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

IN THE MATTER OF THE PROTEST OF
CLASSIC COBWEBS **15-05**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO.'s L0135326672 and L1209068496

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on January 7, 2015 before Chief Hearing Officer Brian VanDenzen, Esq., in Santa Fe. Kathy Karas and Roger Bauer appeared for Classic Cobwebs ("Taxpayer"). Accountant Ray Scott also appeared to testify on Taxpayer's behalf. Deputy Chief Legal Counsel Julia Belles appeared representing the State of New Mexico, Taxation and Revenue Department ("Department"). Protest Auditor Milagros Bernardo appeared as a witness for the Department. Taxpayer Exhibits #1-3 and Department Exhibits A-F were admitted into the record, as more thoroughly described in the Exhibit Log. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On September 22, 2014, under letter id. no. L0135326672, the Department assessed Taxpayer for $1,263.89 in gross receipts tax, $252.78 in penalty, and $156.32 in interest for a total assessment of $1,672.99 for the combined reporting periods between January 1, 2010 through December 31, 2010. [Department Ex. B-1].

2. On September 22, 2014, under letter id. no. L1209068496, the Department assessed Taxpayer for $3,841.82 in gross receipts tax, $768.36 in penalty, and $336.99 in interest

for a total assessment of $4,947.17 for the combined reporting periods between January 1, 2011 through December 31, 2011. [Department Ex. B-2].

3. On October 9, 2014, the Department received Taxpayer's protest of the Department's assessments. [Department Ex. C-1].

4. The Hearings Bureau first learned of this matter when the Department requested a hearing on December 11, 2014.

5. On December 12, 2014, the Hearings Bureau sent Notice of Administrative Hearing to Taxpayer and the Department, setting this matter for a hearing on January 7, 2015.

6. Kathy Karras and Roger Bauer are the proprietors of Taxpayer, Classic Cobwebs.

7. Taxpayer, Classic Cobwebs, is in the business of selling antiques in antique malls.

8. Taxpayer purchases antiques at auctions, estate sales, and garage sales.

9. Taxpayer rents booths/space by the square foot at an antiques mall[1] on a monthly basis.

10. Taxpayer does not staff the booth/space in the antique mall. Taxpayer pre-prices its displayed antiques for sale at the space it rents from the antique mall. Any sales of Taxpayer's merchandise are completed at the mall's sale counter, staffed by mall employees.

11. The mall owner collects the money for the sale of Taxpayer's items. The mall owner does not keep any portion of the sale. Instead, the mall is compensated in the form of Taxpayer's monthly rent.

12. Taxpayer receives all of its receipts from the sale of its items from the antiques mall owner.

[1] The record reveals the specific name and owner of the antique mall at issue. However, it is not necessary to specify that information for the purposes of this decision, other than to note it is one specific mall owner/business.

13. Taxpayer understood that the mall owners paid the gross receipts tax on the sales of their items purchased in the antique mall.

14. Taxpayer and the mall owner did not have a provision in their contract addressing gross receipts tax.

15. Taxpayer filed combined system returns during the relevant periods but did not make any gross receipts tax payments.

16. On June 27, 2014, Taxpayer was sent notice of Limited Scope Audit. The Notice of Limited Scope Audit gave Taxpayer 60-days, until August 26, 2014, to present any nontaxable transaction certificates ("NTTC's") supporting any claimed deductions. [Department Ex. A-1].

17. Taxpayer asked the mall owner for assistance in resolving the Department audit. The mall owner assured Taxpayer that she would take care of it.

18. The antique mall owner was in a delinquent status with the Department. [Department Ex. C-2].

19. On July 18, 2014, the mall owner submitted to the Department form TS-22, an Agreement to Collect and Pay over Taxes and asked that it be retroactive to March 2010. [Taxpayer Ex. #3-2].

20. On July 29, 2014, Laura Gage of the Department informed Taxpayer that the mall owner's requested T-22 agreement had been denied. [Taxpayer Ex. #3-1].

