

**STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT**

**IN THE MATTER OF THE PROTEST OF
YELLOWHOUSE MACHINERY COMPANY
TO DENIAL OF REFUND ISSUED UNDER
LETTER NO. L0980206128**

No. 16-33

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on May 31, 2016 before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Melinda L. Wolinsky, attorney for the Department. Nicholas Pacheco, protest auditor, appeared and testified as a witness for the Department. Yellowhouse Machinery Company (“Taxpayer”) appeared and was represented Troy Harrison, CPA. Witnesses testifying on behalf of Taxpayer were Tracy Thompson, Chief Financial Officer, Rod Thompson, Comptroller, and Jarod L. Standlee, Sales Manager. The record was held open for the filing of briefs which were filed on June 10, 2016 and June 14, 2016.

The Exhibits introduced into the record are Exhibits #1-12 and A and B. The Application for Refund was also included in the record. In addition to the pleadings and filings referred to in the Findings, the record contains the Notice of Telephonic Scheduling Conference issued on March 11, 2016; Scheduling Order and Notice of Administrative Hearing issued on April 1, 2016 setting the hearing for May 11, 2016; Notice of Reassignment of Hearing Officer of Administrative Hearing issued on April 8, 2016; Request for continuance filed by Taxpayer on April 22, 2016; Amended Scheduling Order and Notice of Administrative hearing setting hearing

for May 31, 2016 issued on April 27, 2016; Certificate of Service filed on April 29, 2016; Second request to continue the hearing filed by Taxpayer on May 3, 2016; Amended Notice of Administrative Hearing issued on May 5, 2016 moving the time of the hearing to 1:00 p.m.; Statement filed by Taxpayer on May 11, 2016; New Mexico Taxation and Revenue's Response to Letter Dated May 11, 2016 to the Hearing Officer; Taxpayer's Brief filed on June 10, 2016 and the New Mexico Taxation and Revenue Department's Closing Argument filed on June 14, 2016.

Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On December 10, 2015, Taxpayer applied for a refund of gross receipts tax in the amount of \$89,636.51 for tax period January 1, 2012 through December 31, 2012.
2. On December 21, 2015, the Department denied the refund because Taxpayer's receipts were not deductible under Section 7-9-52.1 Deduction Gross Receipts Tax Lease of Construction Equipment to Persons Engaged in the Construction Business. **[Letter ID No. L0980206128]**.
3. Taxpayer protested the denial of the refund on January 22, 2016.
4. The Department acknowledged the protest on February 1, 2016. **[Letter ID No. L1432572464]**.
5. The Department requested a hearing with the Administrative Hearings Office on March 10, 2015.
6. Taxpayer is incorporated in the state of Texas and is a John Deere franchise. **[CD 05/31/16, 23:10-23:20]**.

7. Taxpayer has six locations in Texas, four locations in Oklahoma and no locations in New Mexico. **[CD 05/31/16, 23:19-23:29]**.

8. Taxpayer has been in business since 1958. **[CD 05/31/16, 23:42-23:50]**.

9. Taxpayer sells and rents (leases) tractors, sells parts and provides repair services on tractors. **[CD 05/31/16, 23:31-23:41]**.

10. Taxpayer is registered in New Mexico and has been paying gross receipts tax on its sales to Ferguson Construction Inc. (“Ferguson”). **[Exhibit #1]**.

11. The receipts at issue are from either payments from leases with an option to purchase or sales to Ferguson. Ferguson is located in Lovington, New Mexico. **[Exhibits #2 and #4]**.

12. Ferguson is a pipeline company for the oil and gas industry and conducts business in the Permian Basin, which is located in the southeastern portion of New Mexico and into southwestern portion of Texas. **[CD 05/31/16, 24:00-24:34]**.

13. Ferguson purchased, through a lease with an option to purchase, side boom tractors, excavators, a loader backhoe, a dozer, and a motor grader. **[Exhibit #4-1 through #4-7]**.

14. Taxpayer leased other tangible personal property to Ferguson, like heavy machinery, e.g., bulldozers, backhoes, hydraulic hammers, hydraulic excavators and motor graders. **[Exhibit #2-1 through #2-189]**.

15. The goods leased or purchased by Ferguson, like side boom tractors, excavators, loader backhoes, dozers, motor graders, bulldozers, hydraulic hammers and hydraulic excavators are collectively referred to as “equipment.”

16. Ferguson entered into a lease agreement with Taxpayer for the lease of the

equipment with an option to purchase the equipment. The equipment was either returned to Taxpayer when Ferguson no longer needed it or the equipment was purchased by Ferguson. The lease agreements were for an indefinite term and each monthly lease was not a “renewal” of the lease. **[Exhibit #3]**.

