

1       **IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO**

2 Opinion Number: \_\_\_\_\_

3 Filing Date: August 22, 2018

4 **No. A-1-CA-35999**

5 **A&W RESTAURANTS, INC.,**

6                   Petitioner-Appellant,

7 v.

8 **TAXATION AND REVENUE**

9 **DEPARTMENT OF THE STATE OF**

10 **NEW MEXICO,**

11                   Respondent-Appellee.

12 **APPEAL FROM THE ADMINISTRATIVE HEARINGS OFFICE**

13 **Brian VanDenzen, Chief Hearing Officer**

14 Sutin, Thayer & Browne, P.C.

15 Stevan Douglas Looney

16 Justin R. Sawyer

17 Andrew J. Baranowski

18 Albuquerque, NM

19 for Appellant

20 Hector H. Balderas, Attorney General

21 Peter Breen, Special Assistant Attorney General

22 Taxation and Revenue Department

23 Santa Fe, NM

24 for Appellee

## OPINION

1 **GALLEGOS, Judge.**

2 {1} A 2013 audit by the New Mexico Taxation and Revenue Department (the  
3 Department) resulted in the assessment of unpaid gross receipts tax against A&W  
4 Restaurants, Inc. (A&W), in the amount of \$29,349.33. A&W protested the  
5 Department's imposition of gross receipts tax on certain trademark-related royalty  
6 fees contained within its franchise agreements with New Mexico businesses. The  
7 hearing officer granted summary judgment in favor of the Department, and A&W  
8 appeals. For the reasons that follow, we affirm.

### 9 **BACKGROUND**

10 {2} A&W, an out-of-state corporation, entered into a number of franchise  
11 agreements with New Mexico businesses. Each of the franchise agreements,  
12 among other terms, contained a provision by which A&W granted to franchisees a  
13 limited license to use specific trademarks. The authority to utilize the trademarks  
14 was limited to use in connection with the operation of an A&W restaurant  
15 franchise. In consideration for the grant of the limited trademark license, the  
16 franchisees agreed to pay A&W a monthly royalty fee equal to 5 percent of gross  
17 sales.

18 {3} Following an audit in 2013, the Department determined that the royalty fees  
19 for the limited trademark license were subject to gross receipts tax as money

1 received “from granting a right to use a franchise employed in New Mexico[.]”  
2 NMSA 1978, Section 7-9-3.5(A)(1) (2007). Consequently, the Department  
3 assessed gross receipts tax on the royalty fees in the amount of \$29,349.33.<sup>1</sup> In  
4 response, A&W filed a tax protest with the Department, seeking an abatement of  
5 the gross receipts tax.

6 {4} Pursuant to the Administrative Hearings Office Act, NMSA 1978, §§ 7-1B-1  
7 to -9 (2015), A&W’s tax protest went before a hearing officer. During the course  
8 of proceedings, A&W and the Department filed cross motions for summary  
9 judgment. A&W argued that the royalty fees it received as consideration from the  
10 limited trademark licensing provisions are exempt from gross receipts tax as a  
11 matter of law because trademarks are not considered “property” under the Gross  
12 Receipts and Compensating Tax Act (the Act), NMSA 1978, §§ 7-9-1 to -116  
13 (1966, as amended through 2018). *See* § 7-9-3(J) (defining “property”); § 7-9-  
14 3.5(A)(1) (defining “gross receipts”). The Department, in contrast, argued that  
15 such royalty fees were taxable as receipts “from granting the right to use a  
16 franchise[.]” Section 7-9-3.5(A)(1). After hearing argument from both sides, the  
17 hearing officer disagreed with A&W’s legal position and awarded summary

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<sup>1</sup>The Department assessed gross receipts tax beginning on June 15, 2007, the date the 2007 amendment to Section 7-9-3.5(A)(1) became effective. The audit period at issue in this case went through December 31, 2011.

1 judgment to the Department. A&W appeals to this Court pursuant to NMSA 1978,  
2 Section 7-1-25(A) (2015).

### 3 **DISCUSSION**

4 {5} This appeal requires us to consider the impact of two 2007 amendments to  
5 the Act on the taxability of trademark licensing royalty fees that make up part of a  
6 franchise agreement.

