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593-022 STATE & LOCAL TAXES
Fall Semester 2005

UNM School of Law
Final Examination
Three Credits

Professor Robert J. Desiderio
Professor James Eads
December 9th & 16th , 2005
9:00 am to 12:00 Noon

Examination Format
Essay Answers

1. **Laptop** computer users: Start the Securexam program entering your examination number, course name, professor's name, & date of examination. Click "proceed" to enter the program. Type START in the next window that is displayed but do NOT press the enter key until the proctor says to begin the exam.

2. **Bluebooks** for writing: write on every-other line and only on the front page of each sheet. On the front of bluebook record the class name, professor's name, date of exam, and your examination number. Make sure to number each bluebook in order. DO NOT WRITE YOUR NAME ON BLUEBOOKS.

A five-minute warning will be given prior to the conclusion of the examination. When time is called, stop immediately. If you are handwriting, lay down your pen & close bluebook immediately. If using a laptop, save & exit the program.

Go to the exam check-in table at the conclusion of the exam & fill out an examination receipt.

PROFESSOR'S INSTRUCTIONS

1. This examination includes two questions. You must answer both. Each question will be given equal weight. Each question should be allocated equal time.
2. You may have with you in the examination your casebook, any materials Jim and I have distributed, and any notes and outlines you have prepared or actively helped in their preparation. You may not have with you any other books, materials, or information.
3. You have three hours in which to complete the examination.

GOOD LUCK

QUESTION 1.

BigTelCo is a telecommunications company operating in all fifty of the United States. It provides long distance telecommunications services to its customers. It owns, in its entirety, a manufacturing subsidiary, BigTalkingMachines, Inc., that manufactures and sells at wholesale and retail telecommunications equipment both to BigTelCo, BigTelCo's customers and to other telecommunications companies as well as others. Approximately 40% of BigTalkingMachines' sales are to BigTelCo.

For the years 2002-2004 both BigTelCo and BigTalkingMachines, Inc. filed tax returns in the State of Grace calculating their income based on the fact that they are engaged in a unitary business. Each return determined the taxpayer's taxable income by taking the combined net income of BigTalkingMachines and BigTelCo and apportioning that total income based on the ratio of the particular taxpayer's property, payroll and gross receipts in Grace to the property, payroll and gross receipts everywhere for both companies. Coincidentally, during these years BigTalkingMachines incurred significant losses.

Grace audited the returns and issued an assessment of tax based on the assertion that the companies were not allowed to file on a unitary basis, but had to file on a separate accounting basis. For the years involved, BigTelCo's tax liability as reflected on the returns filed on a unitary basis was \$1.6 million and increased to \$9.2 million based on the assessment from Grace. BigTalkingMachines' tax liability as reflected on the returns filed on a unitary basis was 1.1 million and decreased to \$250 (the statutory minimum) based on the assessment from Grace.

During the years at issue, the State of Grace Tax Code provided, as to apportionment: "Where the net business income is derived principally from business other than the manufacture, production, or sale of tangible personal property ... the net business income of the corporation shall be equitably apportioned to this state in the ratio that the business within this state bears to the total business of the corporation." There is no question as to nexus for the companies.

You are the Associate Justice of the Supreme Court of Grace assigned to write the opinion for the Court. Please write the opinion, analyzing the unitary business principal, its application to this question the statutory assignments for both parties and any other relevant issue or issues.

QUESTION 2.

Gaspro is New Mexico corporation that produces natural gas. Gaspro's principal gas wells are located in San Juan and McKinley Counties, New Mexico. Some of Gaspro's major purchasers of natural gas are located in southern New Mexico, Arizona, Texas, California and the state of Chihuahua, Mexico (hereinafter designated "Gaspro's southern and western markets."). These purchasers are utility companies who then sell the natural gas to local consumers and businesses and who do not give nontaxable transaction certificates to Gaspro. Gaspro, however, does not own any pipeline to transport the natural gas to its purchasers.

A few years ago, Gaspro entered into a contract with Pipeco to transport the natural gas that Gaspro sold to its (Gaspro's) customers. Pipeco is incorporated in Alberta, Canada, with its principal office in Edmonton Alberta but has its US office in Topeka, Kansas. Pipeco, however, does not own the pipeline that services Gaspro's southern and western markets. Transco, a Colorado company, whose principal place of business is located in Denver, Colorado, owns that pipeline. Gaspro contracted with Pipeco for the delivery of its natural gas because the price that Pipeco charged Gaspro to transport all of its natural gas, including markets not located in Gaspro's southern and western markets, were cheaper than those offered by Transco. Even though Gaspro might pay Pipeco more for the natural gas delivered to its southern and western markets than it would pay Transco, Gaspro's total costs for transport of all natural gas to all its markets was less with Transco. Gaspro understood that Transco would have to contract with Pipeco for the delivery of its natural gas to its southern and western markets.