17. Not all the leased items were purchased by Ferguson. **[Exhibit #4-1 through #4-7 are the purchased equipment for tax year 2012]**.

18. If a piece of equipment was leased first, the lease payments were applied to the purchase price. **[Exhibit #4-2, #4-2, #4-5, and #4-7 and CD 05/31/16, 25:29-25:44]**.

19. Ferguson’s employees called in equipment orders to Taxpayer and Taxpayer processed the orders. Payment was billed to Ferguson. **[CD 05/31/16, 53:14-53:25]**.

20. The lease or sale invoices were created in Lubbock after the order was placed on the telephone. **[CD 05/31/16, 1:19-1:20]**.

21. On all items that were leased or purchased by Ferguson, Ferguson picked up the items at Taxpayer’s Lubbock store by using Ferguson’s own haulers to transport the equipment. **[CD 05/31/16, 25:06-25:26]**.

22. The invoices with Ferguson state that the equipment will be “ship to” Ferguson’s office in New Mexico. **[Exhibit #2]**. The testimony was credible that the “ship to” portion of the invoice was “regular” or “automatically done” on a preprinted form that was generated from the system. **[CD 05/31/16, 1:21-1:22]**.

23. Lubbock, Texas is approximately two hours from Lovington, New Mexico. **<https://www.mapquest.com/directions/list/1/us/nm/lovington-282037492/to/us/texas/lubb>** **(06/26/16)]**.

24. Taxpayer paid gross receipts tax to New Mexico on all the lease payments and the sale amounts of equipment to Ferguson during the tax years at issue. **[Exhibit #6].**

25. Ferguson is a large company with plenty of service vehicles to repair the equipment leased or purchased from Taxpayer. Taxpayer did not repair any of the equipment leased or sold to Ferguson. Taxpayer searched its records to determine whether it had any service records for Ferguson and found none. **[CD 05/31/16, 27:26-28:39].**

26. Taxpayer has no employees, no representatives, no offices, and no ownership of tangible personal property (inventory) in New Mexico.

27. Taxpayer is not sure where Ferguson used the equipment, but maybe somewhere in the Permian Basin. **[CD 05/31/16, 29:30-28:32].**

28. Sometime in 2014, the state of Texas (“Texas”) completed an audit of Taxpayer. **[Exhibit #1].**

29. Prior to the audit, Taxpayer had not paid sales tax to Texas on the lease payments from Ferguson or the sales to Ferguson because it paid the gross receipts tax to New Mexico. **[Exhibit #1, page 1 of 36 through 36 of 36].**

30. Texas determined that all sales that had a destination point or a delivery point of Texas were Texas sales and all lease payments where delivery was in Texas, were also Texas sales taxable in Texas. **[Exhibit #1, pages 1 of 36 through 36 of 36].**

31. Texas described the **location** of Ferguson as Lubbock. **[Exhibit #1, pages 1 of 36 through 36 of 36 and Exhibit #5-1].**

32. Taxpayer was assessed by Texas for the Ferguson sales and lease payments and it paid the sales tax on the Ferguson sales and lease payments. Taxpayer provided a copy of the

check payable to Texas. **[Exhibit #1, pages 1 and 4 and Exhibit #7]**.

33. Texas took the position in the audit that under Section 151.330(a) ...“when a customer picks up good in Texas and removes them from the state, the transaction is simply not covered by the exemption and is, thus, taxable.” **[Exhibit #5-1]**.

34. During the hearing, the Hearing Officer reviewed a sample of the invoices, the Texas audit (item 450), and the amounts requested for refund. The amounts requested in the refund are the same amounts that Taxpayer previously paid gross receipts tax to New Mexico and subsequently paid sales tax to Texas. **[Exhibits #1, page 1 of 36 through 36 of 36, #2 and #7 and CD 05/31/16, 1:33-1:47]**.

35. Taxpayer billed Ferguson for the Texas sales tax it paid but provided them with a credit of the gross receipts tax Ferguson already paid. **[Exhibit #9]**. Taxpayer wrote off the difference between the New Mexico gross receipts tax amount and the higher sales tax from Texas.

36. Taxpayer had an ongoing relationship and long history with Ferguson and did not solicit orders from them. **[CD 05/31/16, 32:00-32:09 and 58:59]**.

37. Taxpayer had other customers in New Mexico and delivered and repaired equipment to some of its customers in New Mexico (not to Ferguson), but it was unclear when this occurred or how often. **[CD 05/31/16, 31:21-32:00]**.

