



MODRALL SPERLING
L A W Y E R S

Memorandum

Via Email Attachment

To: Paula Maes

From: Arthur Melendres and Zachary McCormick

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Re: New Mexico Gross Receipts and Compensating Tax

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This memorandum addresses New Mexico Broadcaster Association questions relating to the applicability of the New Mexico gross receipts and compensating tax liability that may arise out of New Mexico broadcaster sales of advertising time. Set forth below is: 1) an executive summary; 2) a very basic summary of provisions of the Gross Receipts and Compensating Tax Act that are applicable to the questions; and 3) a fairly detailed analysis of several factual scenarios that we understand are common in the industry.

We are confident in our legal analysis, however, in New Mexico there is always a possibility that individuals within the Taxation and Revenue Department (e.g., auditors, people answering telephone questions), or the Department as a whole, may disagree on some issues. That is the nature of dealing with a government agency whose role is to collect and maximize revenue for the State of New Mexico.

I. EXECUTIVE SUMMARY.

- A. The focus of gross receipts and compensating tax analysis of sales of broadcast time is upon whether the advertiser is in New Mexico or a "national or regional" advertiser.
- B. If the advertiser is in New Mexico, gross receipts tax is due.
- C. If the advertiser is regional or national no gross receipts tax is due.
- D.. The location of an intermediate advertising agency whether located in New Mexico or outside New Mexico is irrelevant to determining whether the gross receipts compensating tax applies to the broadcaster (although it may affect the tax liability of the intermediate advertising agency.)
- E. Compensating tax is ONLY due if a deduction for selling advertising time to a national or regional broadcaster is improperly claimed because the advertiser is in fact a New Mexico advertiser rather than a national or regional

advertiser. Based on our understanding of the broadcast industry, this tax should rarely be due because the broadcaster knows who the advertiser is.

- F. Because of the complexity of the issues and fact intensive nature of the analyses for different situations, there is considerable confusion not only amongst the broadcasters, but also at the Taxation and Revenue Department. Verbal communications with the Taxation and Revenue Department on tax issues are notoriously unreliable and not legally binding on the Department.
- G. The only meaningful ways to arrive at legal certainty for all interested parties (advertisers, advertising agencies, broadcasters AND the New Mexico Taxation and Revenue Department) is to have:
 - a. the Department issue industry-wide regulations addressing the issues of concern (some regulations exist and are found in NMAC 3.2.213);
 - b. individual broadcasters obtain revenue rulings from the Department on their particular fact situations; or
 - c. individual broadcasters approach the Department about using its seldom if ever used statutory authority to enter into legally binding agreements governing how to report and pay tax on specific fact situations for up to four years.

II. SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAX IN THE CONTEXT OF NEW MEXICO BROADCASTING.

The gross receipts tax and compensating tax are taxes provided for in the New Mexico Gross Receipts and Compensating Tax Act. Their interrelationship as it pertains to your questions is set forth below.

A. Gross Receipts Tax Applies to Services Performed in New Mexico.

The gross receipts tax applies to receipts from selling services performed in New Mexico, ***unless there is an applicable exemption or deduction.*** NMSA 1978, §§ 7-9-3.5, 7-9-4. There is such a deduction for national and regional advertisers. See NMSA 1978 § 7-9-55 and discussion below.

1. Advertising.

Advertising by broadcasters is considered to be a service for gross receipts tax purposes. Accordingly, receipts of New Mexico broadcasters from selling advertising time is subject to the gross receipts tax unless there is an applicable exemption or deduction. Regulation 3.2.213.9(C) NMAC. There is such a deduction for national and regional advertisers. See NMSA 1978 § 7-9-55 and discussion below.

