STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
BOGLE MANAGEMENT CO., INC., **No. 16-17**
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L0705077632

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on February 26, 2016 before Hearing Officer Dee Dee Hoxie. The Taxation and Revenue Department (Department) was represented by Ms. Elena Morgan, Staff Attorney. Ms. Milagros Bernardo, Auditor, also appeared on behalf of the Department. Mr. Buddy Burton, vice president of Bogle Management Co., Inc. (Taxpayer), appeared for the hearing with his attorney, Mr. Gary Eisenberg. The Hearing Officer took notice of all documents in the administrative file. The parties were given until March 25, 2016 to file their proposed findings of fact and conclusions of law. Both parties submitted timely proposals.

After the proposed findings were filed, the Hearing Officer issued a Notice of Bifurcation and gave the parties the opportunity to object and provide an alternative calculation. The parties filed a timely joint stipulated objection and provided the correct amounts for bifurcation. The Hearing Officer also issued an Order for Further Briefing. The supplemental briefing was due no later than May 6, 2016. Both parties filed a timely supplemental brief. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On December 19, 2007, the Department assessed the Taxpayer for gross receipts tax, penalty, and interest for the tax periods from January 31, 2000 through June 30, 2006.

The assessment was for tax principal of $338,079.42, penalty of $33,807.97, and interest of $194,142.58.

2. On January 24, 2008, the Taxpayer filed a formal protest letter.

3. The Administrative Hearings Office first learned of the protest on May 7, 2015. On that date, the Department filed a Request for Hearing asking that the Taxpayer's protest be scheduled for a formal administrative hearing.

4. The Taxpayer's protest was filed before the statutory change and was not required to be set within 90 days of the receipt of the protest. However, there was no evidence presented that justified a seven year delay in referring the protest for hearing.

5. On May 11, 2015, the Hearings Office issued a notice of hearing.

6. On June 2, 2015, the Taxpayer requested a continuance of the hearing due to a scheduling conflict. The Department did not oppose the request.

7. On June 4, 2015, the request for continuance was granted, and the delay of the hearing from that point was attributable to the Taxpayer.

8. On June 4, 2015, the Hearings Office sent amended notices of hearing. On June 24, 2015, the Hearings Office sent second amended notices of hearing.

9. On July 10, 2015, a telephonic scheduling hearing was held. The date for a hearing on the merits was selected and announced on the record.

10. On July 20, 2015, the Hearings Office issued a scheduling order and notice of hearing.

11. The Taxpayer is a corporation filed in Arizona that began its operations in 1976.

12. The Taxpayer was originally affiliated with two farming operations (the Farms) that are located and engaged in agricultural business in New Mexico. At the time of its incorporation, the Taxpayer was owned by the same people who owned the Farms.

13. The Taxpayer was first registered in New Mexico for gross receipts tax purposes in 1977.

14. The Taxpayer was created as a separate entity from the Farms in order to provide retirement plan benefits and a medical reimbursement plan for the managers of the Farms, which the Farms did not want to provide to its general employees. The managers relied on the relationship between the Farms and the Taxpayer to receive their retirement and medical benefits.

15. In 1997, Mr. Burton and his wife acquired 100% ownership of the Taxpayer. The Burtons were the owners and operators of the Taxpayer during the tax periods at issue.

16. Prior to acquiring ownership of the Taxpayer, Mr. Burton was providing all of the accounting services for the Farms and for the Taxpayer. Mr. Burton was aware of how the Farms and the Taxpayer interacted and the purposes of their association.

17. Effective January 1, 1998, the Taxpayer, under its new ownership, entered into a "Management Agreement" with each of the Farms (the Agreements).

18. In the Agreements, the Taxpayer agrees "to supply [the Farms] with knowledgeable and skilled persons to act as managers (the "Agricultural Managers") for the Agricultural Businesses." Exhibits "D" and "E".