38. The only New Mexico customer that Texas included in its audit for sales tax is Ferguson. **[Exhibit #1, pages 1-22 through 1-76]**.

39. Taxpayer stated that it had nexus with New Mexico because it was doing business in New Mexico. **[Taxpayer’s U.S. Commerce Clause and How it Supports the Refund, page**

1].

40. The authorized dealer for John Deere equipment in New Mexico is 4 Rivers Equipment, a Colorado corporation. [CD 05/31/16, 26:32-26:44; [www.https://portal.sos.state.nm.us/BFS/online/CorporationBusinessSearchCorporationBusinessInformation?businessId=343095](https://portal.sos.state.nm.us/BFS/online/CorporationBusinessSearchCorporationBusinessInformation?businessId=343095) (0628/13)].

41. Taxpayer and 4 Rivers are not interrelated companies. [[www.https://portal.sos.state.nm.us/BFS/online/CorporationBusinessSearch](https://portal.sos.state.nm.us/BFS/online/CorporationBusinessSearch) CorporationBusinessInformation?businessId=343095 (0628/13)].

42. The only transactions that Taxpayer is requesting a refund are the receipts from Ferguson.

DISCUSSION

The issue to be decided in this case is whether Taxpayer owes gross receipts tax on the sale of equipment to Ferguson and on the lease payments of equipment from Ferguson, a New Mexico company, and if not, then is Taxpayer entitled to a refund. The Department argued that Taxpayer owes both gross receipts tax and Texas sales on the sale of the equipment to Ferguson and on the receipts from the lease payments received from Ferguson. The Department argued that Taxpayer's record keeping was poor because it did not know where Ferguson used the equipment and that the Texas audit is incorrect. Taxpayer argued that it is entitled to a refund because under the Commerce Clause, it cannot be charged tax by two different states on the same transaction.

Burden of Proof

Regulation 3.1.8.10(A) provides that (t)he taxpayer shall have the burden of proof, except as otherwise provided by law.

Did the Legislature Intend to Tax Yellowhouse's Underlying Receipts?

Sales of Equipment

When an interstate transaction occurs, the *Kmart Corp.* case should be applied to the transaction to determine whether the sale is taxable in New Mexico.¹ In *Kmart Corp. v. N.M. Taxation & Revenue Dep't.*, 2006-NMSC-006, ¶11, 139 N.M. 172, 131 P.3d 22, the New Mexico Supreme Court set out a two-part analysis to determine whether the gross receipts tax applies in multistate transactions. The first part of the test is whether the Legislature intended to tax the sale of products from Taxpayer, an out of state corporation, to customers in New Mexico.

Generally speaking NMSA 1978, Section 7-9-2 (1966) provides that the Gross Receipts Tax Act is intended to "provide revenue for public purposes by levying a tax on the privilege of engaging in certain activities within New Mexico and to protect *New Mexico businessmen from the unfair competition that would otherwise result from the importation into the state of property without payment of a similar tax.*" (emphasis added). "Gross receipts" is defined as "the total amount of money or the value of other consideration received from selling property in New Mexico." NMSA 1978, Section 7-9-3.5(A)(1) (2007). In *Dell Catalog Sales, LP v. N.M. Taxation & Revenue Dep't.*, 2009-NMCA-001, ¶30, 145 N.M. 419, 199 P.3d 863, the court held that for purposes of determining whether an interstate transaction is a taxable sale under gross receipts tax law, the "destination principle" applies. The "destination principle" is defined as taxing the sale of goods that cross state lines at the point of destination or where the goods are consumed, which may be different from the point of delivery and where title is transferred. Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶18.02[1]. In *Dell*, the assumption is that the goods are

¹ A lease purchase agreement may be treated as a sale. 3.2.1.15 NMAC (2/29/12).

consumed at the destination. *Dell Catalog Sales, LP*, 2009-NMCA-001, ¶28. It is clear from *Dell* that if an out-of-state seller sells goods that are delivered in New Mexico, and consumed in New Mexico, then gross receipts tax applies on the sale of the goods.

However, the *Dell* court also found that its analysis did not “apply in cases where the entire transaction occurs out-of-state and the parties are present out-of-state at the time and place of the transaction.” *Dell Catalog Sales, LP*, 2009-NMCA-001, ¶25. The court concluded that “in those circumstances, the transaction is clearly not a sale “in NM’ for purposes of the Act.” *Dell Catalog Sales, LP*, 2009-NMCA-001, ¶25. We know that the orders were placed on the telephone, and that the lease or purchase agreements were finalized in Lubbock, Texas. We also know that the equipment was picked up or Ferguson took possession in Lubbock, Texas. We know that the equipment was transported somewhere in the Permian Basin. This fact is difficult to ascertain since the Permian Basin knows no geographic taxing boundary. The leading treatise on state and local taxation argues that the crucial factor is where does the buyer take *possession* of the good. Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶18.02[1].

