

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

**IN THE MATTER OF THE PROTEST OF  
SONJA FOOTE,  
TO ASSESSMENT ISSUED UNDER  
LETTER ID NO. L1859893808**

**No. 16-47**

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held on August 25, 2016 before Hearing Officer Dee Dee Hoxie. Hearing Officer Chris Romero was also present. The Taxation and Revenue Department (Department) was represented by Mr. Marek Grabowski, Staff Attorney. Mr. Nicholas Pacheco, Auditor, also appeared on behalf of the Department. Mr. Douglas Mote, Enrolled Agent, appeared for Sonja Foote (Taxpayer) as her representative. The Taxpayer was given additional time to submit evidence. The Taxpayer's deadline was September 2, 2016. A timely supplemental brief was submitted. The Department was given until September 9, 2016 to respond. A timely response was submitted. 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 April 11, 2016, the Department assessed the Taxpayer for personal income tax, penalty, and interest for the periods from January 1, 2011 through December 31, 2013. The assessment was for \$5,958.00 tax, \$1,191.60 penalty, and \$552.05 interest.
2. On May 2, 2016, the Taxpayer filed a formal protest letter.
3. On June 21, 2016, the Department filed a Request for Hearing asking that the Taxpayer's protest be scheduled for a formal administrative hearing.

4. On June 23, 2016, the Hearings Office issued a notice of hearing. The hearing date was set within ninety days of the protest.
5. On July 15, 2016, a telephonic scheduling hearing was conducted.
6. On July 19, 2016, the Hearings Office issued the scheduling order and notice of hearing.
7. The Taxpayer and her husband owned approximately 1300 acres of land in Quay County, New Mexico. They purchased the land in 2009.
8. The Taxpayer's husband earned a substantial income from work unrelated to their land and cattle. The Taxpayer's husband retired, became ill, and passed away prior to the assessment.
9. The Taxpayer made improvements to the land, which included fencing and drilling wells. The Taxpayer bought three cows and began a cattle-breeding operation.
10. The Taxpayer's herd now has 19 pairs of heifers and calves. The Taxpayer intends to continue breeding until her herd is 50 head, which she believes can be reasonably sustained on her land.
11. The Taxpayer has family who also engage in ranching. The Taxpayer has witnessed bad range management in the past, and that is part of the reason she intends to keep her herd fairly small.
12. The Taxpayer's cattle-breeding operation and land improvements have generated substantial losses, which the Taxpayer claimed against her income.
13. The Taxpayer kept receipts relating to the operation and provided copies of receipts to the Department.
14. The Taxpayer has recently taken steps to improve her bookkeeping and is now integrating her financial information into a computer. The Taxpayer did not provide any examples of her improved system.
15. The Taxpayer did not provide any evidence to show that the operation has made 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 operation should be considered as a for-profit business or not under 26 USCS § 183. The Taxpayer argues that looking at the nine factors is not sufficient to determine if an activity is for-profit. The Taxpayer argues that personal observation of the operation itself is necessary and that few activities would hold up as for-profit if looked at solely on paper. The Taxpayer also argues that the land has appreciated substantially in value and that the appreciation should weigh heavily in favor of finding that 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 land appreciation is too speculative and is not enough to prove that the cattle operation is for-profit. The Department also requested that the decision be held in abeyance because the Taxpayer's supplemental brief raised questions about the Taxpayer's income and the deductions that the Department had allowed when it made the assessment. The request is denied. The scope of this protest is limited to the assessment that was made on April 11, 2016.

### 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 she is entitled to an abatement.

The burden is on the taxpayer to prove that she 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 her losses from the operation of her 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 her 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.* There was no evidence that the Taxpayer had a formal business plan for her cattle operation. There was no evidence that the Taxpayer maintained a separate bank account for the operation. There was evidence that the Taxpayer kept track of her expenses and kept receipts for those transactions. Based upon the totality of the evidence, 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. The Taxpayer learned about range management and ways to prevent overgrazing, but there was no evidence that the Taxpayer engaged in extensive study or expert consultation. Therefore, this factor weighs against finding that the activity was for-profit.

There was no evidence that the Taxpayer personally spends her time and effort on maintaining the operation. There was no evidence that the Taxpayer hired others to manage the operation. Given the lack of evidence presented, this factor weighs against finding that the activity is for-profit.

The Taxpayer's herd has increased, and the land has appreciated in value. There is certainly a possibility that the cattle will also 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 she had success in carrying on other similar or dissimilar business activities. This factor weighs against finding that the activity is for-profit.

The Taxpayer has a history of substantial losses with respect to the cattle operation. There was no evidence of the history of income with respect to the operation. However, it is not unusual for a business to experience substantial losses and little profits when it is in the start-up phase. It can take several years to build up a herd since cows are bred every two years. This factor weighs neutrally in finding that the activity is for-profit.

Mr. Mote believes that the Taxpayer's operation has been turning a profit for the last two years. However, there was no evidence presented to show that the Taxpayer has actually earned any profits from the business. Even 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 her livelihood. The Taxpayer relied upon her husband's income and now his retirement income for her support. This factor weighs against finding that the activity is for-profit.

There was no evidence whether the Taxpayer found personal enjoyment out of the cattle operation or not. This factor weighs against finding that the activity is for-profit.

Seven 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).* The word "shall" indicates that the assessment of penalty is mandatory, not discretionary. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n.*, 2009-NMSC-013, ¶ 22, 146 N.M. 24. Assessments of penalty are presumed

to be correct and it is a taxpayer's burden to show that the assessment was not correct. *See* 3.1.11.8 NMAC (2001). *See* NMSA 1978, § 7-1-17. *See also El Centro*, 1989-NMCA-070. Negligence includes inadvertence, mistake, and erroneous belief. *See* 3.1.11.10 (C) (2001). Therefore, penalty was properly assessed.

**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). Again, 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 L1859893808, 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 failed to overcome the presumption of correctness. *See* NMSA 1978, § 7-1-17.

For the foregoing reasons, the Taxpayer's protest is **DENIED**.

DATED: September 28, 2016.

*Dee Dee Hoxie*  
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DEE DEE HOXIE  
Hearing Officer  
Administrative Hearings Office

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