#### 7 **I. Standard of Review and Presumption and Burden Applicable to Tax** 8 **Cases**

9 {6} “Because the facts are not in dispute and the issue presented on appeal is  
10 purely legal, our review is de novo.” *Fed. Express Corp. v. Abeyta*, 2004-NMCA-  
11 011, ¶ 2, 135 N.M. 37, 84 P.3d 85. Likewise, because we must engage in statutory  
12 construction, our review of the hearing officer’s decision is also de novo. *See*  
13 *Cooper v. Chevron U.S.A., Inc.*, 2002-NMSC-020, ¶ 16, 132 N.M. 382, 49 P.3d 61  
14 (“The meaning of language used in a statute is a question of law that we review de  
15 novo.”). “In interpreting statutes, we seek to give effect to the Legislature’s intent,  
16 and in determining intent we look to the language used and consider the statute’s  
17 history and background.” *Valenzuela v. Snyder*, 2014-NMCA-061, ¶ 16, 326 P.3d  
18 1120 (internal quotation marks and citation omitted). “Tax statutes, like any other  
19 statutes, are to be interpreted in accordance with the legislative intent and in a  
20 manner that will not render the statutes’ application absurd, unreasonable, or

1 unjust.” *City of Eunice v. N.M. Taxation & Revenue Dep’t*, 2014-NMCA-085, ¶ 8,  
2 331 P.3d 986 (internal quotation marks and citation omitted).

3 {7} There exists a statutory presumption that all receipts from engaging in  
4 business in New Mexico are taxable. Section 7-9-5(A). “The taxpayer claiming  
5 that receipts are not taxable bears the burden of proving the assertion.” *MPC Ltd. v.*  
6 *N.M. Taxation & Revenue Dep’t*, 2003-NMCA-021, ¶ 12, 133 N.M. 217, 62 P.3d  
7 308.

## 8 **II. The Relevant Provisions of the Act**

9 {8} The purpose of gross receipts tax is to provide revenue for public purposes  
10 by taxing certain business activities within New Mexico. Section 7-9-2. Prior to  
11 2007, the Legislature categorized these activities in the following ways: “selling  
12 property located in New Mexico, . . . leasing or licensing property employed in  
13 New Mexico, . . . selling services performed outside New Mexico,  
14 [and] . . . performing services in New Mexico.” Section 7-9-3.5(A)(1) (2006).  
15 “[G]ross receipts” were defined as “the total amount of money or the value of  
16 consideration received” from engaging in these business activities. *Id.*

17 In 2007, the Legislature amended the definition of gross receipts to  
18 the total amount of money or the value of other consideration received  
19 from selling property in New Mexico, from leasing or licensing  
20 property employed in New Mexico, *from granting a right to use a*  
21 *franchise* employed in New Mexico, from selling services performed

1 outside New Mexico, the product of which is initially used in New  
2 Mexico, or from performing services in New Mexico.

3 Section 7-9-3.5(A)(1) (emphasis added).

4 {9} Also in 2007, the Legislature amended the definition of “property” from  
5 “real property, tangible personal property, licenses, and franchises[,]” Section 7-9-  
6 3(J) (2006), to

7 real property, tangible personal property, *licenses other than the*  
8 *licenses of copyrights, trademarks or patents and franchises.*

9 Section 7-9-3(J).

10 **III. Gross Receipts Tax Applies to the Trademark Licensing Royalty Fees**  
11 **That Are Part of A&W’s Franchise Agreements**

12 {10} After 1991, both franchise agreements and licensing agreements were  
13 considered to be, and analyzed as, the sale of property. *See Sonic Indus., Inc. v.*  
14 *State (Sonic I)*, 2000-NMCA-087, ¶ 12, 129 N.M. 657, 11 P.3d 1219, *rev’d on*  
15 *other grounds by Sonic Indus., Inc. v. State (Sonic II)*, 2006-NMSC-038, ¶ 1, 140  
16 N.M. 212, 141 P.3d 1266. However, by amending the definition of gross receipts  
17 to include the new business activity categories of licensing property employed in  
18 New Mexico and granting a franchise employed in New Mexico, Section 7-9-  
19 3.5(A)(1), the Legislature has effectively taken licensing agreements and franchise  
20 agreements out of the sale of property category. Given this development, and in  
21 light of these new categories of gross receipts, the question before us is how to

1 properly analyze the taxability of a limited trademark license provision contained  
2 within a franchise agreement.

3 {11} Unsurprisingly, A&W and the Department have differing views on the  
4 analysis to be employed, as well as on the effect that the amendments have on the  
5 taxability of the limited trademark license royalties at issue in this case. A&W  
6 asserts that gross receipts tax applies to receipts from the licensing of property and  
7 that under the new 2007 Section 7-9-3(J) definition, trademark licenses are no  
8 longer considered to be property. Based on this definitional exclusion, A&W  
9 contends that the royalty fees received as consideration from the trademark  
10 licensing provisions are exempt from gross receipts tax. Conversely, the  
11 Department maintains that the royalty fees for the limited trademark license are  
12 subject to gross receipts tax as money received from granting a right to use a  
13 franchise, pursuant to Section 7-9-3.5(A)(1).