2. Advertising Agency Commissions.

Receipts for services performed by advertising agencies **in New Mexico** are also subject to the gross receipts tax, whether referred to as a "fee," "commission" or some other term.¹

Receipts of an advertising agency for services performed outside of New Mexico may also be subject to the gross receipts tax. "Gross receipts" are defined to include "the total amount of money or the value of other consideration received ... from selling services performed outside New Mexico, the product of which is initially used in New Mexico." "Product of the service" is discussed extensively in regulations, but the discussion is unhelpful in this situation. The agencies should assume that if the advertisements are going to be broadcast in New Mexico, the product of their service is first used in New Mexico and GRT will be owed on the commissions earned in selling that advertising time. Gross receipts includes commissions or fees derived from selling things like advertising. (Whether the agency is responsible for tax on the advertising time itself will depend on the nature of the advertiser—if it is regional or national, no tax will be due; if it is local, either GRT or compensating tax will be due, unless GRT was paid at the time of the original sale of time.)

B. Gross Receipts Tax Deduction for Sales to National or Regional Advertisers.

NMSA 1978, § 7-9-55(C) provides a gross receipts tax deduction for broadcaster receipts from the sale of radio and television broadcast time when the advertising message is supplied by or on behalf of a national or regional advertiser not: 1) having its principal place of business in New Mexico; or, 2) incorporated in New Mexico.

"Regional" is defined by regulation 3.2.213.7 as a seller or advertiser who sells from locations in more than one state or who advertises in more than one state. The "seller or advertiser" is a person whose identity, business, service, product or products are the primary subject of the advertising message

C. Gross Receipts Tax Deduction for Selling to an Advertising Agency.

Receipts from sales of broadcast time by New Mexico radio and television broadcasters to advertising agencies are subject to gross receipts tax, but those receipts may be deductible under either Section 7-9-48 NMSA 1978 or Section 7-9-55 NMSA 1978. If the receipts are deductible, no GRT will be owed to the state for those receipts.

The deduction under Section 7-9-55 is specifically aimed at broadcasters. It provides that

A New Mexico radio or television broadcaster may deduct from its gross receipts the receipts derived from the sale of broadcast time which is sold either directly to a national or regional seller or advertiser not having its principal place of business in or being incorporated under the laws of New Mexico, or to an advertising agency which purchases the broadcast time on behalf of, or for subsequent sale to, such

¹ Issues relating to gross receipts taxes on out of state services or sales can be complicated and the law has recently changed. Advertising agencies doing business outside New Mexico should consult their own tax advisors for specific requirements and directions.

national or regional seller or advertiser. No nontaxable transaction certificate is required. If the advertising agency subsequently sells the broadcast time to a New Mexico seller or advertiser, however, compensating tax will be due on the value of the broadcast time.

It would be prudent to retain copies of any records that show that the advertiser is regional or national.

The deduction under NMSA 1978, § 7-9-48 is more generic. It provides a deduction for gross receipts from the sale of services for resale, if the buyer/reseller of the service (the advertising agency in this case) provides the seller of the service (the broadcaster) a Type 5 nontaxable transaction certificate ("NTTC") **AND**, the buyer's resale is subject to **gross receipts tax**. That can be a problem if the "final" customer is regional or national, because the sale from the agency will not be subject to GRT. If the advertiser is local, the resale would be subject to GRT and the sale for resale deduction would apply.

The NTTC provided by the buyer to the seller is in effect a certification by the buyer that it will resell the service and pay the gross receipts tax on its resale, thus allowing the seller to deduct its receipts.

If an advertising agency pays the broadcaster for advertising air time AND provides a broadcaster a Type 5 NTTC, the broadcaster must report the receipts, but then claim a deduction. This results in no gross receipts tax being due from the broadcaster for its sale of air time to the agency. The agency, however, is responsible for paying gross receipts tax due on money it receives from the advertiser when it resells the airtime to the advertiser.

Stations should also note that they are not required to have a separate NTTC for each transaction with a particular agency, but only a single one, applicable to all transactions qualifying for the applicable deduction. Evidence other than the NTTC can be offered to show that the sale was for resale, but the NTTC is safest if the broadcaster is relying on the §7-9-48 deduction. Reliance on §7-9-55 would generally be easier, though, since no NTTC is required.

