

**STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT**

**IN THE MATTER OF THE PROTEST OF
DAVID M. GONZALES,
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L0832592944**

No. 16-43

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on July 29, 2016 before Hearing Officer Dee Dee Hoxie. The Taxation and Revenue Department (Department) was represented by Mr. Marek Grabowski, Staff Attorney. Ms. Milagros Bernardo, Auditor, and Ms. Diana Martwick, Staff Attorney, also appeared on behalf of the Department. Mr. David Gonzales (Taxpayer) appeared for the hearing with his representative, Mr. Douglas Mote, Enrolled Agent. Ms. Jessica Elebario also appeared with the Taxpayer. The Hearing Officer took notice of all documents in the administrative file. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On November 16, 2015, the Department assessed the Taxpayer for personal income tax, penalty, and interest for the tax periods from January 1, 2011 through December 31, 2014. The assessment was for \$5,119.00 tax, \$1,000.36 penalty, and \$355.97 interest.
2. On January 14, 2016, the Taxpayer filed a formal protest letter.
3. On March 1, 2016, the Department filed a Request for Hearing asking that the Taxpayer's protest be scheduled for a formal administrative hearing.
4. On March 7, 2016, the Hearings Office issued a notice of telephonic scheduling hearing.

5. The telephonic scheduling hearing was conducted on March 25, 2016. The hearing was held within ninety days of the protest.
6. On March 28, 2016, the scheduling order and notice of hearing was issued.
7. On July 14, 2016, the parties filed their joint prehearing statement.
8. The Taxpayer is a full-time employee for the Department of Transportation (DOT), and has been since approximately 1992.
9. The Taxpayer began a cattle operation sometime in 2001. The initial operation consisted of purchasing some cows and leasing them out to roping and rodeo operators.
10. The Taxpayer determined that this operation was not sustainable. The Taxpayer found that his lessors were subleasing his cattle, moving them to other locations, and were not taking appropriate care of his cattle. Given the time and expense to recover his cattle and to restore them to health, the Taxpayer felt that he would never make a profit at this business.
11. Sometime in 2005, the Taxpayer decided to change his operation to a calving operation. This essentially involves breeding cattle and selling them for beef. The Taxpayer proceeded to buy what he considered to be a good bull and began breeding.
12. The Taxpayer determined that the type of spotted cattle that he had were not desirable for beef cattle and directed his breeding efforts toward cattle that would not be spotted.
13. The Taxpayer determined that it might take up to 10 years to breed the type of cattle he wanted and to grow the herd to a sufficient number of cows to be profitable.
14. The Taxpayer determined that he would need 15 to 20 heifers to be operational and 150 heifers to be able to make a profit. The Taxpayer set a goal of having a herd with 150 heifers by the time he retires from DOT.

15. At the peak of his operations, in approximately 2010, the Taxpayer had 110 head of cattle.
16. In 2011, the drought conditions began to significantly affect the cost of pasture land, feed, cattle, and fuel. In 2011 and 2012, the Taxpayer sold off most of his herd because of the increased cost of keeping them.
17. Sometime in 2012 or 2013, the Taxpayer's herd was as low as 18 head. The herd is currently around 35 head.
18. Even during the peak of his operation, the Taxpayer never made a profit in his cattle operation. The Taxpayer categorized his best years as "breaking even".
19. During all of the tax years in question in this protest, the Taxpayer claimed significant losses on his personal income taxes in relation to his cattle operation.
20. The Taxpayer leases pasture to keep his cattle on and for them to graze. The Taxpayer also buys supplemental feed and distributes it to his herd as he deems necessary.
21. The Taxpayer apparently makes improvements to the leased land and is responsible for the maintenance of pens.
22. The Taxpayer spends around 20 hours a week managing his cattle operation. The Taxpayer often has to take feed or perform other tasks for the cattle in extreme conditions, such as 100 degree heat or during a blizzard.
23. The Taxpayer belongs to a cattle owner's association and attends lectures and seminars about cattle breeding.
24. The Taxpayer's family was in ranching and cattle. The Taxpayer regularly speaks to family and friends about his cattle operation.

25. The Taxpayer tries to keep track of cattle market prices so that he and his friends can make the best money when they sell their cattle.
26. The Taxpayer maintained a separate bank account for cattle operation. The Taxpayer said he kept records on his herd, equipment, improvements, profits, and losses, but failed to produce any copies of such records despite the Department's repeated requests.
27. The Taxpayer did not have a written or formal business plan. The Taxpayer was acting based on his personal knowledge and experience.
28. The only efforts articulated by the Taxpayer to make the cattle operation profitable were to get good bulls, to breed calves that were not spotted, and to try to grow the herd.
29. The Taxpayer indicated that all proceeds realized from sales went back into the operation for land improvements and such, but these things seemed to be necessary for the maintenance of the herd and were not geared toward profitability.
30. The only effort articulated by the Taxpayer to reduce the expenses of the cattle operation was to sell off cattle when the price of feed, pasture, and fuel went too high.
31. The Taxpayer sells his cattle at auction in nearby sale barns. The Taxpayer does not advertise or try to increase his customer base in any way.
32. The Taxpayer relies on word-of-mouth and luck-of-the-draw for buyers at the auctions. The Taxpayer admitted that he has had problems with sales and profits when he took cows to auction and there were few buyers.
33. The Taxpayer derives significant pleasure and personal satisfaction from his cattle operation. The Taxpayer feels that the cattle operation is a way to relieve the stress of his job with DOT.