21. On August 7, 2014, the mall owner again submitted to the Department form TS-22, an Agreement to Collect and Pay over Taxes and asked that it be retroactive to March 2010. [Taxpayer Ex. #2].

22. The Department did not sign or approve the antique mall owner's proposed Form TS-22.

23. Taxpayer did not present a NTTC executed by the August 26, 2014 60-day deadline.

24. On December 3, 2014, after the expiration of the 60-day period, the antique mall executed a type 2 NTTC to Taxpayer. [Taxpayer Ex. #1].

25. As of the date of hearing, for the reporting period ending on December 31, 2010, Taxpayer owed $1,248.89 in gross receipts tax, $249.78 in penalty, and $168.01 in interest for a total year liability of $1,666.68. For the reporting period ending on December 31, 2011, Taxpayer owed $3,841.82 in gross receipts tax, $768.36 in penalty, and $372.67 in interest for a total year liability of $4,982.85. The combined outstanding liability as of the date of hearing was $6,649.53. [Department Ex. F].

DISCUSSION

The main issue in this case is whether Taxpayer was liable for gross receipts when it did not possess a timely-executed NTTC from the mall owner or a valid TS-22 in place with the antiques mall owner. Another issue is whether Taxpayer is entitled to any abatement of tax under an equitable recoupment basis. And the final issue is whether interest and penalty can be abated in this matter.

Presumption of Correctness.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessments issued in this case are presumed correct. Consequently, Taxpayer has the burden to overcome the assessments. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428. Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See*

NMSA 1978, §7-1-3 (X) (2013). Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department's assessment of penalty and interest.

Moreover, "[w]here 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 (internal citation omitted); *See also TPL, Inc. v. N.M. Taxation & Revenue Dep't*, 2003-NMSC-7, ¶9, 133 N.M. 447.

Gross Receipts Tax, Deductions, and the Requirements for a Timely NTTC.

For the privilege of engaging in business, New Mexico imposes a gross receipts tax on the receipts of any person engaged in business. *See* NMSA 1978, § 7-9-4 (2002). "Engaging in business" is defined as "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). Taxpayer acknowledged being a business engaged in the acquisition and sales of antiques, satisfying the engaging in business definition of Section 7-9-3.3. Under the Gross Receipts and Compensating Tax Act, there is a statutory presumption that all receipts of a person engaged in business are taxable. *See* NMSA 1978, § 7-9-5 (2002).

The New Mexico Gross Receipts and Compensating Tax Act provides numerous deductions of gross receipts tax. Taxpayer never specified which particular deduction from gross receipts tax it was claiming in this matter. Nor is it immediately clear which deduction would be potentially relevant. Taxpayer made clear that it was not selling the antiques to the mall for resale; rather, Taxpayer sold its products directly to the consumer, with the mall staff simply handling the

transaction. Considering that Taxpayer carries that burden to establish it was entitled to a deduction and to overcome the presumption of correctness, absence of specificity about which deduction may be at issue undercuts Taxpayer's case.

Although it does not appear directly applicable to the facts of this case, the closest deduction potentially at issue is the sale of tangible personal property for resale found under NMSA 1978, Section 7-9-47 (1994). Section 7-9-47 states that:

> Receipts from selling tangible personal property or licenses may be deducted from gross receipts or from governmental gross receipts if the sale is made to a person who delivers a nontaxable transaction certificate to the seller. The buyer delivering the nontaxable transaction certificate must resell the tangible personal property or license either by itself or in combination with other tangible personal property or licenses in the ordinary course of business.

Again, Taxpayer was clear that no resale occurred in its arrangement with the antiques mall owner. However, even if a resale had occurred as required under the deduction, the statute clearly and unambiguously conditions the deduction on a sale made to a person/entity who delivers a NTTC.

NMSA 1978, Section 7-9-43 (2011) articulates the requirements for obtaining NTTCs:

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

Under Section 7-9-43, Taxpayer had a statutory obligation to possess a NTTC at the time the tax returns were due for the receipts in 2010 and 2011. There is no evidence that Taxpayer possessed a NTTC at those times.