The courts are somewhat split over these interstate transactions where the use or consummation of tangible personal property is different from the destination. In *Williams Rentals, Inc. v. Tidwell*, 516 SW 2d 614, 616 (Tenn. 1974) (quoting *Central Transport Co. v. Atkins*, 202 Tenn. 512, 305 SW 940, 942 (1956), cert. denied, 355 U.S. 912, 78 S. Ct. 343 (1958) the Tennessee court upheld a sales tax on rental receipts from a lease of construction equipment where the equipment was delivered in Tennessee and the lease agreement was entered into in Tennessee. However, the equipment was transported for use in job sites in Arkansas and Mississippi. The court held that the sale occurred in Tennessee because the equipment was delivered in Tennessee

and the lease agreements were entered in Tennessee. *But see, Commercial Leasing, Inc. v. Johnson*, 160 Me. 32, 197 A2d 323, 329 (1964) (the lease payments are only taxable to the state where the trailers were used and not purchased, but if the trailers are returned to the originating state for repairs, then the lease payments are taxable to the originating state). Most states provide a credit for payment of tax to another state which obviates the risk of different taxing jurisdictions imposing a tax on the same transaction. New Mexico provides a credit of compensating tax if a gross receipts, sales, compensating or similar tax has been levied by another state or political subdivision thereof on the transaction under NMSA 1978, Section 7-9-79 (1991).² In addition, New Mexico allows a deduction for receipts from transactions in interstate commerce if the tax would be unlawful under the United States Constitution. NMSA 1978, §7-9-55 (1993).

Regardless, the goods cannot be sold in more than one state (there is no apportionment based on use of a product). Since the orders were placed in Texas, the seller is in Texas, the possession of the equipment occurred in Texas, the purchase agreements were finalized in Texas, the sales occurred in Texas. The receipts from the sale of equipment to Ferguson are receipts from sales occurring in Texas.

Lease Payments

The Department argued that regulation 3.2.1.17 NMAC (2/29/12) supports the proposition that the lease payments from Ferguson to Taxpayer are taxable gross receipts because the equipment was employed in New Mexico. Regulation 3.2.1.17(A)(1) provides that “receipts derived from the rental or leasing of property employed in New Mexico are subject to gross receipts tax.” Regulation 3.2.1.17(A)(1) interprets the general provision under Section 7-9-3.5(A)

² The Department alleged that there was no credit available to Taxpayer, which is true if the gross receipts tax is applied. If the compensation tax is applied, then there is a credit to the buyer whom the tax is imposed upon available under Section 7-9-79.

(1) that gross receipts includes leasing property employed in New Mexico. Both Section 7-9-3.5 and regulation 3.2.1.17(A)(1) require that the leased property be employed in New Mexico. Regulation 3.2.1.17(D)(2) provides a complicated formula for apportioning the multi use of leased equipment in a multistate transaction. Regulation 3.2.1.17(D)(3) provides that “(t)he department will allow a person engaged in the business of leasing property employed both within and without New Mexico to use other methods of apportioning the receipts of such leasing activities upon showing that the other methods more accurately reflect the portion of employment of leased items within New Mexico.” Thus, at best Taxpayer is refunded a portion of the receipts from the leases of equipment under the Department’s argument.

The Hearing Officer found the testimony of Taxpayer’s witnesses very credible that they believed that the equipment was being leased to be used or employed in the Permian Basin and there was no way it could know where the equipment was being employed. Since the regulation contemplates the taxpayer apportioning based on the lessee’s activities, the Hearing Officer accepts Taxpayer’s apportionment of the use occurring entirely outside New Mexico. While the Department argued that Taxpayer had poor record keeping, it is unclear how Taxpayer was required to track the use of the equipment in the Permian Basin.

The Department also argued that the Texas audit is incorrect and Taxpayer should ask for a refund of the Texas sales tax and not of the New Mexico gross receipts tax on both the sale and lease payments received by Taxpayer. The Department submitted a rule from Texas’ Administrative Code, rule §3.294 to stand for the proposition that Texas is incorrect in taxing the lease payments because many of the lease payments are “renewals.”³ In reading rule §3.294(f)(1)

³ The Department provided no legal argument as to why the monthly lease payments constituted a “renewal” of the lease. The lease agreements were for an indefinite term until the equipment was returned or purchased.