34. The Taxpayer intends to continue the cattle operation regardless of its profitability, but the Taxpayer hopes to one day turn a profit.

DISCUSSION

The issue to be decided is whether the Taxpayer is liable for the assessment. The parties agree that the determination hinges on whether the Taxpayer's cattle operation should be considered as a for-profit business or not under 26 USCS § 183. The Taxpayer argues that the time and effort required to engage in the cattle business make it a for-profit activity. The Taxpayer argues that getting up so early and going out even in adverse weather only make sense if the activity is for-profit. The Department argues that the Taxpayer's conduct was not sufficient to show that the activity was for-profit. The Department argues that the Taxpayer's primary purpose in engaging the cattle business is to relieve the stress of his job with DOT, family tradition, and for personal enjoyment.

Burden of Proof.

Assessments by the Department are presumed to be correct. *See* NMSA 1978, § 7-1-17. Tax includes, by definition, the amount of tax principal imposed and, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." NMSA 1978, § 7-1-3. *See also El Centro Villa Nursing Ctr. v. Taxation and Revenue Department*, 1989-NMCA-070, 108 N.M. 795. Therefore, the assessment issued to the Taxpayer is presumed to be correct, and it is the Taxpayer's burden to present evidence and legal argument to show that he is entitled to an abatement.

The burden is on the taxpayer to prove that he is entitled to an exemption or deduction. *See Public Services Co. v. N.M. Taxation and Revenue Dep't.*, 2007-NMCA-050, ¶ 32, 141 N.M. 520. *See also Till v. Jones*, 1972-NMCA-046, 83 N.M. 743. "Where an exemption or deduction

from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer.” *Sec. Escrow Corp. v. State Taxation and Revenue Dep’t.*, 1988-NMCA-068, ¶ 8, 107 N.M. 540. *See also Wing Pawn Shop v. Taxation and Revenue Dep’t.*, 1991-NMCA-024, ¶ 16, 111 N.M. 735. *See also Chavez v. Commissioner of Revenue*, 1970-NMCA-116, ¶ 7, 82 N.M. 97.

Personal income tax.

New Mexico imposes a personal income tax upon the net income of every resident. *See* NMSA 1978, § 7-2-3 (1981). New Mexico’s adjusted gross income is based on the person’s federal adjusted gross income. *See* NMSA 1978, § 7-2-2 (2014). However, the Department has the authority to examine and recalculate a person’s taxable income. *See Holt v. N.M. Dep’t. of Taxation and Revenue*, 2002-NMSC-034, ¶ 23, 133 N.M. 11.

The parties agree that the Taxpayer’s taxable income with respect to the amount of the assessment hinges upon whether the Taxpayer is allowed to deduct his losses from the operation of his cattle business. There is a federal deduction for expenses incurred while engaging in any trade or business. *See* 26 USCS § 162. However, the deduction of losses in excess of profits is disallowed when the activity engaged in is not a for-profit activity. *See* 26 USCS § 183.

For-profit activities.

The federal regulations list nine nonexclusive factors to aid in determining whether an activity is a for-profit activity or not. *See* 26 CFR 1.183-2. These factors are: 1) the manner in which the person carries on the activity; 2) the expertise of the person and his advisors; 3) the time and effort put into the activity; 4) the expectation that assets may appreciate in value; 5) the person’s success in carrying on similar or dissimilar activities; 6) the history of income or loss

with respect to the activity; 7) the amount of profits earned; 8) the financial status of the person; and 9) the elements of personal pleasure and recreation. *See id.*

The manner in which a person engages in an activity has to do with the formality and normal business practice used. *See id.* The Taxpayer did not have a formal business plan for his cattle operation. He did maintain a separate bank account, but there was not sufficient evidence that he kept formal records and tracked the use of the money in a way that is consistent with normal business practices. Therefore, this factor weighs against finding that the operation was for-profit.

