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6/22/2016
Administrative
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STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
VIDIA WESENLUND **No. 16-28**
TO ASSESSMENTS ISSUED UNDER
LETTER ID. NOs. L0688803888, L1762545712,
L0420368432 and L1225674800

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on May 18, 2016 and continuing on May 24, 2016 before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Elena Morgan, attorney for the Department. Amanda Carlisle, protest auditor, Danny Pogan, protest supervisor, Michelle Gonzales, auditor III Schedule C and Andrick Tsbetsaye, audit manager, appeared and testified as witnesses for the Department. Vidia Wesenlund ("Taxpayer") appeared and was represented by R. Tracy Sprouls, Esq., Rodey, Dickason, Sloan, Akin & Robb, P.A. Witnesses testifying on behalf of Taxpayer were Wilfred Emory Smith, Executive Director of Tax for USANA Health Sciences, Inc. ("USANA"), and Jennifer Wright, Director of U.S. Field Development for USANA.

The Exhibits introduced into the record are Exhibits 1-3 and A, B, C, D, F and I. In addition to the pleadings and filings referred to in the Findings, the record contains the Notice of Telephonic Scheduling Conference issued December 7, 2015, Scheduling Order and Notice of Administrative Hearing issued on January 11, 2016, Substitution of Counsel filed January 5, 2016, Motion to Strike Request for Deposition dated March 28, 2016, Response to Department's Motion to Strike Request for Deposition filed April 5, 2016, Taxpayer's Motion for Extension of

Discovery Deadline filed April 5, 2016, Order Extending Deposition Deadline issued April 5, 2016, Motion for Summary Judgment filed by the Department on April 8, 2016, Taxpayer's Response to Motion for Summary Judgment filed on April 25, 2016, Joint Prehearing Statement filed on May 6, 2016, Notice of Reassignment of Hearing Officer for Administrative Hearing issued on May 9, 2016, Joint Motion to Amend Prehearing Statement filed on May 11, 2016, Amended Joint Prehearing Statement filed on May 11, 2016, Order Granting Motion to Amend Joint Prehearing Statement issued on May 17, 2016, Order Continuing Hearing issued on May 20, 2016; and Memorandum on Factual Errors *In re Protest of Sharon Ray* filed on June 8, 2016. The parties were given an opportunity to file briefs in the matter and instead made closing arguments.

There is a Decision and Order, *Sharon Ray, No. 15-14* ("*Ray Decision*"), that was issued by the Administrative Hearings Office (formerly known as the Hearings Bureau) which deals with a different taxpayer but the same facts and the same legal issue. Sharon Ray was a USANA Associate who earned commissions from selling USANA's products. Both parties were provided with the opportunity to correct any factual errors in the *Ray Decision*. Taxpayer corrected the record as to Finding #19, and Finding #19 is not referred to in this Decision and Order. The Hearing Officer incorporates some of the findings of the *Ray Decision* into this Decision for contextual purposes. The parties entered into Stipulated Facts which are set out in the Joint Prehearing Statement filed on May 11, 2016 and some of which are incorporated into the Findings below.

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

FINDINGS OF FACT

1. On or about January 31, 2015, the Department mailed Taxpayer a Notice of Limited Scope Audit commencement for tax years 2008 through 2011. **[Stip. Fact #1]**.

2. Taxpayer was audited through the Department's Schedule C mismatch program whereby the Internal Revenue Service provides computer records of Schedule C returns which are compared to the Department's records for the gross receipts tax program.

3. The Notice was based on a mismatch between the gross receipts reported to the Department and the receipts reported on Taxpayer's Federal Schedule C for tax years 2008 through 2011. **[Stip. Fact #2]**.

4. On July 23, 2015, the Department issued four gross receipts tax assessments against Taxpayer: 1) in the amount of $3,824.78 in principal, $764.96 in penalty, and $895.24 in interest for the tax year of January 1, 2008 through December 31, 2008 **[Letter Id. No. L0688803888]**; 2) in the amount of $3,463.98 in principal, $692.78 in penalty, and $652.78 in interest for the tax year of January 1, 2009 through December 31, 2009 **[Letter Id. No. L1762545712]**; 3) in the amount of $3,043.79 in principal, $608.75 in penalty, and $453.07 in interest for the tax year of January 1, 2010 through December 31, 2010 **[Letter Id. No. L0420368432]**; and 4) in the amount of $3,264.56 in principal, $652.92 in penalty, and $367.92 in interest for the tax year of January 1, 2011 through December 31, 2011. **[L1225674800]**.