Transco did contract with Pipeco for transport of Gaspro's natural gas to Gaspro's southern and western markets. Transco charged Pipeco \$1 million a year to transport Gaspro's natural gas to its southern and western markets. Pipeco calculates that Gaspro is paying it (Pipeco) \$1.25 million for the delivery of such gas.

Gaspro's total receipts from the sale of natural gas are \$10 million. Of that total amount, \$1 million is derived from sales in southern New Mexico, \$2 million from sales to Chihuahua, Mexico, and \$5 million from sales to its Texas, Arizona and California customers.

You are a lawyer with the general counsel's office of the New Mexico Taxation and Revenue Department. The general counsel has asked you to write a memorandum analyzing whether New Mexico can impose gross receipts taxes on all or part of the Gasco, Pipeco and Transco transactions described in this question. The New Mexico statutory provisions that may be relevant to this question are attached. Assume they are the only statutes that may be applicable. Please write the memorandum, analyzing all the issues in detail. You must explain both the arguments for and against New Mexico's statutory and constitutional authority to tax all or part of the transactions.

END OF EXAMINATION

HAPPY HOLIDAYS!

7-9-3.3. Definition; engaging in business.

As used in the Gross Receipts and Compensating Tax Act [Chapter 7, Article 9 NMSA 1978], "engaging in business" means carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit, except that:

A. "engaging in business" does not include having a worldwide web site as a third-party content provider on a computer physically located in New Mexico but owned by another nonaffiliated person; and

B. "engaging in business" does not include using a nonaffiliated third-party call center to accept and process telephone or electronic orders of tangible personal property or licenses primarily from non-New Mexico buyers, which orders are forwarded to a location outside New Mexico for filling, or to provide services primarily to non-New Mexico customers.

7-9-3.5. Definition; gross receipts.

A. As used in the Gross Receipts and Compensating Tax Act [7-9-1 NMSA 1978]:

(1) "gross receipts" means the total amount of money or the value of other consideration received from selling property in New Mexico, from leasing property employed in New Mexico, from selling services performed outside New Mexico, the product of which is initially used in New Mexico, or from performing services in New Mexico. In an exchange in which the money or other consideration received does not represent the value of the property or service exchanged, "gross receipts" means the reasonable value of the property or service exchanged;

7-9-4. Imposition and rate of tax; denomination as "gross receipts tax".

A. For the privilege of engaging in business, an excise tax equal to five percent of gross receipts is imposed on any person engaging in business in New Mexico.

B. The tax imposed by this section shall be referred to as the "gross receipts tax".

History

7-9-47. Deduction; gross receipts tax; governmental gross receipts tax; sale of tangible personal property or licenses for resale.

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

7-9-48. Deduction; gross receipts tax; governmental gross receipts; sale of a service for resale.

Receipts from selling a service for resale may be deducted from gross receipts or from governmental gross receipts if the sale is made to a person who delivers a nontaxable transaction certificate to the seller. The buyer delivering the nontaxable transaction certificate must resell the service in the ordinary course of business and the resale must be subject to the gross receipts tax or governmental gross receipts tax.

7-9-55. Deduction; gross receipts tax; governmental gross receipts tax; transaction in interstate commerce.

A. Receipts from transactions in interstate commerce may be deducted from gross receipts to the extent that the imposition of the gross receipts tax would be unlawful under the United States constitution.

7-9-56. Deduction; gross receipts tax; intrastate transportation and services in interstate commerce.

A. Receipts from transporting persons or property from one point to another in this state may be deducted from gross receipts when such persons or property, including any special or extra service reasonably necessary in connection therewith, is being transported in interstate or foreign commerce under a single contract.

7-9-57. Deduction; gross receipts tax; sale of certain services to an out-of-state buyer.

A. Receipts from performing a service may be deducted from gross receipts if the sale of the service is made to an out-of-state buyer who delivers to the seller either an appropriate nontaxable transaction certificate or other evidence acceptable to the secretary unless the buyer of the service or any of the buyer's employees or agents makes initial use of the product of the service in New Mexico or takes delivery of the product of the service in New Mexico.

B. Receipts from performing a service that initially qualified for the deduction provided in this section but that no longer meets the criteria set forth in Subsection A of this section shall be deductible for the period prior to the disqualification.