STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
AVENTIS PHARMACEUTICALS INC.
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0233517888

& **No. 17-23**

IN THE MATTER OF THE PROTEST OF
SANOFI-SYNTHELABO INC.
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L1206618944

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on June 28, 2016 before Brian VanDenzen, Esq., Chief Hearing Officer of the Administrative Hearings Office, in Santa Fe. At the hearing, Attorneys Michael Jacobs and Timothy Van Valen appeared, representing Aventis Pharmaceuticals, Inc., and Sanofi-Synthelabo, Inc. ("Taxpayers"). Staff Attorney Peter Breen appeared representing the State of New Mexico Taxation and Revenue Department ("Department"). Protest Auditor Andrick Tsabetsaye appeared as a witness for the Department. Dr. Gary Iwomoto was subpoenaed to testify as a Department witness, and did so testify. Taxpayer Exhibits #1-13 and Department Exhibits A through DD were admitted into the record, as described in the detailed exhibit log included in the record. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

Jurisdictional and Procedural History of Protest

1. On April 4, 2013, under letter id. no. L0233517888, the Department assessed Taxpayer Aventis Pharmaceuticals, Inc. for $297,733.00 in corporate income tax, $59,546.60 in

penalty, and $43,722.93 in interest for the reporting periods between December 31, 2007 and December 31, 2009. [Taxpayer Ex. #9].

2. On April 4, 2013, under letter id. no. L1206618944, the Department assessed Taxpayer Sanofi-Synthelabo, Inc. for $424,234.00 in corporate income tax, $84,846.80 in penalty, and $64,025.46 in interest for the reporting periods between December 31, 2007 and December 31, 2009. [Taxpayer Ex. #10].

3. On May 3, 2013, Taxpayers collectively protested the assessments. Along with the protest, Sanofi-Aventis U.S., Inc. moved for a 60-day extension to file a protest. However, there is no evidence on this record whether Sanofi-Aventis U.S., Inc. ever filed a protest and that assessment is not part of this action.

4. On May 17, 2013, the Department's protest office acknowledged receipt of valid protests in this matter.

5. On December 9, 2013, the Department filed requests for hearing in these matters with the Hearings Bureau[1].

6. On December 10, 2013, the Hearings Bureau sent Notice of Telephonic Scheduling Hearing, scheduling this matter for a telephonic conference on December 10, 2013.

7. On January 10, 2014, a telephonic scheduling hearing occurred in these matters. The parties did not object that conducting the telephonic scheduling hearing satisfied the 90-day hearing requirement of the statute while also allowing for a meaningful discovery process and fair hearing process also required by statute.

[1] On July 1, 2015, pursuant to enacted Senate Bill 356, the Hearings Bureau became the Administrative Hearings Office ("AHO"). See NMSA 1978, Section 7-1B-1 through 8 (2015). The Hearings Bureau will be used for events that occurred before July 1, 2015, even though the hearing occurred before the Administrative Hearings Office, an agency now independent of the Taxation and Revenue Department.

8. On January 14, 2014, the Hearings Bureau issued Scheduling Orders and Notices of Administrative Hearings, setting these matters for hearings on January 13, 14, and 15, 2015.

9. On June 11, 2014, Department Staff Attorney Peter Breen entered his appearance in these matters.

10. On July 18, 2014, the Department filed its preliminary witness and exhibit lists in these matters.

11. On August 26, 2014, the Department filed a notice of discovery in the matter of the protest of Sanofi-Synthelabo, Inc.

12. On October 17, 2014, the Department filed a motion to compel discovery in the matter of the protest of Sanofi-Synthelabo, Inc., along with attached motion exhibits A & B.

13. On October 31, 2014, Taxpayers filed a response to the Department's motion to compel discovery in the matter of the protest of Sanofi-Synthelabo, Inc., attaching motion exhibits A-E.

14. On November 11, 2014, the Department filed its reply to Taxpayers' response in the matter of the protest of Sanofi-Synthelabo, Inc., attaching motion exhibits A & B.

15. On November 24, 2014, Taxpayers requested a hearing on the Department's motion to compel discovery in the matter of the protest of Sanofi-Synthelabo, Inc.

16. On December 2, 2014, the Hearings Bureau issued an order partially granting and partially denying the Department's motion to compel discovery in the matter of the protest of Sanofi-Synthelabo, Inc.

17. On December 4, 2014, Taxpayers collectively moved to partially vacate the Scheduling Orders issued in these matters and requested a status conference within two months to discuss the matter further.

18. On December 5, 2014, the Department filed a concurrence only with respect to Sanofi-Synthelabo, Inc.'s request to vacate the scheduling order.

19. On December 17, 2014, the Hearings Bureau issued an order vacating the previous scheduling order in the matter of the protest of Sanofi-Synthelabo, Inc. and setting a telephonic motion, status, and conference hearing on January 14, 2015.

20. On December 18, 2014, the Hearings Bureau issued an order vacating the previous scheduling order in the matter of the protest of Aventis Pharmaceuticals, Inc. and setting a telephonic motion, status, and conference hearing on January 14, 2015.

