinemark USA, Inc. v. Seest*, 190 P.3d 793 (Ct. App. Colo. 2008). Much as the Taxpayer analogizes, the courts have acknowledged that "[t]here is scarcely to be found any article susceptible to sale or rent that is not the result of an idea, genius, skill and labor applied to a physical substance." *Fla. Ass'n of Broadcasters*, 264 So.2d at 438. This is particularly true of movies, all of which are the product of extensive time and effort by the producers. When the item is a movie, the value of the item is not determined by the cost of the celluloid, film, disc, or material on which it is saved; rather, the value is the use of the movie. *See Boswell*, 282 So.2d at 894. Without the movie, the item would have no value to the purchaser. *See id.* Therefore, separating the finished movie from the raw materials on which it is saved would destroy the value of the product. *See id.* Colorado has adopted a totality of the circumstances test in determining whether an item should be considered tangible personal property or a service or an intangible. *See Cinemark*, 190 P.3d at 796. The factors include the comparative value of the item, the constraints on its use, and if the item represents a finished product. *See id.* When the item is a finished product in its final form, like a movie on film, the Colorado court concluded that the item is tangible personal property. *See id.* at 797. The federal courts have adopted a similar rationale and found that when the value of an item is dependent upon its information being embedded in a physical, tangible medium and the price of the item includes the value of the information so embedded, then the item is tangible personal property. *See Comshare Inc. v. U.S.*, 27 F.3d 1142, 1143 (6th Cir. 1994).

The Taxpayer's argument and the line of cases from federal and state courts are persuasive. The true value of the movies is in the State Bar's presentations. The Taxpayer's services in relation

to the movies are to bring a camera to the State Bar's presentations, to hit the record button, to hit the stop button, and to edit the footage a minimal amount so that dead time during breaks in the live presentation is not included in the movies. Therefore, the transactions between the State Bar and the Taxpayer do not require the performance of a service that is substantially greater in value than the tangible personal property. The Taxpayer's production of the movies is not predominantly a service because the Taxpayer's efforts have no value by themselves and the Taxpayer has no recompense without the movies being saved to a tangible medium. The DVDs have no value without the movies contained on them. Therefore, the DVDs are tangible personal property that would be covered by the NTTC in any event.

NTTCs.

A taxpayer engaged in business may be able to deduct certain gross receipts when they are provided with NTTCs from buyers. *See* NMSA 1978, § 7-9-43 (2011). A taxpayer should be in possession of NTTCs when the taxes from the transaction are due, but may also produce NTTCs within a deadline set by the Department. *See* NMSA 1978, § 7-9-43. The seller must accept the NTTC in good faith. *See id.* The Taxpayer produced a timely, properly executed NTTC for tangible personal property. There was no dispute that the NTTC was timely and properly executed. The Taxpayer trusted that the State Bar was using the items in a nontaxable manner, accepted the NTTC, and took the deductions accordingly. A properly executed NTTC "shall be conclusive evidence, and the *only material evidence*, that the proceeds from the transaction are deductible[.]" NMSA 1978, § 7-9-43 (A) (emphasis added). The word "shall" indicates that the provision is mandatory, not discretionary. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n.*, 2009-NMSC-013, ¶ 22, 146 N.M. 24.

The Department argued that the NTTC was not of the proper type and that an NTTC must be in the proper form and of the proper type to be valid. *See* 3.2.201.8 (D) NMAC (2001). *See also*

McKinley Ambulance Serv. v. Bureau of Revenue, 1979-NMCA-026, 92 N.M. 599 (noting that a NTTC is conclusive evidence only if the NTTC applies to the transaction at issue). *See also Arco Materials, Inc. v. State of New Mexico Taxation and Revenue Dep't.*, 1994-NMCA-062, 118 N.M. 12, *overruled on other grounds by Blaze Constr. Co. v. Taxation and Revenue Dep't.*, 1995-NMSC-110, 118 N.M. 647 (holding that the seller had a duty to know that a previously valid NTTC had been invalidated by a change in the statute that disallowed the previously allowed deduction). The Department argued that the Type 9 NTTC was for the sale of tangible personal property to a non-profit entity and that a similar deduction for sale of service to a non-profit entity does not exist. The Department argued that NTTCs were prohibited when the tangible personal property sold in a transaction that was predominantly a service. *See* 3.2.1.29 NMAC (2001). In its brief filed on March 4, 2016, the Department argued that the Type 9 NTTC could not render the taxable transaction into a nontaxable transaction and that "[t]he safe harbor provision of NMSA 1978, § 7-9-43(A) does not apply when a customer tenders a NTTC that does not apply to the transaction at issue."