While taxpayers "should" have possession of required NTTCs at the time the return is due from the receipts at issue, Section 7-9-43 gives taxpayers audited by the Department a second

chance to obtain these NTTCs: within 60-days of when the Department gives notice, taxpayers must possess a NTTC in order to claim a deduction. Taxpayers who rely on this second chance provision run the risk of having their deductions disallowed if they are unable to meet the 60-day deadline set by the Legislature. The reason why a taxpayer cannot obtain a NTTC is irrelevant. The language of Section 7-9-43 is mandatory: if a seller is not in possession of required NTTCs within 60 days from the date of the Department's notice, "deductions claimed by the seller ... that require delivery of these nontaxable transaction certificates *shall be disallowed."* (emphasis added). *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary).

Consistent with the statutory language, under Regulation 3.2.201.12 (C), a taxpayer "is not entitled to the deduction" when the NTTC is untimely. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight). The New Mexico Court of Appeals has held that despite its general reluctance to place "form over substance," the failure to timely and properly present a requisite NTTC is a "valid basis" for the Department to deny a claimed deduction. *Proficient Food Co. v. New Mexico Taxation & Revenue Dep't*, 1988-NMCA-042, ¶22, 107 N.M. 392.

In this case, Taxpayer received a NTTC from the antique mall that was executed on December 3, 2014, after the August 26, 2014 60-day deadline. Taxpayer alluded to the fact that the antique mall owner was delinquent and unable to execute NTTCs as a reason for the delay. However, under Section 7-9-43 (D), the Department may refuse to allow a delinquent taxpayer to issue NTTCs. By waiting to attempt to obtain a NTTC until the second chance provision as opposed to the time of the transaction, taxpayers run the risk of changes in business status, business closure,

or delinquencies. Moreover, the reasons for Taxpayer's non-compliance with the 60-day statutory deadline are not material to the analysis under Section 7-9-43. Under Section 7-9-43 and Regulation 3.2.201.12 (C), the Department has no authority to allow a deduction after the expiration of the second chance, 60-day deadline, even if a taxpayer has a reasonable explanation for the delay. By not presenting the NTTCs in a timely manner, as required by Section 7-9-43 and Regulation 3.2.201.12 (C), Taxpayer waived its right to a claimed deduction that required a supporting NTTC. *See Proficient Food Co.*, ¶22 (internal citations omitted) ("Where a party claiming a right to an exemption or deduction fails to follow the method prescribed by statute or regulation, he waives his right thereto.").

Taxpayer argued that the antique mall owner in this case agreed to pay Taxpayer's gross receipts tax, and thus Taxpayer should not be liable for the assessed tax. That assertion is supported by the antique mall owner's letter attached to Taxpayer's protest letter, Department Ex. C-2. In New Mexico, the incidence of gross receipts tax falls on the person engaged in business. *See* Regulation 3.2.4.8 NMAC & Regulation 3.2.6.9 NMAC. Here, Taxpayer was engaged in business and thus subject to gross receipts tax. Taxpayer acknowledged at hearing that there was no provision in the contract with the antiques mall owner that shifted Taxpayer's gross receipts tax burden to the antiques mall owner.

The antiques mall owner did not submit a Form TS-22, "Agreement to Collect and Pay Over Taxes," in 2010 and 2011. Only in 2014 did the antiques mall owner attempt to submit a Form TS-22 and asked that it be accepted retroactively to the previous reporting periods. The Department did not sign or approve of the Form TS-22 and therefore there was no valid TS-22 in place in this case. While there was no specific statutory provision in place in 2010 or 2011, the Department has had a long standing practice of requiring a TS-22 in order for someone to assume another taxpayer's