D. The Compensating Tax Only Applies When the Gross Receipts Tax Deduction for Selling Advertising Time to a National or Regional Advertiser is Improperly Claimed Because the Advertiser is Local.

Because we understand that broadcasters and advertising agencies nearly always know whether an advertiser is a national or regional advertiser at the time of sale to an advertising agency, **the compensating tax should very rarely be an issue for broadcasters or advertising. If someone thinks that it is an issue, it is probably due to a misconception.** Set forth below is an explanation of why that is true.

The New Mexico compensating tax, in general, applies in several situations. The pertinent application for your questions is that it applies when the seller of broadcast time should have paid gross receipts tax but did not because it was misled by the buyer into thinking the broadcaster's sale was non-taxable when in fact it was subject to GRT. NMSA 1978, § 7-9-7(C). If the buyer misleads the seller into taking an incorrect deduction, then the compensating tax is imposed on the buyer. This is because deductions for sellers in this and other contexts are dependent on the buyer's use of what is sold.

In your situations, the compensating tax is **imposed**, if at all, only on the user of services (the advertiser) for which the seller (broadcaster or advertising agency) improperly claimed the deduction for receipts from selling advertising time to a national or regional advertiser. That means that the tax is **imposed** on the advertiser (not the broadcaster) and it is technically the entity legally responsible for its payment.

However, by regulation, the Taxation and Revenue Department has made New Mexico broadcasters responsible for collecting the compensating tax from the advertiser and paying the compensating tax unless an intermediate advertising agency has done so. Regulation 3.2.13.10(A) NMAC. The regulation states that the broadcaster may collect the compensating tax through the advertising agency, and if it does so it must expressly identify the advertiser and the amount of compensating tax due on its invoice to the advertising agency. Regulation 3.2.13.9(B) NMAC. If the broadcaster pays the compensating tax, then the local advertiser is no longer legally liable for the compensating tax. Regulation 3.2.13.9(B) NMAC. Similarly, if the advertising agency reports and pays the compensating tax, then the broadcaster has no obligation to do so.

The compensating tax would only apply when a broadcaster or advertising agency mistakenly believes that the advertiser is regional or national and, as a result, improperly claims the deduction for receipts from selling broadcast time to a regional or national advertiser. Less clear is whether the Taxation and Revenue Department would determine that compensating tax, instead of gross receipts tax, would be due when the broadcaster or, conceivably the advertising agency, does not know whether or not the advertiser is regional or national and claims the gross receipts tax deduction for selling to a national or regional advertiser. It is possible that the Department would contend that because there was no factual basis for claiming the deduction (because there was no understanding (right or wrong) that the advertising would in fact be used by a national or regional advertiser), the gross receipts tax is due rather than the compensating tax. As a practical matter, it makes no financial difference because compensating tax rates are now the same as gross receipts tax rates, but the reporting would be slightly different.

III. ANALYSIS.

It is our understanding that there are several fact patterns present when a New Mexico broadcaster sells advertising air time. The scenarios analyzed below reflect various alternatives relating to the location of the advertising agency, whether the advertising agency provides the broadcaster a Type 5 NTTC and whether the advertiser is in New Mexico or a "national or regional advertiser."

A. ASSUMPTIONS FOR SCENARIOS ANALYZED BELOW.

For simplicity of presentation, the analysis of each of the scenarios set forth below assumes that:

- 1) The broadcaster is located in New Mexico;
- 2) The advertising agency resells the broadcaster's air time to the advertiser in a manner that constitutes a resale for purposes of application of the deduction in NMSA 1978, § 7-9-48; and,
- 3) the advertiser (rather than the broadcaster) pays the agency a commission for the advertising agency's services.