14 {12} In resolving these arguments, the crucial question to be answered is whether  
15 the royalty fees flowing from this particular trademark licensing provision should  
16 be treated as being received from the grant of a franchise or from the licensing of a  
17 trademark. If we were to limit ourselves to A&W's view—that the limited  
18 trademark licensing provision is a separately-itemized standalone agreement,  
19 although contained within the franchise agreement—it would appear that the  
20 answer is clear that the royalties received from the trademark license are excluded

1 from gross receipts under Sections 7-9-3.5(A)(1) and 7-9-3(J). Yet, it is not so  
2 simple. We must also, as the Department contends, consider the meaning of the  
3 word “franchise.” See *Valenzuela*, 2014-NMCA-061, ¶ 16, 326 P.3d 1120 (“[W]e  
4 should read the entire statute as a whole so that each provision may be considered  
5 in relation to every other part.” (internal quotation marks and citation omitted)).

6 {13} Although we have no statutory definition of franchise in New Mexico, this  
7 Court observed in *Sonic I* that “[b]y 1969, when the Legislature extended the Act’s  
8 definition of property to ‘licenses, franchises, patents, trademarks and  
9 copyrights,’ the use of the term franchise to describe a prepackaged system for  
10 doing business appears to have been well established.” 2000-NMCA-087, ¶ 24.

11 This Court also set forth the following definition of a franchise:

12 In its simplest terms a franchise is a license from the owner of a  
13 trademark or trade name permitting another to sell a product or  
14 service under that name or mark. More broadly stated, the franchise  
15 has evolved into an elaborate agreement under which the franchisee  
16 undertakes to conduct a business or sell a product or service in  
17 accordance with methods and procedures prescribed by the franchiser  
18 and the franchiser undertakes to assist the franchisee through  
19 advertising, promotion and other advisory services.

20 *Id.* ¶ 23 (internal quotation marks and citation omitted).

21 {14} We further observed in *Sonic I* that the Department had adopted a regulation  
22 defining the word “franchise”:

1 A franchise is an agreement in which the franchisee agrees to  
2 undertake certain business activities or to sell a particular type of  
3 product or service in accordance with methods and procedures  
4 prescribed by the franchiser, and the franchiser agrees to assist the  
5 franchisee through advertising, promotion and other advisory services.  
6 The franchise usually conveys to the franchisee a license to use the  
7 franchiser's trademark or trade name in the operation of the  
8 franchisee's business.

9 *Id.* ¶ 25 (emphasis omitted); see *Black's Law Dictionary* 569 (9th ed. 2010)  
10 (defining "franchise" as "[t]o grant (to another) the sole right of engaging in a  
11 certain business or in a business using a particular trademark in a certain area").  
12 We further held "that for purposes of the Act, a franchise is to be treated as a  
13 compound or 'bundled' form of property, which typically includes a license to use  
14 the franchiser's trademark and a commitment by the franchiser to perform various  
15 services to assist the franchisee in the operation of the franchised business." *Sonic*  
16 *I*, 2000-NMCA-087, ¶ 28.

17 {15} We can presume that the Legislature was aware of these longstanding and  
18 undisturbed definitions of franchise in 2007 when it amended the definition of  
19 gross receipts to include "the total amount of money or the value of other  
20 consideration received . . . from granting a right to use a franchise employed in  
21 New Mexico[.]" Section 7-9-3.5(A)(1); see *Sonic I*, 2000-NMCA-087, ¶ 25 ("[W]e  
22 may infer from the Legislature's inaction in response to this longstanding

1 administrative construction of the term franchise that this definition is consistent  
2 with the Legislature's intent.”).

3 {16} Furthermore, we observe that the 2007 gross receipts amendment followed  
4 our Supreme Court's 2006 decision in *Sonic II*. See 2006-NMSC-038, ¶ 9. The  
5 Supreme Court analyzed Sonic's franchising activities under the then-current  
6 definition of gross receipts, which only included the money or value received from  
7 the sale or lease of property. *Id.* The Supreme Court first determined, in agreement  
8 with this Court's opinion in *Sonic I*, that Sonic's franchising activities constituted  
9 the sale of property. *Id.* ¶ 13. The Supreme Court went on to hold that when a  
10 franchise agreement is executed outside of New Mexico, it is considered to be an  
11 out-of-state sale, and thus not considered to fall within the definition of gross  
12 receipts. *Id.* ¶ 14. Therefore, the practical effect of *Sonic II* was to render franchise  
13 agreements with out-of-state franchisers, such as the agreement in the present case,  
14 non-taxable.

15 {17} Less than a year after the *Sonic II* decision, the Legislature added a new  
16 category of business activity resulting in taxable gross receipts: granting a right to  
17 use a franchise employed in New Mexico. See § 7-9-3.5(A)(1). By this change, the  
18 Legislature effectively overruled *Sonic II* and restored the taxability of franchise  
19 agreements, even those entered into out-of-state, so long as they are employed in  
20 New Mexico. Nothing in the statute as amended indicates to us that the Legislature

1 intended to change the definition of a franchise as adopted by the Department or as  
2 laid out by this Court in *Sonic I*, or to use the word franchise in a manner  
3 unmoored from these longstanding definitions.