19. At least twice more, the Agreements contain language that indicates that the Taxpayer will "supply" managers to the Farms. *See id.*

20. The responsibilities of the managers were also outlined in the Agreements. *See id.*

21. The Agreements set compensation for the Taxpayer "as a management fee an amount equal to 10% of the gross salary of the Agricultural Managers". *Id.*

22. The Agreements also indicated that the Farms would "reimburse" the Taxpayer for the payments that the Taxpayer issued to the managers, "including salary, the cost of

worker's compensation insurance, payroll taxes, pension benefits, group insurance and medical benefits and all other normal and reasonable costs required for the employment of the Agricultural Managers." *Id.*

23. The Agreements placed the ultimate responsibility of paying all costs associated with the managers' salaries and taxes on the Farms. *See id.*

24. The Agreements also indicated that the Farms would indemnify the Taxpayer against all claims relating to the management of the Farms, and that the Farms and Taxpayer were not joint venturers for any purpose. *See id.*

25. The Farms were required to make all payments to the Taxpayer, the reimbursements and the management fee, on a monthly basis. *See id.*

26. The Agreements were not to be modified or amended except in writing approved by both parties. *See id.*

27. All of the following findings are in reference to the tax periods at issue in the assessment.

28. The Taxpayer's owners were residing and working in Georgia. The Taxpayer had no physical offices in New Mexico.

29. The Taxpayer was providing payroll services for the Farms on the managers. The Taxpayer did all of its calculations and physical activities related to the payroll service in Georgia.

30. The Taxpayer paid the managers' compensation, withholding tax, and took care of the various benefits' programs. The Taxpayer issued the paychecks by mail to the Farms, and the Farms distributed the paychecks to the managers. At the end of the tax years, the Taxpayer issued W-2s to the managers.

31. As the entity in charge of issuing the managers' paychecks, the Taxpayer was required to pay the withholding taxes and to issue W-2s. Therefore, the Taxpayer is an employer of the managers.

32. The Taxpayer has a physical presence in New Mexico through the managers.

33. Generally, at least once per year, the Farms would send the Taxpayer a notice regarding the managers. The Farms dictated who would be considered as managers, who was no longer a manager, what each manager's salary would be, and if any existing manager's salary should be increased.

34. When the Farms notified the Taxpayer that the Farms had hired or promoted a new manager, the Taxpayer would send that manager a notice of eligibility for the medical reimbursement plan. After the manager served for a year, the Taxpayer would also send the manager a pension plan enrollment form. These documents, along with the W-2s, were the only direct communication that the Taxpayer ever had with the managers.

35. The Taxpayer did not recruit, interview, hire, promote, or fire any of the managers at the Farms. There were no formal agreements between the Taxpayer and the managers.

36. The Taxpayer did not determine the starting salaries or raises in salaries of the managers.

37. The Taxpayer did not give instructions to the managers, did not direct any of the managers' activities, and did not provide any equipment or supplies to the managers.

38. The Farms notified the Taxpayer of all changes that the Farms wanted to make in salary and employment, and the Taxpayer adjusted the payroll according to the Farms' wishes.

39. The Farms controlled and supervised all of the work performed by the managers.

40. In 2007, the Taxpayer was audited by the Department. The Department concluded that the Taxpayer was engaged in business in New Mexico via its managers at the Farms and assessed it for gross receipts taxes, penalty, and interest.

41. The assessment of gross receipts taxes included the amounts related to the management fees and the amounts related to the payroll reimbursements.

42. The parties agreed that the assessed amount of gross receipts tax attributable to the management fees was $23,172.92, and the amount of gross receipts tax attributable to the payroll reimbursements was $314,906.50.

43. There was no evidence that the Department of Labor had made a determination finding that the Taxpayer and the Farms were joint employers.

DISCUSSION

The issue to be decided is whether the Taxpayer is liable under the assessment.

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.

Timeliness of the Hearing.

The Taxpayer filed its protest on January 24, 2008. The Administrative Hearings Office (AHO) first learned of this protest when the Department referred the Taxpayer's protest to the

AHO on May 7, 2015, more than seven years after the protest was filed. The AHO promptly set the hearing. The Taxpayer argued that the Department's delay was inherently unreasonable. The Taxpayer argued that the protest should be granted or that the Department should be penalized for its inherently unreasonable delay. The Department offered no justification for the delay.