5. Taxpayer filed a protest to the assessments on October 21, 2015. The Department acknowledged the protest on October 23, 2015. **[Letter Id. No. L0328276016]**.

6. On December 4, 2015, the Department requested a hearing in this matter.

7. Taxpayer was not registered to do business in New Mexico for the tax years at

issue. **[Stip. Fact #25]**.

8. Taxpayer failed to file gross receipts returns for the tax years at issue. **[Stip. Fact #24; Letter Id. No. L0688803888; Letter Id. No. L1762545712; Letter Id. No. L0420368432; and Letter Id. No. L1225674800]**.

9. During the tax years at issue, Taxpayer was an Associate or Distributor and an independent contractor for USANA. **[CD 05/18/16, 1:03-1:04 and Stip. Fact #16]**.

10. During the tax years at issue, Taxpayer had a contract with USANA, but it was not offered into evidence. **[CD 05/18/16, 58:52-59:19]**.

11. USANA is a "down the line" sales organization. **[*Ray Decision*, Finding #11]**.

12. USANA offers its products to customers through a process it calls "direct selling." **[*Ray Decision*, Finding #12]**.

13. "Direct selling," according to USANA's website is the "distribution method employed … where products are sold person-to-person, away from a fixed retail location." **[*Ray Decision,* Finding #13]**.

14. The headquarters and where all USANA products are shipped from is 3838 West Parkway Blvd., Salt Lake City, Utah. **[CD 05/18/16, 54:55-55:12]**.

15. USANA manufactures and sells nutritional (including vitamins), weight loss products and personal care products. **[CD 05/18/16, 16:39 and 29:30-31:18]**.

16. USANA describes its associates as "Our customer base comprises two types of customers: "Associates" and "Preferred Customers." Associates share in our company vision by acting as independent distributors of our products in addition to purchasing our products for their personal use. Preferred Customers purchase our products strictly for personal use and are not

permitted to resell or to distribute the products." **[*Ray Decision*, Finding #16]**.

17. Compensation is earned in four ways by USANA Associates:

- *Commissions.* "The primary way an Associate is compensated is through earning commissions. Associates earn commissions through generating sales volume points, which are a measure of the product sales of their down-line sales organization. Sales volume points are assigned to each of our products and comprise a certain percent of the product price in U.S. dollars. To be eligible to earn commissions, an Associate must sell a certain amount of product each month ("Qualifying Sales"). Qualifying Sales may include product that the Associates use personally or that they resell to consumers. Associates do not earn commissions on these Qualifying Sales. Associates may earn commissions on their sale of products above the Qualifying Sales as well as the sale of products by Associates in their down-line organization and to Preferred Customers. Additionally, Associates do not earn commissions for simply recruiting and enrolling others in their down-line organization. Commissions are paid only when products are sold. We pay Associate commissions on a weekly basis."
- *Bonuses. "*We offer Associates several bonus opportunities, including our leadership bonus, elite bonus, and lifetime matching bonus. These bonus opportunities are based on a pay-for-performance philosophy and, therefore, are paid out when the Associate achieves the required performance measures."
- *Retail Mark-Ups.* "As discussed previously, in markets where retail mark-ups are permitted, our Associates purchase products from us at the Preferred Price and may resell them to consumers at higher retail prices. In this case, the Associate retains the retail mark-up as another form of compensation."
- *Contests and Promotions.* "We periodically sponsor contests and promotions designed to incentivize Associates to generate sales, grow their down-line organization, and increase product users. These promotions are also based on a pay-for-performance philosophy and, therefore, are only paid upon the achievement of the promotion objectives."

[*Ray Decision*, Finding #17].

18. Taxpayer has been in business of "down the line" sales with USANA since 2000, but it took her a while to build her business up until maybe 2004. **[CD 05/18/16, 35:31-35:54].**

19. Taxpayer testified that she would meet and recruit potential customers or preferred customers and describe USANA's products to them in hopes that they would purchase the products. Taxpayer thought of herself as an educator. **[CD 05/18/16, 18:46-19:20]**.

20. Taxpayer recruited preferred customers in New Mexico. The customers purchased USANA's products on-line using a code that was specific to Taxpayer. Taxpayer earned a commission on these sales. **[Stip. Fact #19 and Exhibit #3, Scenario D]**.

21. Once the order was placed on-line, USANA's products were shipped directly to the customer in New Mexico by outside shipping companies, e.g., FedEx, UPS or USPS, from is headquarters in Salt Lake City, Utah. **[CD 05/18/16, 54:55-55:12 and 55:16-55:22]**.