Preparation, study, and consultation of experts can indicate that the activity is engaged in for-profit. *See id.* The Taxpayer's family was actively engaged in cattle ranching for part of his childhood. Members of the Taxpayer's extended family are also engaged in ranching, and the Taxpayer has several friends involved in the cattle business. The Taxpayer regularly speaks to his friends and family about the cattle operation. The Taxpayer is also a member of a cattle-owner's association and regularly attends lectures and seminars. However, there was not sufficient evidence that the Taxpayer engaged in serious discussions with the intent to improve his cattle operation. The evidence indicated that the Taxpayer's interactions with friends and family were more casual and social than they were seeking expert advice on his operation. Therefore, this factor weighs against finding that the activity was for-profit.

The Taxpayer expends a substantial amount of time and effort in his cattle operation. The Taxpayer works at least 20 hours a week with his cattle and often has to work outside during extreme weather. This factor weighs in favor of finding that the activity is for-profit.

The Taxpayer hopes that his cattle will be profitable in the future. There is certainly a possibility that the cattle will appreciate in value, depending on several market variables. This factor weighs in favor of finding that the activity is for-profit.

The Taxpayer presented no evidence to indicate that he had success in carrying on other similar or dissimilar business activities. Before beginning the cattle-breeding operation, the Taxpayer was leasing cows for roping, but he indicated that the roping-cattle operation was not profitable and was abandoned for that reason. This factor weighs against finding that the activity is for-profit.

The Taxpayer has a history of substantial losses and very little to no income with respect to the cattle operation. The Taxpayer characterized his best years as “breaking even”. However, there were several circumstances which were beyond the Taxpayer’s control, such as the severe drought, that influenced the cattle operations ability to make a profit. *See id.* This factor weighs neutrally in finding that the activity is for-profit.

The Taxpayer sold some cattle for a very small profit during some years, and sold other cattle for a very large loss most of the time. These types of occasional small profits, when the activity generates substantial losses, are not indicative of for-profit activities. *See id.* This factor weighs against finding that the activity is for-profit.

The Taxpayer is not reliant on the cattle operation for his livelihood. The Taxpayer has a full-time job with DOT, which provides him with income to live on and to run his cattle operation. This factor weighs against finding that the activity is for-profit.

The Taxpayer admitted that the cattle operation is a source of personal enjoyment for him. The Taxpayer considers the cattle operation to be a stress-reliever from his job with DOT. This factor weighs against finding that the activity is for-profit.

Six of the nine factors weigh against finding that the Taxpayer is engaged in the cattle operation for-profit. Therefore, the Department's disallowance of the deduction was reasonable, and the Taxpayer failed to overcome the presumption that the assessment is correct. *See* NMSA 1978, § 7-1-17.

Assessment of Penalty.

Penalty “*shall* be added to the amount assessed” when a tax is not paid on time due to negligence. *See* NMSA 1978, § 7-1-69 (2007) (emphasis added). However, a taxpayer will generally not be negligent when the taxpayer relied on advice from tax counsel or an accountant. *See* 3.1.11.11 NMAC (2001). The Taxpayer consulted with Mr. Mote on his tax liability, and Mr. Mote prepared the Taxpayer's returns. Mr. Mote is not an attorney or an accountant, but he is an Enrolled Agent. Mr. Mote advised the Taxpayer to take the deductions that have now been disallowed. Based upon the totality of the circumstances, the Taxpayer was not negligent. Therefore, the penalty is hereby abated.

Assessment of Interest.

Interest “shall be paid” on taxes that are not paid on or before the date on which the tax is due. NMSA 1978, § 7-1-67 (A). The word “shall” indicates that the assessment of interest is mandatory, not discretionary. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n.*, 2009-NMSC-013, ¶ 22, 146 N.M. 24. The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Because the tax was not paid when it was due, interest was properly assessed.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely written protest to assessment issued under Letter ID number L0832592944, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Taxpayer's cattle operation was not engaged in as a for-profit activity. *See* 26 CFR 1.183-2. Therefore, the deductions were properly disallowed. *See* 26 USCS §§ 162 and 183. *See also* NMSA 1978, §§ 7-2-2 and 7-2-3.

C. The Taxpayer relied on advice from an Enrolled Agent when he claimed the deductions. Therefore, the Taxpayer was not negligent. *See* 3.1.11.11 NMAC. Penalty is **HEREBY ABATED.**

D. The Taxpayer failed to overcome the presumption that the assessment of tax and interest was correct. *See* NMSA 1978, § 7-1-17.

For the foregoing reasons, the Taxpayer's protest is **DENIED IN PART AND GRANTED IN PART.**

DATED: September 9, 2016.

Dee Dee Hoaxie

DEE DEE HOXIE
Hearing Officer
Administrative Hearings Office
Post Office Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, § 7-1-25, 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. *See* Rule 12-601 NMRA. If an appeal is not filed within 30 days, this Decision and Order will become final. A copy of the Notice of Appeal should be mailed to John Griego, P. O. Box 6400, Santa Fe, New Mexico 87502. Mr. Griego may be contacted at 505-827-0466.