In 2008, there was not a strict statutory deadline or time frame within which a hearing must be held. *See* NMSA 1978, § 7-1-24 (2003). Currently, a hearing must be set within ninety days of the protest. *See* NMSA 1978, § 7-1B-8 (2015). However, there is no statutory or regulatory authority for the Hearing Officer to dismiss a previously filed protest for unreasonable and unjustified delays. *See id. See also* 3.1.8.8 and 3.1.8.9 NMAC. Another taxpayer previously argued that the Department denied it the statutory right to a prompt hearing on its protest. *See Ranchers-Tufco Limestone Project Joint Venture v. Revenue Div.*, 1983-NMCA-126, ¶ 12, 100 N.M. 632. That argument ultimately failed. *See id.* at ¶ 13 (holding that public officers' failure to timely carry out their duties is not a defense to an action by the state and that the statute does not provide a remedy for failure to set a hearing promptly). *See also Kmart Properties, Inc. v. Taxation and Revenue Dep't.*, 2006-NMCA-026, ¶ 54, 139 N.M. 177 (noting that tardiness in performing duties is not a defense to an action taken by the state). As there was not a statutory or regulatory violation in failing to refer the Taxpayer's protest for such an extended period of time, there is no administrative remedy that can be granted.

Gross Receipts Tax.

Services performed within the State of New Mexico are subject to the gross receipts tax. *See* NMSA 1978, § 7-9-3.5 (2007). *See also* 3.2.1.18 (A) NMAC (2003). Engaged in business means "carrying on or causing to be carried on any activity with the purpose of direct or indirect

benefit". NMSA 1978, § 7-9-3.3 (2003). The Taxpayer argued that all of its services were performed in Georgia and that it was not subject to the gross receipts tax. The Department argued that the Taxpayer had employees, the managers, who were performing services in New Mexico and that the Taxpayer was subject to the gross receipts tax. Supplying employees whose services are performed in New Mexico is sufficient to establish that the Taxpayer was engaging in business in New Mexico. *See* NMSA 1978, § 7-1-14. *See also* 3.1.4.13 (G) NMAC. *See also Dell Catalog Sales L.P. v. Taxation and Revenue Dep't,* 2009-NMCA-001, 145 N.M. 419. Therefore, the Taxpayer was subject to the gross receipts tax.

Management fees.

The Taxpayer argued that even if it were doing business in New Mexico, its payments from the Farms were excluded from gross receipts tax because the Taxpayer was acting as a disclosed agent on behalf of the Farms. *See* NMSA 1978, § 7-9-3.5 (A) (3) (f) (2007). Even if the Taxpayer were acting as a disclosed agent for purposes of providing payroll to the managers, the Taxpayer was not acting as an agent for the Farms in receipt of management fees. The fees belonged solely to the Taxpayer and were paid in exchange for the Taxpayer's provision of the managers and their payroll. Consequently, the management fees are clearly subject to gross receipts tax.

Disclosed agency and Regulation 3.2.1.19.

The parties both argued on Regulation 3.2.1.19. The Hearing Officer ordered further briefing on that regulation to give the parties the opportunity to make a thorough and complete record since a different version of the regulation was in effect during the tax years in question. *See Kewanee Industries, Inc. v. Reese*, 1993-NMSC-006, ¶ 24, 114 N.M. 784 (indicating that the regulations that were in effect at the time that the tax was due are the appropriate ones to apply).

There is an exclusion from gross receipts for "amounts received solely on behalf of another in a disclosed agency capacity". NMSA 1978, § 7-9-3.5 (A) (3) (f) (2007) and previously NMSA 1978, § 7-9-3 (1997). 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. Regulation 3.2.1.19 interprets what constitutes receipts of disclosed agents.

Subsection (C).