liability. *See the Decision and Order in the Matter of the Protest of M. Kory and Lucia Rowberry*, No. 98-59, non-precedential (discussing the requirements of a TS-22 in 1998, some 12-years before this controversy). In 2013, the TS-22 agreement was codified by the Legislature into statute, NMSA 1978, Section 7-1-21.1 (2013). Since the antiques mall owner did not attempt to enter into a TS-22 with the Department until 2014, the provisions of Section 7-1-21.1 would apply. Section 7-1-21.1 gives the Department discretion in whether to enter into a TS-22 agreement. Respectfully, it is reasonable for the Department to use that discretion to decline to enter into a TS-22 that shifts the gross receipts tax obligations from Taxpayer to a person whom is already delinquent with gross receipts obligations. Moreover, without deciding the question, it is unclear whether the Department has the authority under the statute to enter into a TS -22 retroactively, as the antiques mall owner requested in this matter. Without a valid TS-22, the incidence of gross receipts tax did not shift from Taxpayer to the antiques mall owner.

Equitable Recoupment.

Taxpayer's protest letter indicated that since the antiques mall owner collected the gross receipts tax, Taxpayer should not also have to pay the tax. Taxpayer also asked about its ability to claim a refund of taxes once the mall owner paid the collected gross receipts tax. These arguments potentially raise the issue of equitable recoupment.

Under NMSA 1978, Section 7-1-28 (F) (2013), an assessment can be abated by the "amount of tax previously paid by another person on behalf of the taxpayer on the same transaction; provided that the requirements of equitable recoupment are met." Similarly, NMSA 1978, Section 7-1-29 (H) (2013) allows for a claim for refund premised on equitable recoupment[2]. Equitable recoupment in tax matters is a doctrine developed largely by federal

[2] This case does not involve a claim for refund, but an assessment, making Section 7-1-28 (F) the pertinent provision.

courts and is given a limited application in tax litigation. *See Vivigen, Inc. v. Minzner*, 1994-NMCA-027, ¶20, 117 N.M. 224. New Mexico has adopted equitable recoupment with the same limitations set forth by federal courts. *See Vivigen, Inc.*, ¶23. The elements of equitable recoupment are: "1) a single taxable event, 2) taxes assessed on that event on inconsistent theories, and 3) a strict identity of interest." *Teco Invs. v. Taxation & Revenue Dep't,* 1998-NMCA-55, ¶8, 125 N.M. 103. However, under the presumption of correctness that attached to Department's assessments pursuant to Section 7-1-17 (C), Taxpayer has the burden of establishing that it is entitled to an abatement of assessed taxes under Section 7-1-28 (F)'s equitable recoupment basis.

In this case, there is insufficient evidence that the antiques mall owner actually paid the gross receipts tax. In fact, a careful reading of the antiques mall owner's letter indicates that while she collected gross receipts tax from customers purchasing Taxpayer's products, she did not submit CRS returns or make payments to the Department. As such, there is no proof that the taxes at issue were paid by another, as required by the plain language of Section 7-1-28 (F) to support a claim for equitable recoupment. Moreover, the antiques mall owner did not appear to testify at the hearing, leaving only hearsay and incomplete information about the status of the gross receipts tax in dispute. While hearsay evidence is admissible evidence in an administrative proceeding, without more in this case it is of insufficient persuasive weight for Taxpayer to establish the elements of equitable recoupment. Therefore, Section 7-1-28 (F) does not provide grounds for the abatement of assessed taxes.

Interest and Penalty.

When a taxpayer fails to make timely payment of taxes due to the state, "interest *shall* be paid to the state on that amount from the first day following the day on which the tax becomes

due...until it is paid." NMSA 1978, § 7-1-67 (2007) (italics for emphasis). Under the statute, regardless of the reason for non-payment of the tax, the Department has no discretion in the imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary). The language of Section 7-1-67 also makes it clear that interest begins to run from the original due date of the tax until the tax principal is paid in full. The Department has no discretion under Section 7-1-67 and must assess interest against Taxpayer from the time the 2010 and 2011 gross receipts tax was due but not paid until Taxpayer satisfies the gross receipts tax principal.