22. Taxpayer recruited Distributors in New Mexico for USANA. These Distributors recruited preferred customers. **[Stip. Fact #20]**.

23. Taxpayer received a commission when a preferred customer of the Distributor purchased USANA's products. **[Stip. Fact #20 and Exhibit #3, Scenario E]**.

24. The word Associate and Distributor are used interchangeably by USANA. **[CD 05/18/16, 1:03-1:04]**.

25. During the tax periods at issue, Taxpayer did not sell any USANA's products to any New Mexico customers and had no revenue from selling products to customers. **[Stip. Fact #17 and Exhibit #1-"Personal"]**.

26. Taxpayer purchased USANA's products for her own use. On these transactions Taxpayer did not receive a commission on any orders she placed for personal consumption. **[*Ray Decision*, Finding #17 and Exhibit #3, Scenario A]**.

27. Other Distributors purchased USANA's products for themselves. **[Stip. Fact #21 and Exhibit #3, Scenario C]**.

28. For other Distributors who purchased and resold USANA's products for resale to customers, they did not receive commissions on any of these orders. **[*Ray Decision*, Finding #17**

and Exhibit #3, Scenario C].

29. Taxpayer received 1099s from USANA in the following amounts:

2008	$66,979.00
2009	$57,931.00
2010	$50,242.00
2011	$46,948.00

[Stip. Fact #4].

30. For tax year 2011, Taxpayer received a 1099 from Magidson Films Inc. in the amount of $5,726.00 and Taxpayer does not protest the imposition of gross receipts tax on this income. **[Stip. Fact #5]**.

31. The Department made a number of adjustments based on commissions earned on sales that were out of state sales prior to the assessments being issued. **[Stip. Facts #6 and #7]**.

32. The Department entered into a Form TS-22DS agreement with USANA to pay and report gross receipts taxes on New Mexico sales for Distributor sales. **[Exhibit I, page 3];** and **[CD 05/24/16, 6:52-6:57]**.

33. A Form TS-22DS Agreement to Collect and Pay Over Taxes ("TS-22") is one in which a taxpayer may apply to the Department to pay gross receipts tax on behalf of another taxpayer.

34. The TS-22 was entered into in 2011 and applied retroactively by the Department to USANA's 2009 tax year. **[CD 05/24/16, 7:00-7:14]**. The TS-22 entered into the record is dated January 1, 2015 through December 31, 2017 and is a renewal of a prior TS-22. **[Exhibit I, page 3]**.

35. The description of the TS-22 from USANA's website states that USANA is collecting the gross receipts tax on the sale of the "products sold to New Mexico resident

Associates." The description is dated February 11, 2011. **[Exhibit I, page 2]**.

36. Per the TS-22, USANA charged and collected gross receipts taxes on the resale of its products by a New Mexico Distributor, on behalf of the Distributer, and not on its own behalf.

37. The Department, through its employees, Joe Lopez ("Lopez"), Aaron Brown ("Brown") and Louis Gomez ("Gomez"), advised Wilfred Smith ("Smith") that USANA, through the TS-22, USANA should charge and collect gross receipts tax on behalf of its Distributors who resold the products to New Mexico customers. **[CD 05/24/16, 9:23-9:44 and 10:00-10:12]**.

38. Prior to February 2011, USANA charged its customers and Distributors gross receipts tax and paid gross receipts on its sale of products to both Distributors and customers. **[CD -5/24/16, 11:01-11:16]**. (These transactions are not the subject of the TS-22.)

39. Sometime in 2010, Smith spoke with Department employees, Lopez, Brown and Gomez, about whether USANA had nexus with New Mexico for gross receipts tax purposes. **[CD 05/24/16, 9:00-9:43]**.

40. The Department, through its employees, advised Smith that USANA did not have sufficient gross receipts nexus with New Mexico to charge and collect gross receipts taxes on its sale of products to either Distributors or New Mexico customers. **[CD 05/24/16, 9:00-9:56 and 10:00-10:56]**.

41. In February 2011, USANA stopped collecting gross receipts tax on the sale of USANA's products to its Distributors for resale to New Mexico customers and to its New Mexico customers. **[CD 05/24/16, 4:22-4:49; 11:01-11:16; and 11:48-12:26]**.