21. A status, motion, and scheduling hearing in the above-captioned matters in fact occurred on January 14, 2015. At that hearing, the matters were officially consolidated and a new scheduling order was discussed and agreed upon.

22. On January 15, 2015, the Hearings Bureau issued a consolidation order, second scheduling order, and amended notice of administrative hearing, setting the merits hearing for January 19, 20, and 21, 2016.

23. On January 28, 2015, the Department moved for a reconsideration of the Hearing Bureau's order partially granting and partially denying the Department's motion to compel discovery. The Department attached motion exhibits A-G to its reconsideration.

24. On February 12, 2015, Taxpayers filed its response to the Department's motion for reconsideration, attaching motion exhibits A-D.

25. On March 3, 2015, the Department filed a reply to Taxpayers' response on the motion for reconsideration, attaching motion exhibits A & B.

26. On March 10, 2015, the Hearings Bureau granted the Department's reconsideration and issued an order compelling Taxpayers to respond to question four of the Department's first set of interrogatories.

27. On April 8, 2015, Taxpayers filed a revised response to Department's question number four of the first set of interrogatories.

28. Between April 22, 2015 and November 20, 2015, both parties filed a series of certificates of service on discovery, notices of subpoena, and responses to discovery.

29. On December 4, 2015, Taxpayers moved for partial summary judgment in this matter.

30. On December 11, 2015, Taxpayers requested a status conference to discuss a letter they received from the Department's counsel about the unauthorized practice of law and requesting Taxpayers to withdraw their motion for summary judgment.

31. On December 11, 2015, the Department moved to strike Taxpayers' motion for partial summary judgment and opposed the request for a status conference.

32. On December 15, 2015, the Department filed a motion for extension of time to file its summary judgment response, continuance request, motion to compel, and request to address the issues during the status conference requested by Taxpayers.

33. On December 18, 2015, the Administrative Hearings Office sent notice of status conference for December 30, 2015.

34. On December 20, 2015, New Mexico licensed attorney Timothy Van Valen entered his appearance on behalf of Taxpayers.

35. On December 28, 2015, Taxpayers filed a response to the Department's December 15, 2015 motion.

36. On December 30, 2015, a status hearing occurred. On that same date and as a result of the issues addressed and ruled upon during that hearing, the Administrative Hearings Office issued an order: continuing the January 19, 20, and 21, 2016 hearing; setting a telephonic

motion hearing on January 19; setting an accelerated response deadline; and resetting the merits hearing for June 28, 29, and 30, 2016.

37. On January 6, 2016, the Department filed its reply to Taxpayers' response to the Department's December 15, 2015 motion to strike and compel discovery.

38. On January 6, 2016, Taxpayers filed a motion for partial summary judgment, with attached exhibits A through F.

39. On January 13, 2016, Taxpayers filed its reply to the Department's reply on motion to compel discovery and motion to extend time to respond to summary judgment.

40. On January 14, 2016, Taxpayers' representative Michael Jacobs filed his Registration Certificate of a Non-Admitted Lawyer (Admission pro hac vice).

41. On January 29, 2016, the Department filed its response to Taxpayers' motion for partial summary judgment, with attached exhibit A.

42. On February 4, 2016, the Administrative Hearings Office issued an order ruling on numerous outstanding matters, setting motions deadlines, and scheduling a summary judgment motion hearing on March 16, 2016.

43. On February 8, 2016, Taxpayers filed its reply to the Department's response to the partial motion for summary judgment, along with attached exhibits A and B.

44. A summary judgment motion hearing occurred on March 16, 2016.

45. On March 23, 2016, after conducting oral argument on the parties' respective partial summary judgment pleadings, the Administrative Hearings Office issued an order granting partial summary judgment to Taxpayers on the election of reporting method issue in the event that Taxpayers were found liable to pay corporate income tax in New Mexico.

46. On May 26, 2016, the Department filed notice of issuance of a subpoena for appearance of a witness, Dr. Gary Iwamoto, at the scheduled hearing.

47. On June 21, 2016, Taxpayers filed their prehearing statement, noting that the Department had not been responsive to its request to proceed with preparing and filing a joint prehearing statement. Taxpayers requested that the Department stipulate to the authenticity of its proposed exhibits identified in its prehearing statement.

48. On June 23, 2016, the Department filed its prehearing statement, noting that "[t]he Department believes that there is little controversy about the facts." The Department made no other statement accepting or rejecting Taxpayers proposal that it stipulate to the authenticity of Taxpayers' proposed exhibits.

49. On June 24, 2016, the Department filed an amendment to its prehearing statement, listing Dr. Gary Iwamoto as a witness.

50. On June 24, 2016, Taxpayers filed an amended prehearing statement.

51. On June 28, 2016, a merits hearing occurred in this matter without Taxpayers presenting a single testifying witness to support its protest.

52. On July 15, 2016, the Administrative Hearings Office issued a post-hearing briefing schedule.

53. On August 26, 2016, Taxpayers submitted its written closing arguments, proposed findings of fact, and proposed conclusion of law.