As a note of caution, we have some concerns with regard to the Taxation and Revenue Department's acceptance of the third assumption. We understand that the broadcasters understand that the commission is paid by the advertiser to the agency, and not paid by the broadcaster to the agency. However, our understanding of broadcaster invoicing of advertising agencies suggests that a Taxation and Revenue Department auditor might contend that the broadcaster pays the commission. In certain fact scenarios, the consequence of this interpretation would be potential broadcaster liability for tax on the payment received from the agency for the broadcast time PLUS the amount of the commission.

It is our understanding that broadcaster invoices to advertising agencies typically show the full value of broadcast time, minus ("net of") the agency commission. We understand that the following is illustrative of the typical case:

- 1) An advertiser contacts an advertising agency.
- 2) The agency contacts a broadcaster for advertising air time.
- 3) Broadcast time is worth \$100.
- 4) The broadcaster bills the agency with an invoice that shows the value of the advertising (\$100) sold to the agency and then subtracts out the amount of the agency 15% commission (\$15), for a total due from the agency of \$85. This is sometimes referred to in the business as a discount for advertising sold to an agency or, simply "the net."
- 5) The agency bills the advertiser for \$100 and receives \$100. It is not clear whether the agency bills \$100 shown as advertising alone, or whether it bills \$85 for advertising plus a \$15 commission.
- 6) The agency pays the broadcaster \$85, retaining \$15 of the \$100 it received from the advertiser.

One interpretation of this scenario, which we understand is the broadcasters' understanding, is that the broadcaster only receives \$85 for broadcast air time. The advertiser is the one buying and paying for the agency services, and the payment goes to the agency. The broadcaster never receives the \$15 commission, and so owes no gross receipts tax on that \$15.

An alternative interpretation is that the broadcaster receives \$100 in "gross receipts" and pays the advertising agency \$15 through its invoicing process rather than cutting a separate check to the agency. This is similar (but not identical) to a very common "commission" scenario that Taxation and Revenue Department auditors are familiar with in other contexts: a commissioned sales agent gets a percentage of the amount **received by the seller** of goods or services when they are sold. The Taxation and Revenue Department very clearly views this situation as involving two sales: 1) the seller (broadcaster or station) of goods or services receiving the full sales price (e.g., \$100); and, 2) the seller (broadcaster or station) paying the sales agent a commission out of the total amount received (e.g. \$15) as compensation for the service of selling the good or service for the seller. Accordingly, the seller owes gross receipts tax on the full \$100 and the agent owes gross receipts tax on \$15. Under this approach, an auditor could contend that the invoice showing a net due of \$85 out of \$100 in advertising value is merely a mechanism for the **broadcaster** to pay the agency a \$15 commission without the need for cutting a separate

check to the agency, but the broadcaster is still receiving \$100—it just has to then pay out \$15 of the \$100 total.. This interpretation is supported by the fact that, by statute, “gross receipts” include not only money received, but also other value or “consideration” received for selling something. Thus, an auditor could contend that the “net” or “discount” sales price to the agency is a smoke screen that obscures the fact that the broadcaster really receives \$100 from the agency, but lets the agency keep \$15. If the broadcaster merely valued the air time at \$85 without showing the “discount,” the argument would be harder to make. Presumably, invoicing showing a 15% discount netted off of the full value is a national industry custom. The custom is probably irrelevant for sales taxes in most states which don’t impose a sales tax on airtime, but in New Mexico it may make a difference, or at least create a risk not present in other states (the risk being that both the broadcaster and the agency have to pay tax on the \$15).

B. NEW MEXICO ADVERTISING AGENCY.

This set of scenarios relate to fact patterns involving sales of advertising time to a New Mexico advertising agency.

1. New Mexico Advertiser.

a. Advertising Agency Provides Broadcaster a Type 5 NTTC.

i. Broadcaster:

Reports all receipts received from agency as gross receipts.

Deducts all receipts received from agency as receipts from selling broadcast time for resale.

ii. Advertising Agency:

Reports all receipts from advertiser (payment for airtime resold to the advertiser+ commission) as gross receipts because they are receipts from selling services performed in New Mexico.