42. On January 29, 2016, Michelle Gonzales ("Gonzales"), a Department employee informed USANA in an e-mail that "there is no gross receipts tax due when a NM customer orders

products using your website. Therefore, if a NM sales representative (rep.) earns commissions on this particular sale then it will not be taxable GRT." **[Exhibit 2 and CD 05/18/16, 1:06-1:09]**.

43. Gonzales testified that when she stated that there was no gross receipts tax on the sale of USANA's products, she did not know that USANA had sale representatives in New Mexico. **[CD 05/18/16, 1:10-1:11]**.

44. USANA made a business decision not to claim a refund for gross receipts taxes it paid on the sale of its products to Distributors and to New Mexico customers. **[CD 05/24/16, 13:30-14:49]**.

45. One reason that upper management at USANA decided not to request a refund was that it believed that the gross receipts tax was not something it paid out but that it charged and collected, and it believed that it would be an overwhelming task to refund the collected tax back to the New Mexico customers who paid the tax. **[CD 05/24/16, 13:30-14:49]**.

46. Dan Armor ("Armor"), a Department employee with the Corporate Income Tax unit, called Smith sometime in 2015 to ask why USANA stopped filing corporate income tax returns and why had USANA filed a TS-22. Smith explained that a determination was made that no nexus existed between USANA and New Mexico. **[CD 05/24/16, 18:00-18:45]**.

47. Armor and Smith discussed that the TS-22, by itself, does not create nexus, and Smith believed that Armor agreed with his conclusion that charging and collecting gross receipts on behalf of another does not confer nexus. **[CD 05/24/16, 18:00-18:45]**.

48. Smith testified that USANA is a multinational corporation and that it complies with all the tax laws in the different tax jurisdictions.

49. Smith was credible in his testimony regarding his interactions with the

Department's employees and his general testimony.

50. USANA has no employees in New Mexico, no offices, no ownership of tangible personal property (inventory) and uses outside shipping companies, e.g., FedEx, UPS or USPS, for delivery of its products into New Mexico. **[CD 05/18/16, 54:55-55:12 and 55:16-55:22 and CD 05/24/16, 1:06]**.

51. USANA's sales are dependent on its Associates and Distributors recruiting, educating and shepherding customers to purchase USANA's products through USANA's website.

52. The purpose of hiring Associates and Distributors is to establish and maintain a market in New Mexico.

53. Pogan and Tsbetsaye testified that for gross receipts tax purposes, USANA has nexus with New Mexico. **[CD 05/18/16, 2:20-2:21 and 05/24/16, 1:06-1:13].**

54. Pogan and Tsbetsaye were very believable and credible in their testimony.

55. Sprouls was authorized by USANA to discuss USANA tax matters.

56. USANA requested no Ruling by the Secretary on whether it has nexus with New Mexico.

57. Smith wrote a letter addressed to "To Whom it May Concern" that "USANA does not have taxable presence in New Mexico and thus is not subject to the gross receipts tax." **[Letter Dated June 12, 2015, Exhibit A, Attached to Protest].**

58. On August 17, 2015, Cabrini Sanchez, a Department employee, informed Taxpayer that her receipts were taxable. **[Exhibit C]**.

59. Taxpayer made a mistake of law in good faith regarding the taxability of her commissions.

DISCUSSION

There are a number of issues to be decided in this case. The issue directly affecting Taxpayer is whether she is entitled to deduct her commissions from her receipts because the underlying transaction is deductible pursuant to NMSA 1978, Section 7-9-66 (1999), which permits commissions to be deducted if the underlying transaction is nontaxable. The underlying transaction is nontaxable only if USANA's products were not delivered or consumed in New Mexico and if USANA has no nexus (Commerce Clause) with New Mexico. There were conflicting positions asserted by Department employees whether USANA has nexus. Taxpayer argues that even though USANA paid gross receipts tax on the underlying transactions, it did so in error, and since 2011, USANA is no longer charging and collecting gross receipts tax on the underlying transactions. The Hearing Officer commends both parties in their efforts to set out the facts in this case.

Burden of Proof and Standard of Review

Section 7-1-17(C) provides that any assessment of taxes made by the Department is presumed to be correct. NMSA 1978, §7-1-17(C) (2007). *See, Carlsberg Management Co. v. State, Taxation and Revenue Dep't.,* 1993-NMCA-121, ¶10, 116 N.M. 247, 861 P.2d 288. In addition, all receipts of a person engaging in business are presumed to be subject to the gross receipts tax pursuant to NMSA 1978, Section 7-9-5(A) (2002). Taxpayer has the burden of overcoming the statutory presumption created by Section 7-9-5(A) and establish that she is entitled to a deduction. *TPL, Inc. v. Taxation & Revenue Dep't*., 2000-NMCA-083, ¶8, 129 N.M. 539, 10 P.3d 863, *rev'd on other grounds,* 2003-NMSC-007, 133 N.M. 447, 64P.3d 474.