54. On August 26, 2016, the Department submitted its proposed findings of fact and written closing arguments.

Merits of Protest

55. The entities involved in this protest, Aventis Pharmaceuticals Inc. ("API") and Sanofi-Synthelabo Inc. ("SSI"), are two wholly owned subsidiaries of Sanofi-Aventis Amerique du Nord of France. [Taxpayers Ex. #11.5; #12.5; Dept. Ex. A; Dept. Ex. J.4]

56. Sanofi-Aventis Amerique du Nord is part of the large multinational pharmaceutical company, Sanofi Aventis SA of France. [Dept. Ex. J.4]

57. Sanofi Aventis SA of France is the fourth largest pharmaceutical country in the world. [Dept. Ex. A.80]

58. Sanofi-Aventis US Inc. serves as headquarters (located in Bridgewater, New Jersey) for US operations of Sanofi-Aventis Amerique du Nord. [Taxpayers Ex. #11.7; Dept. Ex. A].

59. Sanofi-Aventis US Inc. has research facilities in California, New Jersey, Pennsylvania, Massachusetts, Virginia and Arizona. [Taxpayers Ex. #11.7; Dept. Ex. A]

60. Sanofi-Aventis US Inc. also manages clinical trials and other studies related to prescription drugs across the country. [Taxpayers Ex. #11.7; Dept. Ex. A]

61. Sanofi-Aventis US LLC is owned by two partners, the Taxpayers in this protest API and SSI. [Taxpayers Ex. #11.9; Dept. Ex. A]

62. Sanofi-Aventis US LLC is Sanofi-Aventis Is Inc.'s North American selling entity, with product distribution centers in Georgia, Missouri, and Nevada. [Taxpayers Ex. #11.9; Dept. Ex. A]

63. Sanofi-Aventis US LLC also has one product manufacturing facility in Kansas City. [Taxpayers Ex. #11.9; Dept. Ex. A]

64. The Multistate Tax Commission ("MTC") conducted a Joint Income Tax Audit of Sanofi-Aventis US Inc. and Subs and Affiliates in multiple states, including New Mexico, for tax years 2007 through 2009. [Taxpayers Ex. #11, #12, and Dept. Ex. A]

65. The MTC determined that API sole activity is as a flow through for its 57.28% (capital) ownership interest in Sanofi-Aventis US LLC. [Taxpayers Ex. #11.5; Dept. Ex. A]

66. The MTC determined that SSI sole activity is as a flow through for its 42.72% (capital) ownership interest in Sanofi-Aventis US LLC. [Taxpayers Ex. #11.5; Dept. Ex. A].

67. The MTC audit concluded that Aventis, Inc. and its subsidiaries (including API) along with SSI operate a unitary business in the United States. [Taxpayers Ex. #11.10-14]

68. Sanofi-Aventis US LLC and Sanofi-Aventis US Inc. have an intercompany management agreement and a service agreement leading to payment by the LLC for the services Inc. provided to the LLC. [Taxpayers Ex. #11-21; Dep. Ex. K]

69. The intercompany management agreement requires both Sanofi-Aventis US LLC and Sanofi-Aventis US Inc. to send notice to an identical address of 55 Corporate Drive, Bridgewater, NJ 08807. [Dept. Ex. K.5]

70. Sanofi-Aventis US Inc. provided Sanofi-Aventis US LLC with administrative support such as human resources and legal, general marketing advice, advertising, management consulting, product importation, research and development, and field medical personnel services, at the a fee of cost plus 5%. [Dept. Ex. J.29; Dept. Ex. K.7-10]

71. Under the service and management agreement, Sanofi-Aventis US Inc. provides field medical services to Sanofi-Aventis US LLC. Field medical services entail approximately 20 field medical professionals located throughout the country that serve as liaisons on scientific, medical, or health outcomes education/information with medical professionals. Rather than focusing on sales, these field medical professionals have medical training and focus on research and managing clinical trials of new drugs not yet approved or approved drugs being tested for new indications. [Taxpayers Ex. #11-21; Taxpayers Ex. 13]

72. Sanofi-Aventis US LLC has a large New Mexico payroll, employing sales people (described as detailers in this line of business) that meet with healthcare providers in order to encourage prescriptions for Sanofi-Aventis drug products. This would involve on-on-one

meetings with local doctors to describe the benefit of the drug and provide them with free samples of the drug [Taxpayers Ex. #11.15; 11.28].

73. Sanofi-Aventis US LLC did not maintain any inventory in New Mexico.

74. While Sanofi-Aventis US LLC detailers did solicit sales in New Mexico, the LLC employees did not make, approve, or enter into any contracts for sale of Sanofi-Aventis products. Instead, orders were submitted to Sanofi-Aventis US Inc.'s corporate headquarters facility in New Jersey.

75. Sanofi-Aventis US LLC employees did not perform collections on accounts, investigate or authorize credit, accept any funds, or address complaints.

76. While the job descriptions provided to the MTC auditor by Sanofi-Aventis US LLC seemed limited to duties related to the solicitation of sales, the MTC auditor located an online, unabridged job description for detailers that included a much broader role beyond solicitation of sales, including collaborative work with external partners and hospitals on the development of treatment protocols. [Taxpayers Ex. 11-27]

77. More than just solicitation for sales, the MTC audit found that Sanofi-Aventis US LLC provided doctors with ongoing education and textbooks and funding for training materials and classes at doctor offices. [Taxpayers Ex. 11-27].