Pays gross receipts tax on all amounts received from advertiser.

iii. Deduction for Sale to National or Regional Advertisers:

Not applicable because the advertiser is a New Mexico advertiser and not national or regional.

iv. Compensating Tax:

Does not apply. Compensating tax is only applicable when a broadcaster or advertising agency incorrectly deducted from gross receipts amounts for advertising time sold to a national or regional advertiser that later turns out to be used by a New Mexico advertiser.

If the advertising agency did not/will not pay the compensating tax, then by regulation the broadcaster is responsible for

reporting and paying the tax on behalf of the advertiser. If it collects the tax from the agency, it must invoice the agency for the compensating tax and the broadcaster must identify the in-state advertiser and the amount of the compensating tax billed on its invoice to the advertising agency.

b. Advertising Agency Does NOT Provide Broadcaster Type 5 NTTC.

i. Broadcaster:

Reports all receipts received from agency as gross receipts.

May deduct all receipts received from the agency but will need to have alternative evidence that demonstrates the facts necessary to support entitlement to the deduction, with burden of proof being on the broadcaster (NMSA § 7-9-43.)

ii. Advertising Agency:

Reports all receipts from advertiser (airtime resold + commission) as gross receipts because receipts from selling services performed in New Mexico.

Pays gross receipts tax on all amounts received from advertiser.

iii. Deduction for Sale to National Or Regional Advertisers:

Not applicable because the advertiser is not national or regional.

iv. Compensating Tax:

Does not apply unless broadcaster or advertising agency incorrectly deducted from gross receipts amounts for advertising time sold to a national or regional advertiser.

If the advertising agency did not/will not pay the compensating tax, then the broadcaster is responsible for reporting and paying the tax on behalf of the advertiser. If it collects the tax from the agency, it must invoice the agency for the compensating tax and the broadcaster must identify the in-state advertiser and the amount of the compensating tax billed.

2. National or Regional Advertiser.

a. Because the Advertiser is Regional or National no Gross Receipts Tax or Compensating Tax is due or owed.

b. Broadcaster CAN NOT use Advertising Agency Type 5 NTTC to Deduct Receipts from Sale of Broadcast Time for Resale.

This is because the agency's resale to the national or regional advertiser is not subject to gross receipts tax-required for the resale deduction.

c. The Advertising Agency Does NOT Provide Broadcaster Type 5 NTTC Applicable to This Transaction.

i. Broadcaster:

Reports all receipts received from agency as gross receipts.

Deducts all receipts received from agency as receipts from selling broadcast time to national or regional advertiser. No NTTC is required to claim the deduction.

ii. Advertising Agency:

Reports all receipts from advertiser (airtime resold + commission) as gross receipts because receipts from selling services performed in New Mexico.

Deducts receipts received from advertiser as receipts from (re)selling broadcast time to national or regional advertiser.

Pays gross receipts tax on amount of commission.

iii. Compensating Tax:

Does not apply unless broadcaster and/or advertising agency incorrectly deducted from gross receipts amounts for advertising time resold to a national or regional advertiser and time was actually sold to a New Mexico advertiser. In that case, broadcaster should use Type 5 NTTC from advertising agency to claim deduction for resale.

If the advertising agency did not/will not pay the compensating tax due from advertiser, then the broadcaster is responsible for reporting and paying the tax on behalf of the advertiser. If it collects the tax from the agency, it must invoice the agency for the compensating tax and the broadcaster must identify the in-state advertiser and amount of the compensating tax billed.

C. ADVERTISING AGENCY LOCATED OUTSIDE NEW MEXICO.

1. New Mexico Advertiser.

a. The Advertising Agency Provides the Broadcaster a Type 5 NTTC.

This appears to be an unlikely scenario for an out-of-state advertiser, but is theoretically possible, particularly if the agency has registered as a New Mexico taxpayer-thus allowing it to obtain NTTCs. Note, however, if an

agency provides a Type 5 NTTC to the broadcaster, the agency must pay **gross receipts** tax on money received from the advertiser.

i. Broadcaster:

Reports all receipts received from agency as gross receipts.