Further, the Department has no basis to abate civil negligence penalty under NMSA 1978, Section 7-1-69 (2007) in this case. When a taxpayer fails to pay taxes due to the State because of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, by its use of the word "shall", Section 7-1-69 requires that civil penalty be added to the assessment. As discussed above, the statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meets the legal definition of "negligence."

Regulation 3.1.11.10 NMAC defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required"; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." Under New Mexico's self-reporting tax system, "every person is charged with the reasonable duty to ascertain the possible tax consequences" of his or her actions. *Tiffany Construction Co. v. Bureau of Revenue*, 1976-NMCA-127, ¶5, 90 N.M. 16.

To be clear, Taxpayer credibly testified to its history of tax compliance and its positive intentions to always meet its tax obligations. It is clear that Taxpayer had no intention in this situation to avoid its tax liability. But, despite the best of intentions, Taxpayer's inaction in not paying gross receipts tax or securing a fully executed Form TS-22 in 2010 and 2011 constitutes civil negligence under Regulation 3.1.11.10 NMAC. There is no evidence supporting abatement of penalty under either Section 7-1-69 (B) or the multiple scenarios listed under Regulation 3.1.11.11 (D) NMAC. Therefore, the Department properly assessed penalty and interest. Taxpayer's protest is denied.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the assessments. Jurisdiction lies over the parties and the subject matter of this protest. The hearing was held within 90-days of receipt of the protest.

B. Taxpayer did not overcome the presumption of correctness that attached to the assessments under NMSA 1978, Section 7-1-17 (C) (2007) and *Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428.

C. Taxpayer was engaged in business under NMSA 1978, Section 7-9-4 (2002), and therefore all of Taxpayer's receipts in 2010 and 2011 are presumed subject to gross receipts tax under NMSA 1978, Section 7-9-5 (2002).

D. Taxpayer did not carry its burden to establish that any deduction applied to Taxpayer's receipts in 2010 and 2011.

E. Even if there was an applicable deduction, Taxpayer did not present timely executed NTTCs to support a claimed deduction. Under NMSA 1978, Section 7-9-43 (2011) and Regulation 3.2.201.12 (C), without a timely executed NTTC at either the time of the filing of returns or within

60-days of notice of audit, the Department is not allowed to grant and Taxpayer is not entitled to a claimed deduction requiring a NTTC. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary). *See also Proficient Food Co. v. New Mexico Taxation & Revenue Dep't*, 1988-NMCA-042, ¶22, 107 N.M. 392 (Court found it valid for the Department to deny a claimed deduction when taxpayer did not timely present a requisite NTTC).

F. Taxpayer is liable for incidence of gross receipts tax under Regulation 3.2.4.8 NMAC & Regulation 3.2.6.9 NMAC.

G. The Department did not enter into a TS-22 agreement with the antiques mall owner to shift Taxpayer's gross receipts tax obligations to the antiques mall owner.

H. Taxpayer did not establish the elements of equitable recoupment and therefore was not entitled to an abatement of tax under NMSA 1978, Section 7-1-28 (F).

I. Under NMSA 1978, Section 7-1-67 (2007), Taxpayer is liable for accrued interest under the assessment. Interest continues to accrue until the tax principal is satisfied.

J. Under NMSA 1978, Section 7-1-69 (2007), Taxpayer is liable for civil negligence penalty because Taxpayer's inaction met the definition of civil negligence under Regulation 3.1.11.10 NMAC.

For the foregoing reasons, Taxpayer' protest **IS DENIED**. As of the date of hearing, for the reporting period ending on December 31, 2010, Taxpayer owed $1,248.89 in gross receipts tax, $249.78 in penalty, and $168.01 in interest for a total year liability of $1,666.68. For the reporting period ending on December 31, 2011, Taxpayer owed $3,841.82 in gross receipts tax, $768.36 in

penalty, and $372.67 in interest for a total year liability of $4,982.85. The combined outstanding liability as of the date of hearing was $6,649.53.

DATED: February 6, 2015.

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