78. The MTC audit concluded that New Mexico had nexus to tax Sanofi-Aventis US LLC, including the two partners in that LLC, API and SSI, the Taxpayers in this protest, in part because of clinical trials performed in this state by Sanofi-Aventis US, Inc. [Dept. Ex. A.114-5].

79. Dr. Gary Iwomoto of the University of New Mexico Hospital ("UNMH") participated in the conduct of an investigator-sponsored clinical trial of the drug Epidra and Glucommander (both related to the treatment of diabetes) under a Clinical Research Grant Agreement with Sanofi-Aventis, US, Inc. [Dept. Ex. R; Dept. Ex. B]

80. The trial was conducted at three hospitals: UNMH, Presbyterian Hospital in Albuquerque, NM, and St. James Hospital and Health Centers in Chicago Heights, IL. [Dept. Ex. B].

81. UNMH and Sanofi-Aventis, US, Inc. entered into Investigator-Sponsored Clinical Research Grant Agreement in the fall of 2006. [Dept. Ex. R].

82. Under the applicable Investigator-Sponsored Clinical Research Grant Agreement, UNMH was required to send any notice required to the general counsel of Sanofi-Aventis, US, LLC (emphasis added). [Dept. Ex. R]

83. Under the terms of the agreement, Sanofi-Aventis, US, Inc. provided UNMH and Dr. Iwomoto at no cost study drugs for up to 50 patients and financial support totaling $202,800.00. [Dept. Ex. R.1].

84. The clinical trial was designed to test the effectiveness of a new dosage schedule/determination method of two previously approved drugs for the treatment of diabetes.

85. Dr. Mario Rodriguez was the representative, liaison, and contact from Sanofi-Aventis, US, Inc. during the course of the study. Dr. Rodriguez participated in weekly status calls about the survey. Dr. Rodriguez helped the three hospitals involved in the trial coordinate the study and comply with applicable reporting requirements for a clinical trial.

86. In emails addressed to Dr. Iwomoto, Dr. Rodriguez listed his title at RML Region Director Southwest, Sanofi-Aventis US, US Medical Affairs. Dr. Rodriguez did not specify whether he worked for Sanofi-Aventis, US, Inc. or Sanofi-Aventis US, LLC. [Dept. Ex. AA]

87. Dr. Rodriguez's email address merely ended as "@sanofi-aventis.com." [Dept. Ex. AA]

88. In his emails, Dr. Rodriguez listed RML's mission as "[t]o facilitate scientific exchange of medical information and research through the development of relationships with

members of the healthcare community as well as collaboration with our medical and commercial colleagues to provide innovative solutions to achieve the optimal health outcomes in patients with diabetes an cardiometabolic disease." [Dept. Ex. AA]

89. Patients who participated in the clinical research study at UNMH were informed as part of their informed consent that the Sanofi-Aventis, US, Inc. funded the study. [Dept. Ex. E]

90. Dr. Iwomoto believed that Sanofi-Aventis was the sponsor of the clinical research project and had no knowledge of any separate or distinct corporate entity being involved other than Sanofi-Aventis.

91. As of the date of hearing, Sanofi-Synthelabo, Inc. owed $424,234.00 in corporate income tax, $84,846.80 in penalty, and $105,814.75 in interest for a total outstanding liability of $614,895.55. [Dept. Ex. DD].

92. As of the date of hearing, Aventis Pharmaceuticals, Inc. owed $297,733.00 in corporate income tax, $59,546.60 in penalty, and $73,051.20 in interest for a total outstanding liability of $430,330.80 [Dept. Ex. DD].

DISCUSSION

The main issue in this case is whether Taxpayers are subject to New Mexico Corporate Income Tax or are protected from such taxation under Public Law 86-272 and the Commerce Clause. Another issue is whether Taxpayers presented sufficient factual evidence to support their protest and election of filing method (which they were permitted to legally do under the grant of partial summary judgment) when they failed to present any factual witnesses at hearing. The final issue is whether Taxpayers are liable for the payment of civil negligence penalty and interest.

Presumption of Correctness.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessments issued in this case are presumed correct. Consequently, Taxpayers have 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. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight). Accordingly, it is Taxpayers' burden to present some countervailing evidence or legal argument to show that they are entitled to an abatement, in full or in part, of the assessments. *See N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8. "Unsubstantiated statements that the assessment is incorrect cannot overcome the presumption of correctness." *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 2003 NMCA 21, ¶13, 133 N.M. 217; *See also* Regulation 3.1.6.12 NMAC. When a taxpayer presents sufficient evidence to rebut the presumption, the burden shifts to the Department to show that the assessment is correct. *See MPC Ltd.*, 2003 NMCA 21, ¶13.