Several cases indicate that a NTTC is conclusive evidence that the seller is entitled to take the deduction even when the buyer improperly issued the NTTC. *See Leaco Rural Tel. Coop. v. Bureau of Revenue*, 1974-NMCA-076, ¶ 22, 86 N.M. 269 (holding that the taxpayer was not entitled to deduct the sale of phone services as they were not tangible personal property, but also holding that the taxpayer was not liable for the tax because the NTTC that it accepted in good faith protected it from liability). *See also Continental Inn v. N.M. Taxation and Revenue Dep't.*, 1992-NMCA-030, ¶ 12-13, 113 N.M. 588 (holding that a NTTC represents to the seller that it is entitled to take a deduction and that the NTTC does not transform the taxable transaction into a nontaxable transaction but allows the Department to pursue the buyer for compensating tax). *See also Gas Co. v. O'Cheskey*, 1980-NMCA-085, ¶ 12, 94 N.M. 630 (holding that a NTTC does not transform a taxable

transaction into a nontaxable transaction and recognizing that a NTTC does serve to shift the burden of the tax to the buyer when the seller accepts a NTTC in good faith even though the buyer wrongly issued it).

The Taxpayer accepted the NTTC in good faith from the State Bar. The Taxpayer believed in good faith that it was selling tangible personal property that was deductible under the NTTC, and the safe harbor provision would apply even if the movies were predominantly the sale of a service. Therefore, the NTTC was accepted in good faith even if improperly issued and is conclusive evidence that the Taxpayer was entitled to take the deduction. *See* NMSA 1978, § 7-9-43 (A). However, the evidence and argument established that the movies were items of tangible personal property that were, in fact, deductible under the NTTC.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely written protest to the Notice of Assessment issued under Letter ID number L0257619264, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Taxpayer accepted a NTTC from the State Bar in good faith, and it is conclusive evidence that the Taxpayer was entitled to take the deduction. *See* NMSA 1978, § 7-9-43. *See also Leaco*, 1974-NMCA-076; *Continental Inn*, 1992-NMCA-030; *Gas Co.*, 1980-NMCA-085; and *Arco Materials*, 1994-NMCA-062.

C. The DVDs that the Taxpayer provided to the State Bar were tangible personal property and were covered by the NTTC. *See Walt Disney Productions*, 480 F.2d 66; *Cinemark*, 190 P.3d 793; and *Comshare*, 27 F.3d 1142.

D. The Taxpayer overcame the presumption of correctness and the burden shifted to the Department to establish that the assessments were correct. *See* NMSA 1978, § 7-1-17. *See also MPC Ltd. v. New Mexico Taxation and Revenue Dep't.*, 2003-NMCA-021, ¶ 13, 133 N.M. 217.

E. The Department failed to rebut the Taxpayer's evidence. *See MPC Ltd.*, 2003-NMCA-021; *Leaco*, 1974-NMCA-076; *Continental Inn*, 1992-NMCA-030; *Gas Co.*, 1980-NMCA-085; and *Arco Materials*, 1994-NMCA-062.

F. As the Taxpayer was entitled to deduct the gross receipts, no gross receipts taxes were owed and penalty and interest do not apply. *See* NMSA 1978, §§ 7-9-43, 7-1-69, and 7-1-67.

For the foregoing reasons, the Taxpayer's protest **is GRANTED and the assessment is HEREBY ABATED in full**.

DATED: April 6, 2016.

Dee Dee Hoxie

DEE DEE HOXIE
Hearing Officer
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