4 {18} We are therefore not convinced that the trademark licensing provision in this  
5 case should be treated as a standalone agreement—separate and apart from the  
6 franchise—simply because it is a separate line item in the franchise agreement, as  
7 A&W urges. To the contrary, it is especially clear here in the context of a fast-food  
8 franchise that the trademark license is the heart of the franchise agreement.  
9 Consider the value of an A&W franchise in which the franchisee is not granted a  
10 license to use A&W’s logos, colors, or menu items. Is such an agreement even a  
11 franchise? It certainly would bear little resemblance to a traditional franchise as  
12 commonly defined and understood. And in fact, A&W itself agreed during oral  
13 argument before this Court that a franchise of this sort would be “not entirely  
14 complete” without the trademark. In this light, we conclude that the trademark  
15 licensing provision at issue in this case is central to the overall franchise and  
16 should be treated as part of the franchise for purposes of gross receipts, regardless  
17 of whether it was separately stated and itemized in the franchise agreement.

18 {19} This is consistent with the Legislature’s intent, made manifest through the  
19 2007 amendment to the definition of gross receipts, to subject franchise  
20 agreements like the one in *Sonic II* to gross receipts tax. This is also consistent

1 with the 2006 legislative amendment that added the licensing category to the  
2 definition of gross receipts. Section 7-9-3.5(A)(1) (2006). Presumably, the addition  
3 of this new category will subject certain types of licensing agreements to gross  
4 receipts tax. We acknowledge, though, as A&W has forcefully argued, trademark  
5 licenses are not considered to be property under the 2007 definition, and are  
6 therefore not taxable. This does not mean, however, that the trademark license  
7 provision at issue in this case is untaxable. The provision here is notably different  
8 from a traditional trademark license, which exists apart from a franchise  
9 agreement. See Irene Calboli, *The Sunset of "Quality Control" in Modern*  
10 *Trademark Licensing*, 57 Am. U.L. Rev. 341, 348-51 (2007) (explaining that  
11 trademark licenses generally take three forms: (1) production outsource  
12 agreements, wherein a company that normally produces a product outsources  
13 production of that product, under the trademark, to another company; (2) collateral  
14 licensing agreements, wherein a company licenses the use of its trademark to  
15 another company for use on products collateral to those traditionally produced by  
16 the licensing company; and (3) trademark promotional licensing (also known as  
17 trademark merchandising), wherein a company licenses its trademark for use on a  
18 product wholly unrelated to products originally bearing the licensed mark).

19 {20} We can see nothing absurd or unreasonable about subjecting trademark  
20 licensing provisions contained within a franchise to gross receipts tax, while at the

1 same time exempting standalone trademark licensing agreements, like those  
2 described above, from gross receipts tax. *See City of Eunice*, 2014-NMCA-085, ¶  
3 8; *cf. Michael J. Maloof & Co. v. Bureau of Revenue*, 1969-NMSC-100, ¶ 7, 80  
4 N.M. 485, 458 P.2d 89 (“In the field of taxation, more than in other fields, the  
5 [L]egislature possesses the greatest freedom in classification[.]”). This is especially  
6 so where we have held that “a franchise is to be treated as a compound or  
7 ‘bundled’ form of property, which typically includes a license to use the  
8 franchiser’s trademark and a commitment by the franchiser to perform various  
9 services to assist the franchisee in the operation of the franchised business.” *Sonic*  
10 *I*, 2000-NMCA-087, ¶ 28. Our conclusion—that the Legislature intended to subject  
11 a franchise, including the bundled trademark license agreement, to gross receipts  
12 tax, while at the same time intending not to tax standalone trademark licensing  
13 agreements—harmonizes the various statutory provisions at issue here. *See*  
14 *Luboyeski v. Hill*, 1994-NMSC-032, ¶ 10, 117 N.M. 380, 872 P.2d 353  
15 (“Whenever possible, we must read different legislative actions as harmonious  
16 instead of as contradicting one another.”).

## 17 **CONCLUSION**

18 {21} We conclude that the Legislature’s 2007 amendment to the definition of  
19 gross receipts to add money or the value of other consideration received from the  
20 grant of a franchise employed in New Mexico evidenced its intent to subject

1 franchise agreements such as the one at issue in this case to gross receipts tax, and  
2 that the taxable gross receipts include the royalties received from a limited  
3 trademark license granted as part of the franchise.

4 {22} Therefore, we affirm.

5 {23} **IT IS SO ORDERED**

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 **DANIEL J. GALLEGOS, Judge**

8 **WE CONCUR:**

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 **EMIL J. KIEHNE, Judge**

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 **JENNIFER L. ATTREP, Judge**  
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