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

Before determining whether Taxpayer owes gross receipts on her commissions, a determination must be made whether the underlying transactions, the sales by USANA, are taxable. 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 USANA, an out of state corporation, to customers or to Distributors/Associates 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). 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. Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶18.02[1]. In *Dell*, the assumption is that the goods are 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. The facts in *Dell* are very similar to the facts in this case: An

out of state company sold tangibles through orders placed on the internet with the company and the company shipped the products to the customer in New Mexico.

Up until the court decided the *Dell* case, the Department had analyzed interstate transactions by determining where the title transferred and risk of loss passed which may be why the Department employees thought USANA's products were not taxable for gross receipts tax purposes. *Dean Baldwin*, No. 06-08, *Apple Computer, Inc*., No. 00-37. These Uniform Commercial Code concepts are no longer relevant or applicable to multistate transactions.

Thus, the only relevant inquiry is where USANA's products were consumed or delivered in New Mexico. In this case, all of USANA's products were delivered into New Mexico by outside shipping companies, e.g., FedEx, UPS or USPS. There is no dispute that USANA's products were ordered on-line by customers and that the order was placed at the headquarters of USANA in Salt Lake City, Utah. Once the order was placed by customers, the shipment was fulfilled in Salt Lake City. The products were delivered by outside shipping companies, e.g., FedEx, UPS or USPS and shipped into New Mexico. The destination or delivery point of the products was New Mexico. All of USANA's products were consumed in New Mexico by customers who accepted delivery in New Mexico. Ergo, the underlying transaction is taxable unless USANA does not have nexus.

Commerce Clause

The second prong of the test under *Kmart Corp.* 2006-NMSC-006, ¶ 11, is more difficult to apply because USANA is not the taxpayer in this matter and USANA has not had an opportunity to fully develop the argument that it did not have nexus with New Mexico. What is clear is that a deduction under Section 7-9-66 cannot be applied to Taxpayer's commissions unless a review of USANA's nexus with New Mexico occurs or the determination of nexus is accepted

without review, leading to the possible use of a deduction for this Taxpayer and other similarly situated taxpayers which may be incorrect. In addition, the nexus issue is before this Hearing Officer because there clearly is a difference of opinion on whether USANA has nexus with New Mexico. Pogan and Tsbetsaye testified that it was their belief that nexus existed between USANA and New Mexico while other Department employees took the position that there was no nexus between USANA and New Mexico. In Taxpayer's protest, Taxpayer argues that there is no nexus because the sales are deductible under NMSA 1978, Section 7-9-55 (1993) and the Commerce Clause of the United States Constitution. Because of the contradiction within the Department on an essential point of law and Taxpayer's statement that there is no nexus because of the Commerce Clause, there is no choice but to address the (substantial) nexus issue. The Hearing Officer relies on the facts before her.

In determining whether the sales of a multistate transaction are taxable, the second prong of the *Kmart Corp.*, 2006-NMSC-006, ¶11 case is whether the tax violates the Commerce Clause of the United States Constitution. The Commerce Clause authorizes Congress to "regulate Commerce ... among the several States." U.S. Const. art. I, §8, cl. 3. In addition to this "affirmative grant of power," courts have construed the Commerce Clause to have a "negative sweep" as well, which "prohibits certain state actions that interfere with interstate commerce." *Quill Corp. v. N.D. ex rel. Heitkamp*, 504 U.S. 298, 309, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992).

The United States Supreme Court set out a four-part test to determine whether a tax passes constitutional muster under the Commerce Clause in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). Under *Complete Auto*, state taxation of out-of-state businesses conducting interstate commerce will be upheld under the Commerce Clause so

long as the tax (1) is fairly apportioned, (2) does not discriminate against interstate commerce, (3) is fairly related to the services provided by the taxing state, and (4) is applied to an activity with a *substantial nexus* with the taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279.