The current version and the previous versions of Regulation 3.2.1.19 all address reimbursed expenditures in subsection C. *See* 3.2.1.19 (C) NMAC (2000, 2003, and 2010). Reimbursement of expenditures in connection with the performance of a service are considered to be gross receipts, which are subject to tax. *See id.* However, the reimbursements are not considered to be gross receipts if the expense is incurred by an "agent on behalf of the principal while acting in a *disclosed* agency capacity." *Id.* (emphasis added). The agent is also required to keep its books in a way that reflects that the reimbursements are expenses and not revenue, and the expenses are required to be separately stated on the billing. *See id.* If these specific bookkeeping requirements are not met, then the reimbursements are included in gross receipts. *See id.*

The Taxpayer argued that it was a disclosed agent of the Farms because the Farms were ultimately responsible for the payment of the managers' wages and the Farms were required to indemnify the Taxpayer. The Taxpayer argued that its communications with the managers and the long-standing relationship between the Taxpayer and the Farms is sufficient to show that the managers knew or should have known that the Taxpayer was acting on behalf of the Farms. The Department argued that the Taxpayer failed to prove that it could bind the Farms in an agreement with a third party. The Department argued that the Taxpayer failed to establish that it satisfied the bookkeeping requirements. The Department argued that the Taxpayer failed to prove that it had disclosed itself as an agent. The Department argued that the managers' purported knowledge is not sufficient without evidence of actual disclosure.

Prior to the amendment of the statute, an agent did not have to be disclosed for purposes of exclusion from gross receipts. *See Carlsberg Mgmt. Co. v. State of New Mexico Taxation and Revenue Dep't,* 1993-NMCA-121, 116 N.M. 247. However, the legislature amended the statute, and beginning in 1997, the exclusion applied only to disclosed agents. *See* NMSA 1978, § 7-9-3 (1997) and current § 7-9-3.5. Disclosure requires "making known something that was previously unknown; a revelation of facts". *Black's Law Dictionary* 531 (9th ed. 2009). The Taxpayer's communication with the managers was very limited. The Taxpayer's only substantive contact with the managers was when it sent and received forms on benefits enrollment during the first year of a manager's employment. Those enrollment forms did not inform the managers about the Taxpayer's relationship with the Farms and did not inform the managers that the Farms were ultimately responsible for the payment of the managers' wages. An employee's awareness of the relationship between two companies is not sufficient to show that the employee knew or was told that the employee could enforce a payroll obligation against another entity. *See MPC LTD v.*

New Mexico Taxation and Revenue Dep't, 2003-NMCA-021, ¶ 38, 133 N.M. 217. There must be an affirmative disclosure to the employee of the agency relationship. *See id.* at ¶ 37. As there was no evidence that the managers were so informed, there is not sufficient evidence to establish that the Taxpayer was a disclosed agent as required by the statute and by subsection (C) of Regulation 3.2.1.19. Moreover, there was no evidence presented to establish that the Taxpayer satisfied all of the bookkeeping requirements.

Subsection (E).

During the tax years in question, the regulation also contained a special provision interpreting disclosed agency in the context of employee leasing. *See* 3.2.1.19 (E) NMAC (2000 and 2003). The current version of the regulation has eliminated this subsection. *See* 3.2.1.19 NMAC (2010). A party engaged in employee leasing in New Mexico is engaged in business in New Mexico and the receipts from the employee leasing are subject to gross receipts tax. *See* 3.2.1.19 (E) (2000 and 2003). However, the receipts from employee leasing will not be subject to the gross receipts tax if the party engaged in employee leasing is a " 'joint employer', as that term is used by the United States department of labor for purposes of enforcing federal labor law….Such receipts instead are receipts of a disclosed agent on behalf of others." *Id.*

The Department argued that the Taxpayer was not a "joint employer" for federal labor law purposes. The Taxpayer argued that it was a "joint employer" under 29 C.F.R. 791.2 (1961). The Taxpayer also argued that the department of labor has published a general guideline for determining "joint employer" status, and that the Taxpayer meets the criteria under the economic realities.