New Mexico Corporate Income Tax, Nexus, and P.L. 86-272

Under NMSA 1978, Section 7-2A-3, New Mexico levies an income tax on the "the net income of every domestic corporation and upon the net income of every foreign corporation employed or engaged in the transaction of business in, into or from this state or deriving any income from any property or employment within this state." As used under the Corporate Income and Franchise Tax Act, the term "corporations" includes corporations, joint stock corporations, certain real estate trusts, financial corporations, banks, other business associations, limited liability

companies and partnerships taxed as corporations under the Internal Revenue Code. *See* NMSA 1978, § 7-2A-2 (D).

For the purpose of Section 7-2A-4, Taxpayers were engaged in the transactions of business into this state for which they derived income, and thus presumed subject to New Mexico Corporate Income Tax. Taxpayers were the two partners who owned Sanofi-Aventis US LLC. Taxpayers' argument about the application of Public Law 86-272 (addressed in greater detail below) is an acknowledgement that Taxpayers, through their ownership of Sanofi-Aventis US LLC, had sales people that entered into the state in order to facilitate the sales of Taxpayers product to doctors, hospitals, and pharmacies. Additionally, the evidence established by the preponderance that Taxpayers, as controlling partners in Sanofi-Aventis US LLC, provided ongoing educational opportunities, textbooks, and trainings to doctor's offices in New Mexico and collaborated with hospitals in establishing treatment protocols.

Despite fitting within the parameters of New Mexico statute, in order for New Mexico to impose a corporate income tax upon a foreign corporation, the tax must not run afoul of the Due Process Clause or Commerce Clause of the United States Constitution. *See Quill Corporation v. North Dakota,* 504 U.S. 298 (1992). Like in *Quill*, there is little doubt in this matter that Taxpayers purposefully directed activities at New Mexico doctors and had substantial contacts with the state through those contacts, satisfying the due process requirements for taxation. *id*. at 308. Thus, there is little need in this instance to analyze the Due Process clause in this protest.

The heart of the dispute in this matter turns on concepts related to or encompassing the Commerce Clause. In *Complete Auto Transit v. Brady,* 430 U.S. 274 (1977), the United States Supreme Court held that a state tax on foreign corporations performing exclusively interstate business will not violate the protections of the Commerce Clause if the tax meets the following four-part test: (1) a sufficient nexus exists between the activity being taxed and the taxing state;

(2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to services provided by the state. Of these potential Commerce Clause issues, Taxpayers only challenged the sufficient nexus prong on two separate but related grounds. First, Taxpayers asserted that pursuant to Public Law 86-272 Congress prohibited state taxation under the Commerce Clause in this case because at most, Taxpayers were engaged in the mere solicitation of sales and *de minimis* activities in New Mexico. Secondly, Taxpayers challenged the Department's assertion of attributional nexus between Taxpayers and the clinical research in New Mexico sponsored by the separate entity Sanofi-Aventis US Inc.

Taxpayers primary argument throughout the proceeding has been that their solicitation of sales activity in New Mexico is not subject to state taxation under Public Law 86-272, as codified under 15 USCS § 381. Congress enacted Public Law 86-272 in response to decision of the United States Supreme Court in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959) and business concerns about uncertainty of when and under what circumstances a state may tax a foreign corporation engaged in interstate commerce for solicitation of sales activity. *See Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275, 279 (U.S. Dec. 18, 1972) (discussing the history and purpose of Public Law 86-272). Public Law 86-272 confers immunity from state income taxes on foreign corporations whose only business activities in a state consist of the solicitation of orders for interstate sales. In pertinent part, Public Law 86-272 reads:

> P. L. 86-272—The Interstate Income Law
> Title I—Imposition of Minimum Standard
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> Sec. 101. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).
>
> (b) . . . .
>
> (c) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors, whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.
>
> (d) For purposes of this section—
>
> (1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and
>
> (2) the term "representative" does not include an independent contractor.

Public Law 86-272 does not define the term "solicitation of orders." In *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992), the United States Supreme Court held that the solicitation of orders covers more than activities that are "strictly essential" to making requests for purchases. *Id*. at 228. For example, providing a salesman with a company car and product samples comes within the term "solicitation of orders" because these activities serve no purpose other than to facilitate requests for purchases. *Id*. at 229. *Wrigley*

drew a line, however, “between those activities that are *entirely ancillary* to requests for purchases—those that serve no independent business function apart from their connection to the soliciting of orders—and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force." *Id*. at 228-229. (emphasis in original). A *de minimis* exception applies to these additional activities. Whether a particular activity is sufficiently *de minimis* to avoid loss of the immunity afforded by Public Law 86-272 depends upon whether that activity establishes a “nontrivial additional connection” with the taxing State. *Id*. at 232.

In *Wrigley*, the Court found that the company was subject to Wisconsin corporate income tax because its in-state activities of replacing stale chewing gum, supplying gum through agency stock checks, renting storage space and storing gum served a separate business purpose and were not entirely ancillary to the solicitation of orders. On the other hand, Wrigley's recruitment and training of sales staff, as well as the in-state sales staff's periodic intervention in credit disputes between customers and the Wrigley home office, were entirely ancillary because they served no function other than to facilitate the solicitation of orders.