The Supreme Court in a number of decisions, *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), and *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), has held that a seller must have a *physical presence* in a state in order to satisfy the *substantial nexus* requirement. The physical presence requirement may be met when "activities performed in this state on behalf of a taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in the taxing state for the sales." *Dell*, 2009–NMCA–001, ¶ 43, (quoting *Tyler Pipe Indus., Inc. v. Wash. State Dep't. of Revenue*, 483 U.S. 232, 250, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987) (alteration and emphasis omitted)).[1]

In the case of *In re Barnesandnoble.com LLC*, 2012-NMCA-63, ¶15, 283 P.3d 298, the court said that "(t)he threshold for establishing a physical presence is not high." In *Nat'l Geographic Soc'y v. Cal. Bd. of Equalization,* 430 U.S. 551, 561, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977), the Supreme Court held that "(t)he relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the (s)tate, but simply whether the facts demonstrate some definite link, some minimum connection, between the (s)tate and the

[1]In December 2013, the U.S. Supreme Court's rejected Amazon.comLLC's and Amazon Services LLC's petition for writ of certiorari on the issue of whether New York's affiliate nexus law (third party advertisers) created substantial nexus for Amazon. Amazon has no representatives, no offices and no property in New York. The U.S. Supreme Court denied certiorari in the case, allowing New York's affiliate nexus law to remain in place.

person it seeks to tax." (alteration, internal quotation marks, and citation omitted). The threshold for finding physical presence is not high and all you need is minimum connection between the taxpayer, USANA, and the state.

For purposes of finding a link and physical presence in New Mexico, it is relevant that USANA does not have employees or any offices in New Mexico. It is also relevant that USANA does not have any ownership of tangible personal property and uses outside shipping companies, e.g., FedEx, UPS or USPS, for delivery of its products into New Mexico. However, the inquiry does not end at this juncture. *Quill Corp*., 504 U.S. 312, 314-315. If there are no employees, no offices or tangible personal property within a state, substantial nexus is present if the taxpayer has independent contractors who perform services on the taxpayer's behalf and are establishing and maintaining a market. *Tyler Pipe Indus., Inc.* at 249. In *N.M. Taxation & Revenue Dep't. v. Barnesandnoble.com LLC*, 2013-NMSC-023, 303 P.3d 824, the physical presence requirement was met with an out of state company, who had no employees, no offices and no tangible personal property, by finding that the out of state company maintained a market in New Mexico.

USANA has Associates and Distributors in New Mexico who only receive commissions if they can recruit potential customers to purchase USANA's products. It is not material that the Associates and Distributors are independent contractors. The sole purpose of the Associates and the Distributors is to promote USANA's products and in return, if the customer purchases USANA's products, the Associates and Distributors receive a commission. The Associates and Distributors are clearly trying to establish and maintain a market on behalf of USANA.

The link or minimal connection between USANA and New Mexico is that USANA has more than one independent contractor working on its behalf to establish and maintain a market for

its products in New Mexico. USANA would have no market in New Mexico but for the efforts of its Associates and Distributors. It is the Associates and Distributors that meet, recruit and shepherd the customers to purchase USANA's products. Hence, Pogan and Tsbetsaye are correct in their determination that USANA has substantial nexus with New Mexico, and the underlying transactions with USANA are taxable.

Taxpayer argued that there was no nexus because Department employees Lopez, Brown and Gomez, and in an e-mail from Gonzales to Smith, that no gross receipts tax should be imposed on the sale of USANA's products to the customers or the Distributors.[2] Ms. Gonzales testified that at the time she wrote the e-mail that she had no idea that USANA had sale representatives in New Mexico. Smith was credible in his testimony that he had many conversations with Department employees Lopez, Brown and Gomez and that he was told that the transactions were not taxable for gross receipts tax purposes because USANA did not have nexus with New Mexico. These Department employees are incorrect in their analysis that the multistate transactions are not taxable; primarily because they either focused on where title transferred or risk of loss and/or focused on the nexus issue to determine whether the transactions were taxable. The first part of the *Dell* test is to determine whether the products are delivered and consumed in New Mexico. If the answer to the first part of the analysis is yes, then the second part of the analysis is to determine whether there is nexus with New Mexico.

Taxpayer also argued that the deduction found in NMSA 1978, Section 7-9-55 (1993) applied. While the taxpayer in the *Dell* case did not argue that the transactions were deductible because of Section 7-9-55, it made a similar argument; namely that the imposition of gross

[2] The Department did not present any rebuttal testimony from these employees that Lopez, Brown or Gomez said anything different to Smith.

receipts tax on its interstate sales violated the Commerce Clause of the United States Constitution. In the *N.M. Taxation & Revenue Dep't. v. Barnesandnoble.com LLC* and *In re Barnesandnoble.com LLC* cases, again no mention was made of Section 7-9-55. However, the argument again was whether the gross receipts tax applied to its transactions violated the Commerce Clause of the United States Constitution. Generally, given this language, the deduction found in Section 7-9-55 is related to whether the gross receipts tax violates the Commerce Clause of the United States Constitution.