Deducts all receipts received from agency as receipts from selling broadcast time to be resold by the agency.

ii. Advertising Agency:

Reports receipts from advertiser for air time resold as gross receipts because the receipts are from (re)selling services performed in New Mexico.

Pays **gross receipts tax** on amount received from advertiser for advertising services.

iii. Deduction for Sale to National or Regional Advertisers:

Not applicable because the advertiser is a New Mexico Advertiser and not national or regional.

iv. Compensating Tax:

Does not apply unless broadcaster or advertising agency incorrectly deducted from gross receipts amounts for advertising time resold to a national or regional advertiser because advertiser is in New Mexico.

If the advertising agency did not/will not pay the compensating tax, then the broadcaster is responsible for reporting and paying the tax on behalf of the advertiser. If it collects the tax from the agency, it must invoice the agency for the compensating tax and the broadcaster must identify the in-state advertiser and the amount of the compensating tax billed.

b. Advertising Agency Does NOT Provide Broadcaster Type 5 NTTC.

i. Broadcaster:

Reports all receipts received from agency as gross receipts.

Pays gross receipts tax on amount received from advertising agency as receipts from selling broadcasting services to a local advertiser.

ii. Advertising Agency:

Probably reports and pays no gross receipts tax. However, in theory, if New Mexico has taxing jurisdiction over it ("nexus"),

the agency may need to report and pay gross receipts tax received for selling advertising performed in New Mexico resulting in double taxation.

Does not report or pay gross receipts tax on commissions.

iii. Deduction for Sale to National or Regional Advertisers:

Not applicable because the advertiser is not national or regional.

iv. Compensating Tax:

Does not apply unless broadcaster and/or advertising agency incorrectly deducted from gross receipts amounts for advertising time resold to a national or regional advertiser.

If the advertising agency did not/will not pay the compensating tax, then the broadcaster is responsible for reporting and paying the tax on behalf of the advertiser. If it collects the tax from the agency, it must invoice the agency for the compensating tax and the broadcaster must identify the in-state advertiser and the amount of the compensating tax billed.

2. National or Regional Advertiser.

a. Broadcaster does NOT use Advertising Agency Type 5 NTTC to Deduct Receipts from Sale of Broadcast Time for Resale.

This is because the agency's resale to the national or regional advertiser is not subject to gross receipts tax-required for the resale deduction, so the NTTC would be ineffective. Per NMSA Section 7-9-55, no NTTC is needed for sales of time for national or regional advertisers.

i. Broadcaster:

Reports all receipts received from agency as gross receipts.

Deducts all receipts received from agency as receipts from selling broadcast time to national or regional advertiser. No NTTC is required to claim the deduction.

ii. Advertising Agency:

If New Mexico has taxing jurisdiction over the advertising agency ("nexus", which generally requires having done more than \$100,000 in business in New Mexico in the previous year), the agency should probably report and then deduct all receipts from advertiser for airtime (but not commission) as gross receipts because these are receipts from (re)selling services performed in New Mexico. The receipts can then be deducted.

The commission would need to be reported and tax paid because it is either for services performed in New Mexico (if it is a New Mexico advertising agency) or for services performed outside of New Mexico, the "product" of which is first used in New Mexico.

iii. Compensating Tax:

Does not apply unless broadcaster and/or advertising agency incorrectly deducted from gross receipts amounts for advertising time resold to a national or regional advertiser and time was actually sold to a New Mexico advertiser. In that case, broadcaster should use Type 5 NTTC from advertising agency to claim deduction for resale.

If the advertising agency did not/will not pay the compensating tax due from advertiser, then the broadcaster is responsible for reporting and paying the tax on behalf of the advertiser. When collecting the compensating tax from the advertising agency, the broadcaster must identify the seller or advertiser and the amount of compensating tax due in its billing to the advertising agency.

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