(A), the rule states that the lessor or Taxpayer is responsible for paying the tax on the lease payments regardless of where the leased goods were used, so long as the person leasing the property taxes delivery in the state. The Department's own evidence does not support the Department's position.

The information provided by Ms. Laura Lane, CPA for Texas, deals only with sales and states that the Texas Tax Code applicable is Section 151.330(a) which provides that "(w)hen the customer picks up the goods in Texas and removes them from the state, the transaction is simply not covered by the exemption and is, thus, taxable." This Section dovetails with the aforementioned rule. As for the sales, it appears as if the exemption from sales tax cannot apply to the Ferguson transactions because Ferguson took possession or delivery of the goods in Texas. The Hearing Officer is unable to make a finding regarding whether the Texas sales tax was applied appropriately to the receipts from Ferguson and takes no position on whether the Texas sales tax was applied correctly.

The Hearing Officer does not rule on the issue of whether compensating tax is due on the buyer or Ferguson, who purchased and used the equipment and whether Taxpayer should be an agent for compensating tax on its transactions with New Mexico customers. The Gross Receipts and Compensating Tax Act, NMSA 1978, Sections 7-9-1 to 114 (1966, as amended through 2011), imposes a compensating tax on the buyer or the person using property "acquired inside or outside of this state as a result of a transaction with a person located outside of this state that would have been subject to the gross receipts tax had the tangible personal property been acquired from a person with nexus with New Mexico" NMSA 1978, Section 7-9-7(A)(2)(2011). Compensating tax is imposed when gross receipts tax cannot be imposed because the seller has no nexus with New Mexico and the

goods are destined for New Mexico and used in New Mexico. In *Dell Catalog Sales, LP*, 2009-NMCA-001, ¶30, the court used the same “destination principle” to apply to transactions taxable under the compensating tax. New Mexico provides a credit of compensating tax if a gross receipts, sales, compensating or similar tax has been levied by another state or political subdivision thereof on the transaction under NMSA 1978, Section 7-9-79. This matter is for the Department to develop and make its determination. If a compensating tax is owed, Ferguson is entitled to a credit of the (revised) sales tax it paid to Taxpayer under Section 7-9-79.

CONCLUSIONS OF LAW

- A. Taxpayer filed a timely written protest to the Department’s denial of claim for refund issued under Letter Id No. L0980206128 and jurisdiction lies over the parties and the subject matter of this protest.
- B. The hearing was timely set as required by NMSA 1978, Section 7-1B-8(A) (2015).
- C. Holding the April 1, 2016 telephonic scheduling hearing satisfied the 90-day hearing requirement found in NMSA 1978, Section 7-1B-8 (2015).
- D. Pursuant to regulation 3.1.8.10(A) NMAC (8/30/01), it is Taxpayer’s burden to come forward with evidence and legal argument to establish that it was entitled to a refund.
- E. Taxpayer sold equipment to Ferguson in Texas during the tax period at issue under a lease with an option to purchase agreement, and the sale transactions did not occur in New Mexico.
- F. Ferguson leased equipment from Taxpayer during the tax period at issue and Taxpayer apportioned the lease payments outside New Mexico based on the information it had.
- G. Ferguson took possession of the equipment from Taxpayer in Lubbock, Texas,

where the lease agreements with option to purchase were entered into and finalized.

H. The equipment was consumed or used in the Permian Basin, which encompasses both New Mexico and Texas.

I. After Texas conducted an audit of Taxpayer, Taxpayer paid sales tax to Texas on the transactions with Ferguson and it applied the sales tax to Ferguson's invoices, writing off the difference in the higher sales tax in Texas.

J. Taxpayer paid sales tax to Texas on both the lease payments received from Ferguson and on the sales of equipment to Ferguson.

K. The Department improperly denied Taxpayer's claim for refund for gross receipts tax in the amount of \$89,636.51 for tax period January 1, 2012 through December 31, 2012.

L. The Department shall pay interest on the refunded amount in accordance with NMSA 1978, Section 7-1-68 (2011).

For the foregoing reasons, the Taxpayer's protest **IS GRANTED**.

DATED: June 31, 2016

Monica Ontiveros

Monica Ontiveros
Hearing Officer
Administrative Hearings Office
Post Office Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), the Taxpayer has 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 Notice of Appeal with the Administrative Hearings Office contemporaneously with the filing of the Notice with the Court of Appeals so that the Administrative Hearings Office may prepare the record proper. The Notice of Appeal should be mailed to John Griego, Administrative Hearings Office at P.O. Box 6400, Santa Fe, New Mexico 87502. Mr. Griego may be contacted at 505-827-0466.

John Griego