The Department argued at the hearing that the underlying transaction or the sale of USANA's products to customers and Distributors was taxable because the TS-22's purpose was to collect gross receipts tax on the sale of USANA's products to Distributors, Associates and preferred customers. Taxpayer argued that this interpretation of the TS-22 did not make sense. The Hearing Officer agrees with Taxpayer that this argument does not make sense because the Department does not need an agreement to collect tax from a taxpayer. The purpose and intent of a TS-22 agreement is to pay gross receipts tax on ***behalf*** of another taxpayer. *See*, *Teco Investments, Inc.*, No. 96-27; *Richard L. Trulious*, No. 99-08; *April Muniz*, No. 99-09; *Marc K. Schaefer,* No. 99-10; *David J. and Nancy L. Debusk*, No. 99-11; and *Cornerstone Contract Service*, No. 01-32.

The intent of the TS-22 agreement entered into between the Department and USANA was to report and pay gross receipts taxes on the sales of USANA's products by the Distributors to preferred customers. This is an entirely separate transaction and is not taxable to USANA but to the Distributor. The TS-22 was entered into in 2011 and applied retroactively by the Department to USANA's 2009 tax year. The TS-22 entered into the record is dated January 1, 2015 through

December 31, 2017 and is a renewal of a prior TS-22. Per the TS-22, USANA, on behalf of an Associate or Distributor, charges and collects gross receipts taxes on the resale of its products by a New Mexico Distributor and not on its own behalf. USANA is charging and collecting gross receipts tax on behalf of the Distributors on the sale of USANA's products to New Mexico customers, and not on its own transactions.

Commissions

Since the underlying transaction is taxable, Section 7-9-66, does not apply. The only issue left is whether Taxpayer's commissions are taxable. Commissions are considered remuneration for providing a service. Regulation 3.2.1.18(HH)(1) NMAC provides that:

> Commissions and other consideration received by an independent contractor from performing a sales service in New Mexico with respect to the tangible or intangible personal property of other persons are gross receipts whether or not the other person reports and pays gross receipts tax with respect to the receipts from the sale of the property. This situation involves two separate transactions. The first is the sale of the property by its owners to the customer and the second is the performance of a sales service by the independent contractor for the owner of the property. … Receipts, whether in the form of commissions or other remuneration, of the person performing a sales service in New Mexico are gross receipts of the person performing the sales service.

During the tax years at issue, Taxpayer was an independent contractor called an Associate or a Distributor for USANA, a "down the line" sales organization. She explained and educated potential customers on the value of USANA's nutritional and personal care products. Taxpayer received a commission through the "direct selling" of USANA's products. Taxpayer's job as an independent contractor was to meet potential customers and explain USANA's products to them in hopes that they would purchase the products. To purchase USANA's products, a customer went on-line using a code that was specific to Taxpayer and placed an order. Taxpayer earned a

commission based on whether the customer that she interacted with purchased USANA's products. Taxpayer also recruited Distributors for USANA who recruited their respective preferred customers to USANA. Again, Taxpayer received a commission when a preferred customer of the Distributor purchased USANA's products. Taxpayer received remuneration for providing a sales service, the sale of products, for USANA. Therefore, the commissions received from USANA are gross receipts and taxable.

Civil Penalty

Civil penalty is imposed when a taxpayer is "negligent" or disregards the Department's rules and regulations in not filing a return or paying tax when it is due. Section 7-1-69(A) states that:

> (e)xcept as provided in Subsection C of this section, in the case of **failure due to negligence or disregard of department rules and regulations, but without intent to evade or defeat a tax,** to pay when due the amount of tax required to be paid, to pay in accordance with the provisions of Section 7-1-13.1 NMSA 1978 when required to do so or to file by the date required a return regardless of whether a tax is due, there shall be added to the amount assessed a penalty in an amount equal to the greater of:
>
> (1) two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed twenty percent of the tax due but not paid;

(emphasis added) NMSA 1978, §7-1-69(A)(1) (2007). The Department's regulation provides that "negligence" includes "failure to exercise ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances; inaction where action is required; inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention" for either failing to file a return on time or failing to make a payment on time. Regulation 3.1.11.10 NMAC.