In this case, the MTC and the Department correctly determined that Taxpayers were engaged in more than the mere solicitation of sales and more than *de minimis* activity in New Mexico. It is true that Taxpayers exhibited some of the classic hallmarks of Public Law 86-272 protection. Other than sending sales-detailers into the state to solicit sales, Taxpayers’ LLC had no offices, facilities, or other employees in New Mexico. Taxpayers’ LLC employees did not directly make, approve, or contract for any sales in New Mexico. Taxpayers’ LLC employees did not perform collections on accounts, investigate or authorize credit, accept any funds, or address customer complaints. All sales were handled by Sanofi-Aventis US from the Bridgewater, New Jersey headquarters, and shipped into the state by common carrier.

But Taxpayers, as controlling partners of the LLC, engaged in other activities that were not entirely ancillary to sales of Sanofi-Aventis pharmaceuticals. In addition to securing sales of Sanofi-Aventis pharmaceuticals shipped from out of state, Sanofi-Aventis US LLC's detailers engaged in collaborative work with external parties and hospitals on the development of treatment protocols. Given the professional obligations of health practitioners in the medical field, it cannot be said that the only purpose of such collaborative work was entirely ancillary of sales of Sanofi-Aventis products, but also to further the general medical professional obligation to serve the vital needs of the patients and their doctors.

Similarly, Sanofi-Aventis US LLC's detailers provided ongoing education training courses and materials, and funding for such training, to doctors and medical staff. While providing such training opportunities may inure goodwill to Taxpayers that also assists with sales of pharmaceuticals, it is also serves an independent function of informing the medical profession of advancements and developments in the treatment of patients, something that any pharmaceutical company engaged in the medical profession at a high level of research and clinical trial is expected to do. Indeed, one only need to look at the mission statement Sanofi-Aventis US employee, Dr. Rodriguez, included in his email: "to facilitate scientific exchange of medical information and research…" to see that Sanofi-Aventis would likely conduct such activities regardless of a sales motive.

Moreover, the activities of Sanofi-Aventis US, Inc. in sponsoring ongoing clinical research at two New Mexico hospitals, which are attributable to Taxpayers under applicable attributional nexus case law discussed below, also involved a non-trivial, not entirely ancillary to sales connection to New Mexico. While Taxpayers argue that the activities of Sanofi-Aventis US, Inc. cannot be attributed to Taxpayers, that argument is not persuasive in light of relevant law.

In *Tyler Pipe Industries Inc. v. Washington Department of Revenue,* 483 U.S. 232 (1987), the United States Supreme Court held that Washington could impose its wholesale tax on an out-of-state vendor whose only contact with the state was through the activities of independent contractors. In dismissing that taxpayer's argument that it was immune under the Commerce Clause from taxation when the in-state activity was conducted by an independent contractor, the Court in *Tyler Pipe Industries, Inc.* was less concerned about the formal nature of the relationship between the entities involved and more concerned about the role the third party entity had in the market: "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." 483 U.S. at 251 (quoting from the Washington Supreme Court's decision). *See also Scripto, Inc. v. Carson,* 362 U.S. 207 (1960) (taxing state had nexus with an out-of-state vendor based solely on the presence of independent contractors; "to permit such formal 'contractual' shifts to make a constitutional difference would open the gates to a stampede of tax avoidance").

Two relatively recent cases in New Mexico reached a similar conclusion. In *Dell Catalog Sales L.P. v. Taxation and Revenue Department of the State of New Mexico,* 2009-NMCA-001, 145 N.M. 419, cert. denied, 129 S.Ct. 1616, the New Mexico Court of Appeals found that Dell's exercise of authority and control over a non-affiliated third party service technician it contracted with provided sufficient nexus for state taxation because the third party helped Dell establish and maintain a New Mexico market. Importantly, the New Mexico Court of Appeals noted that there was no case law prohibiting the attribution of a third-party's non-sales activity under the Commerce Clause and that the non-sales activity of the third party was sufficient to help Dell foster a New Mexico sales market. *See Dell Catalog Sales, L.P.*, ¶48.

Here, although Sanofi-Aventis US, Inc., was engaged in non-sales activity in New Mexico in sponsoring the clinical research trial, like in *Dell Catalog Sales, L.P.*, such activity could lead to attributional nexus if it helped Sanofi-Aventis US LLC develop or maintain a market in New Mexico. The clinical research activity occurred at UNMH and Presbyterian Hospital, two of the largest hospitals in New Mexico's largest city, potentially exposing numerous potential New Mexico doctor-customers to the goodwill of Sanofi-Aventis. Moreover, although the trial ultimately proved unsuccessful, the clinical trial conducted in New Mexico had the potential to lead to a new indication/use/dosages regime of a Sanofi-Aventis diabetic treatment course in a state commonly known to have a high rate of diabetes, thereby potentially significantly increasing Sanofi-Aventis US LLC's market in the state.