The regulation interprets the statute to mean that a finding that a party is a "joint employer" for federal law purposes is sufficient to show agency as well as disclosure. *See MPC,*

2003-NMCA-021, ¶ 37. The taxpayer in *MPC* also cited to 29 C.F.R. 791.2 and to a general opinion letter by the department of labor regarding "joint employers" and economic realities. *See id.* at ¶ 16. Ultimately, the court found that the taxpayer was not in the employee leasing business, so its status as a joint employer was moot. *See id.* at ¶ 39. However, the court indicated that it was highly unlikely that the regulation intended to instigate a full-scale trial on whether a taxpayer was a "joint employer" for federal purposes. *See id.* at fn. 3. The court indicated that a determination of joint employer status by the department of labor appeared to be necessary. *See id.* "At the very least, something more than…listing of 'economic realities' and calling our attention to fairly general [department of labor] documents is required to establish joint employer status." *Id.* Although it is *dicta*, the court's analysis is consistent with the requirements of disclosed agency. There was no evidence that the Taxpayer and the Farms were determined to be joint employers by the department of labor. Without some sort of public determination of joint employers, there is insufficient evidence to establish disclosure as required by the statute and contemplated by the regulation. Consequently, the Taxpayer has failed to overcome the presumption, and its receipts of the payroll reimbursements are subject to the gross receipts tax.

Assessment of Penalty.

A taxpayer's lack of knowledge or erroneous belief that the taxpayer did not owe tax is considered to be negligence for purposes of assessment of penalty. *See Tiffany Const. Co., Inc. v. Bureau of Revenue*, 1976-NMCA-127, 90 N.M. 16. However, no penalty is owed when the failure to pay the tax "results from a mistake of law made in good faith and on reasonable grounds." NMSA 1978, § 7-1-69 (B). A mistake of law is a mistake about the legal effect of a known fact. *See State v. Hubble*, 2009-NMSC-014, ¶ 22, 146 N.M. 70 (quoting from

dictionary). The Taxpayer made a mistake of law. The Taxpayer believed in good faith and on reasonable grounds that the long-standing relationship of the Farms, the managers, and the Taxpayer, and the economic realities of their arrangements were sufficient to make the Taxpayer a disclosed agent of the Farms. Therefore, the penalty is hereby abated.

Assessment of Interest.

Interest "shall be paid" on taxes that are not paid on or before the date on which the tax is due. NMSA 1978, § 7-1-67 (A). The word "shall" indicates that the assessment of interest is mandatory, not discretionary. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n.*, 2009-NMSC-013, ¶ 22, 146 N.M. 24. The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Because the tax was not paid when it was due, interest was properly assessed.

Administrative costs.

A taxpayer is entitled to an award of administrative costs for pursuing a protest if the taxpayer is the prevailing party. *See* NMSA 1978, § 7-1-29.1. To be a prevailing party, a taxpayer must substantially prevail with respect to the amount in controversy or with respect to the issues involved. *See* NMSA 1978, §7-1-29.1 (C) (1). However, even a taxpayer who is a prevailing party shall not be treated as such if the Department can establish that its position "in the proceeding was based upon a reasonable application of the law to the facts of the case." NMSA 1978, §7-1-29.1 (C) (2). In this case, the Taxpayer is not the prevailing party. The Taxpayer failed to overcome the presumption with respect to the majority of the assessment and did not prevail with respect to the issues. The Department's position was also supported by the law. Therefore, no administrative costs are awarded.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely written protest to the Assessment issued under Letter ID number L0705077632, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Taxpayer was engaged in business in New Mexico by supplying managers to the Farms. *See* NMSA 1978, § 7-9-3.3 and § 7-1-14. *See also* 3.1.4.13 (G) NMAC. *See also Dell Catalog Sales*, 2009-NMCA-001.

C. The Taxpayer was not a disclosed agent of the Farms, and all of its receipts were subject to the gross receipts tax. *See* NMSA 1978, § 7-9-3.5. *See also* 3.2.1.18 (A) and 3.2.1.19 NMAC. *See also MPC*, 2003-NMCA-021.

D. The Taxpayer's position was a mistake of law made in good faith and on reasonable grounds. Therefore, penalty is HEREBY ABATED. *See* NMSA 1978, § 7-1-69 (B).

E. The Taxpayer is not the prevailing party, and no administrative costs will be awarded. *See* NMSA 1978, § 7-1-29.1.

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

DATED: May 16, 2016.

Dee Dee Hoxie

DEE DEE HOXIE
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