Inadvertent error is defined as "negligence." *El Centro Villa Nursing Ctr. v. Taxation & Revenue Dep't.*, 1989-NMCA-070, ¶9, 108 N.M. 795, 779 P.2d 982.

Section 7-1-69(B) provides that "(n)o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds. The term "reasonable" is a factual determination made by the Hearing Officer. It requires evidence that the taxpayer acted reasonably or acted in a "(f)air, proper or moderate under the circumstances." *Black's Law Dictionary*, 1379 (9th ed. 2009).

In this case, there was some confusion within the Department and with USANA as to whether the underlying transactions were taxable. Taxpayer had reasonable grounds to believe that her commissions were nontaxable because she relied on Smith's statements to her that USANA did not have nexus with New Mexico, and therefore no gross receipts tax was due on the underlying transaction, allowing for the deduction of the commissions. There was a mistake of law made in good faith and on reasonable grounds. Albeit during almost all of the tax years at issue, USANA was paying gross receipts tax on the underlying transactions. Nonetheless, penalty is abated.

Interest

On the subject of interest, New Mexico law is very clear on the imposition of interest when the principal amount of tax is unpaid when due, even if the payment is received one day late. Section 7-1-67(A) (2013) states that 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) (2013). The word "shall" is interpreted to mean that the Department does not have discretion and must assess interest if principal tax is due and owing. *Marbob Energy Corporation v. NM Oil Conservation Commission*, 2009-NMSC-013, ¶22, 146 N.M. 24, 206 P.3d 135. The assessment of interest is not designed to punish

taxpayers, but to compensate the state for the time value of unpaid revenues. Because the principal amount of tax was not paid when it was due, interest was properly assessed on the principal amount until the date it was paid. Therefore, Taxpayer owes the interest amount calculated through date of payment of the principal as set out in the Department's worksheet. **[Exhibit F].**

CONCLUSIONS OF LAW

A. Taxpayer filed a timely written protest to the Notice of Assessments Letter Id. Nos. L0688803888, L1762545712, L0420368432 and L1225674800 for gross receipts tax principal, penalty and interest for the tax years ending 2008, 2009, 2010 and 2011.

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

C. The hearing was timely set as required by NMSA 1978, Section 7-1-24.1(A) (2013).

D. Pursuant to NMSA 1978, Section 7-1-17(C) (2007), the Department's assessment is presumed to be correct, and it is Taxpayer's burden to come forward with evidence and legal argument to establish that she was entitled to an abatement.

E. Taxpayer provided services in New Mexico to USANA; specifically, she recruited, educated and shepherded preferred customers to purchase USANA's products.

F. Taxpayer also provided services in New Mexico to USANA by recruiting Distributors whose preferred customers purchased USANA's products.

G. Taxpayer received commissions when her preferred customers or the recruited Distributor's preferred customers purchased USANA's products.

H. The sale of USANA's products to preferred customers in New Mexico is taxable.

I. The sale of USANA's products to Distributors in New Mexico is taxable.

J. The intent of the TS-22 agreement is to collect gross receipts tax on the sale of USANA's products by its Distributors to preferred customers.

K. The deduction found in Section 7-9-66 does not apply to Taxpayer because the underlying transaction or the sale of USANA's products to either a preferred customer or a Distributor is a taxable event.

L. USANA has substantial nexus with New Mexico because it has independent contractors (Associates and Distributors) whose purpose is to establish and maintain a market in New Mexico for USANA.

M. USANA would have no market in New Mexico, but for the Associates and Distributors.

N. USANA's sales to Distributors, Associates and preferred customers are not deductible pursuant to Section 7-9-55.

O. Taxpayer was not negligent in not filing her gross receipts returns when due for the tax years 2008, 2009, 2010 and 2011; accordingly, she does not owe penalty.

P. The total amount due for tax year 2008 is $3,824.78 in principal and $991.42 in interest; for the tax year 2009, the amount due is $3,463.98 in principal and $739.89 in interest; for the tax year 2010, the amount due is $3,043.79 in principal and $529.61 in interest; and for the tax year of January 2011, the amount due is $3,264.56 in principal and $450.02 in interest.

Q. Interest continues to accrue until the principal is paid in full.

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

DATED: June 21, 2016

Monica Ontiveros

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

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, 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 Grieg, Administrative Hearings Office at P.O. Box 6400, Santa Fe, New Mexico 87502. Mr. Griego may be contacted at 505-827-0466.

/s/ John D. Griego

John Griego