The other New Mexico case addressing the role of a third-party's instate activities for purposes of substantial nexus under the Commerce Clause, *N.M. Taxation & Revenue Dep't v. Barnesandnoble.com LLC (BN.com)*, 2013-NMSC-023, is even more applicable to the facts of this protest than *Dell Catalog*. In *BN.com*, the New Mexico Supreme Court noted that while there were two separate corporations involved (Barnes and Noble Bookseller and BN.com), both entities shared a parent company that owned both entities during the audit period. *id*. at ¶9. From a customer's perspective, as the New Mexico Supreme Court noted in *BN.com*, the two entities involved were identical. *id*. at ¶10. The customers association of one entity with the other allowed both entities involved plus the parent company to benefit from the established brand loyalty and goodwill associated with the brand. *See id*. Consequently, the New Mexico Supreme Court held that the instate brick and mortar activities of one of the entities benefitted the efforts of the other to establish and maintain a market in the state, granting the state sufficient nexus under the Commerce Clause to impose tax on BN.com. *See id*. In reaching its ultimate holding,

the New Mexico Supreme Court noted "that ownership of the corporations is not dispositive of substantial nexus inquiry." *id*. at ¶12.

Like in *BN.com*, in this matter, Taxpayers and Sanofi-Aventis, US, Inc. share a common parent owner: Sanofi-Aventis Amerique du Nord of France. Since Sanofi sells pharmaceuticals that require a prescription for issuance, Sanofi's customers are primarily the doctors who are allowed to write prescriptions. As Dr. Iwomoto made clear, a potential customer of Sanofi-Aventis, US, Inc. and Sanofi-Aventis, US, LLC, he had no way of knowing the niceties of Taxpayers corporate structure and just assumed he was dealing with one entity, Sanofi-Aventis. The conclusion of Dr. Iwomoto (someone in the medical field with experience with pharmaceuticals) that he was simply working with one corporate entity is not unreasonable, as evidenced by the communications with Dr. Rodriguez, who served as liaison and coordinator for the clinical research project. Dr. Rodriguez indicated in his emails that he worked for Sanofi-Aventis US, not specifying a distinct corporate entity.

Moreover, Sanofi-Aventis, US, Inc. engaged with Sanofi-Aventis, US, LLC in providing services such as legal support, HR, payroll, etc. In fact, the clinical research agreement between UNMH and Sanofi-Aventis, US, Inc. mandated that any required notice also be sent to Sanofi-Aventis, US, LLC and the same address as Sanofi-Aventis, US, Inc. These connections, in conjunction with the customer's belief they were dealing with only one Sanofi entity, shows that Taxpayers benefited in New Mexico from the activities of Sanofi-Aventis, US, Inc. Sanofi-Aventis, US, Inc's sponsorship of a clinical trial at two New Mexico hospitals, where it paid the facilities to conduct the trials and provided drugs to the doctors and patients, certainly would convey goodwill for the Sanofi brand in New Mexico with Taxpayers' perspective customer—doctors at both UNMH and Presbyterian Hospital in Albuquerque. *See BN.com*, at ¶10. Again, as discussed above, the potential of the clinical trial developing a new indication or treatment

protocol for an approved Sanofi-Aventis drug could have also significantly increased Sanofi-Aventis, US, LLC's market in the state.

Sanofi-Aventis, US, Inc.'s clinical trials, which benefitted the goodwill of the Sanofi brand among Taxpayers' customers in New Mexico, were nontrivial additional connections into New Mexico. As such, Taxpayers exceeded the mere solicitation/*de minimis* activity protections of Public Law 86-272. *See Wrigley, Jr., Co.*, 505 U.S. 214. Moreover, there was sufficient nexus for the state to impose the assessed tax on Taxpayers under the Commerce Clause, both because Sanofi-Aventis, US, LLC's had activities in the state beyond the mere solicitation of sales and because the attributional activities of Sanofi-Aventis, US, Inc. increased Taxpayers market and market potential in the state. *See Tyler Pipe Industries Inc.*, 483 U.S. 232. *See also Dell Catalog Sales L.P.*, 2009-NMCA-001. *See also BN.com*, 2013-NMSC-023.

Election of Reporting Methods

After reviewing the pleadings of the parties and conducting a motion's hearing, the undersigned hearing officer granted Taxpayers partial summary judgment on the question of making a first election of a reporting method, since Taxpayers have never before made any election of reporting methods. Although the Department seeks to relitigate that legal determination already addressed in the order granting partial summary judgment, it is unnecessary to do so. This is because Taxpayers inexplicably did not present their proposed return showing their first elected reporting method at the hearing, when the assessment was ripe for challenge.

This failure to present evidence was part of the broader problem the day of the hearing, where Taxpayers presented no factual witnesses to support the factual elements of their protest and the Department (interposed with some valid objections) tediously objected to the admission of some exhibits that it had already included in its proposed exhibit binder. This lead to the

development of a disorganized record. It is perplexing that Taxpayers would choose not to present any fact witnesses to support their protest, even in a setting where the formal rules of evidence do not apply, particularly when it is Taxpayers who have the burden to overcome the presumption of correctness. The Department's attorney bears some of the responsibility as well, as it is quite clear that the Department's attorney did not effectively communicate with opposing counsel on preparation of the joint prehearing statement (as required to do so under the scheduling order issued in this matter), where Taxpayers hoped to reach stipulation of facts. Further, when the Department's counsel finally filed its prehearing statement, it began by stating that the facts were not largely in dispute. Taxpayers were given numerous opportunities to request a continuance so they could present a witness, but choose to proceed with the presentation of their case.

At the end of the day, however, Taxpayers bore the burden to overcome the presumption of correctness of the assessment. By failing to present their proposed return showing their first elected reporting method, the hearing officer has no factual basis to modify the assessed tax principal and Taxpayers failed to overcome the presumption of correctness that attached to the assessment in this matter. Therefore, Taxpayers are liable for the entire tax principal assessment.

Penalty and Interest.

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, 32 (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 Taxpayers until Taxpayers satisfies the corporate income tax principal.

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, NMSA 1978 Section 7-1-69 (2007) requires that

> 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.

(*italics* added for emphasis).

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." *See Marbob Energy Corp.*, ¶22.

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." Taxpayers failure to file and pay New Mexico corporate income tax met these definition negligence for inaction where action was required.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception: "[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." A mistake of law is a "mistake about the legal effect of a known fact or situation," whereas a mistake of fact is a "mistake about a fact that is material to a transaction; any mistake other than a mistake of law." BLACK'S LAW DICTIONARY 1153-4 (10th ed. 2009). This provision generally requires evidence that a taxpayer engaged in an informed consultation and decision-making process that the tax was not legally due. *Cf. C & D Trailer Sales v. Taxation and Revenue Dep't*, 1979-NMCA-151, ¶8-9, 93 N.M. 697 (penalty upheld where there was no evidence that the taxpayer "relied on any informed consultation" in deciding not to pay tax).

In 2007, which was the first year under assessment, Taxpayers consulted with a major national law firm about their potential tax liabilities under Public Law 86-272. That law firm wrote a detailed memo, analyzing the issue and concluding that it was more likely than not that Taxpayers activities were mere solicitation, protected from state taxation by Public Law 86-272. In light of that detailed memo, Taxpayers decision to not file and pay New Mexico Corporate Income Taxes was a mistake of law made in good faith and on reasonable grounds. Thus, under Section 7-1-69 (B), Taxpayers are not liable for the assessed penalty in this case.

CONCLUSIONS OF LAW

A. Taxpayers filed timely, written protests to the Department's assessment, and jurisdiction lies over the parties and the subject matter of this protest.

B. The scheduling hearing was timely set within 90-days of protest under NMSA 1978, Section 7-1-24.1 (A) (2013) and the parties did not object that the scheduling hearing satisfied the hearing timely hearing requirement of that statute while also affording sufficient time to conduct discovery and other fair hearing requirements articulated under that section.

C. Taxpayers' activities in New Mexico were not limited to mere solicitation of sales, were not entirely ancillary to sales, and were not *de minimis*. Thus, Taxpayers were not protected

from state taxation under Public Law 86-272. *See Wisconsin Department of Revenue v. William Wrigley, Jr., Co*., 505 U.S. 214 (1992).

D. New Mexico had sufficient nexus to impose corporate income tax on Taxpayers based on Taxpayers' activities in the state and the clinical trial activities of Sanofi-Aventis, US, Inc. in the state, which furthered the goodwill of the Sanofi-Aventis brand with Taxpayers' New Mexico customers. *See Tyler Pipe Industries Inc.*, 483 U.S. 232. *See also Dell Catalog Sales L.P.*, 2009-NMCA-001. *See also BN.com*, 2013-NMSC-023.

E. Although Taxpayers were granted partial summary judgment on the legal question to allow them to select a reporting method, Taxpayers did not provide their returns under their selected reporting method at the hearing. Without presentation of such evidence, Taxpayers did not overcome the presumption of correction of the assessed tax principal amount in this matter and the hearing officer has no factual basis to support further adjustments to the assessed tax principal.

F. Taxpayers did not overcome the presumption of correctness of the tax principal and interest 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.

G. Under NMSA 1978, Section 7-1-69 (B) (2007), Taxpayers are not liable for civil negligence penalty because Taxpayers' decision to not pay New Mexico tax resulted from mistake of law, made in good faith and on reasonable grounds.

For the foregoing reasons, the Taxpayers' protest **IS PARTIALLY DENIED AND PARTIALLY GRANTED**. The Department is ordered to abate the assessed penalty against each of the two Taxpayers totaling $144,393.40. Taxpayers are ordered to pay the combined outstanding tax principal and interest liability for each entity, which as of the date of hearing totaled

$721,967.00 in corporate income tax and $178,865.95 in interest. The total outstanding liability as of the date of the hearing was $900,832.95.

Dated: May 19, 2017

Brian VanDenzen
Chief 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 parties have 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. If an appeal is not timely filed with the Court of Appeals within 30 days, this Decision and Order will become final. Rule of Appellate Procedure 12-601 NMRA articulates the requirements of perfecting an appeal of an administrative decision with the Court of Appeals. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may begin preparing the record proper. The parties will each be provided with a copy of the record proper at the time of the filing of the record proper with the Court of Appeals, which occurs within 14 days of the Administrative Hearings Office receipt of the docketing statement from the appealing party. *See* Rule 12-209 NMRA.