

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

**IN THE MATTER OF THE PROTEST OF
LINO E. & JUANITA B. SALAZAR
TO ASSESSMENT
ISSUED UNDER LETTER
ID NO. L1796980272**

No. 17-14

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on February 23, 2017 before Hearing Officer Chris Romero. The Taxation and Revenue Department (Department) was represented by Mr. Marek Grabowski, Staff Attorney. Ms. Milagros Bernardo, Auditor, also appeared on behalf of the Department. Mr. Lino E. Salazar and Mrs. Juanita B. Salazar (Taxpayers) appeared in person and represented themselves. 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 September 22, 2016, the Department assessed the Taxpayers for personal income tax and interest for the periods from January 1, 2009 through December 31, 2015. The assessment was for \$17,803.00 in tax and \$1,976.94 in interest. The Department did not assess penalty. [Dept. Ex. A; Testimony of M. Bernardo].
2. On October 30, 2016, the Taxpayers executed a formal protest letter which was received by the Department's Protest Office on December 15, 2016.
3. On December 28, 2016, the Department acknowledged the receipt of the Taxpayers' protest.
4. On February 8, 2017, the Department filed a Hearing Request asking that the Taxpayers' protest be scheduled for a formal administrative hearing.

5. On February 8, 2017, the Hearings Office issued a Notice of Administrative Hearing setting a hearing on the merits of the protest to occur on February 23, 2017. The hearing date was set within ninety days of the protest.

6. Taxpayers, Lino E. Salazar and Juanita B. Salazar are husband and wife.

7. Mr. Salazar's parents owned property in New Mexico for many years. The property has long been utilized for ranching activities. Mr. Salazar's father died in 1979. Mr. Salazar's mother died two or three years ago. Since Mr. Salazar's mother's death, Mr. Salazar's ownership interest in the property has been divided among his parents' heirs, but Taxpayers are presently in the process of acquiring an undivided interest in the property. [Testimony of L. Salazar].

8. Taxpayers anticipate that their undivided interest will consist of approximately 400 acres. [Testimony of L. Salazar].

9. Ranching is Mr. Salazar's family tradition which he described as "a way of life." He has been in ranching since childhood. He enjoys it immensely despite the hard work involved. [Testimony of L. Salazar].

10. Taxpayers presently own 24 head of cattle and three horses. [Testimony of L. Salazar].

11. Mr. Salazar's siblings have also conducted ranching activities on the property. [Testimony of L. Salazar].

12. During all relevant times, Taxpayers have incurred expenses in pursuit of their ranching activities. Such expenses have included: maintenance, repair, purchase, and installation of fixtures; purchase, maintenance, and repair of equipment, including trucks and trailers; purchase of supplies, including feed and fuel; labor; and property taxes. [Testimony of L. Salazar].

13. Taxpayers intend to eventually reside on their property and are presently constructing what Mr. Salazar described as a homestead. [Testimony of L. Salazar].

14. Sales from cattle for the relevant periods of time have ranged from \$6,000 to \$10,000 per year. Expenses for the same periods of time have ranged from \$40,000 to \$50,000 per year.

[Testimony of L. Salazar].

15. The sources of funds employed to finance Taxpayers' ranching activities have been Taxpayers' wages from employment and income from retirement. [Testimony of L. Salazar].

16. Taxpayers expect to realize a profit from their ranching activities when they eventually relocate their residence to their ranch property. Mr. Salazar currently commutes 120 miles daily to attend to his ranching tasks. [Testimony of L. Salazar].

17. The primary source of an anticipated profit will be cattle sales. [Testimony of L. Salazar].

18. Taxpayers have no intention of selling any portions of their interest in the property. Taxpayers intend to keep the property in the family and eventually pass it to their children.

[Testimony of L. Salazar].

19. At all relevant times, Taxpayers relied on a tax preparer for preparing their federal and state income tax returns. Every year, Taxpayers followed the direction of the tax preparer in compiling and providing documentation to establish expenses relating to Taxpayers' ranching activities. [Testimony of L. Salazar].

20. Mr. Salazar was interviewed by a representative of the Audit and Compliance Division. The interview occurred on July 15, 2016. The purpose of the interview was to obtain more information for consideration of the nine nonexclusive factors to aid in determining whether an activity is a for-profit activity or not. [Dept. Ex. B; Testimony of M. Bernardo].

21. Taxpayers started the ranching activity in 1991. Taxpayers did not have a formal written business plan. [Dept. Ex. B].

22. Taxpayers comingled personal funds with business funds indicating that the activity was not being operated consistent with standard business practices. [Dept. Ex. B; Testimony of M. Bernardo].

23. Mr. Salazar, while in high school, participated in activities intended to provide experience and education in ranching and farming. [Dept. Ex. B]. Mr. Salazar also consults and confers with other area ranchers. [Testimony of L. Salazar].

24. Taxpayers devote significant amount of time to the activity. Taxpayers estimated 40 hours or more per week were devoted to ranching activities from 2009 through 2015. [Dept. Ex. B; Testimony of L. Salazar].

25. Taxpayers' cattle might appreciate in value depending on the market. [Dept. Ex. B; Testimony of L. Salazar].

26. The evidence did not establish that other property, including real property, has appreciated in value. Even if the real property did appreciate in value, Taxpayers have no intention of selling it. [Testimony of L. Salazar].

27. There is no evidence to establish that Taxpayers' ranching activities have been profitable at any time or that Taxpayer had enjoyed previous success in operating a profitable ranching business. [Dept. Ex. B].

28. Ranching activities have not been profitable due to significant reinvestment in the form of the claimed expenses. [Dept. Ex. B; Testimony of L. Salazar].

29. The Taxpayers expressed potential for the activity to become profitable in 2019. [Dept. Ex. B].

30. In 2009, Taxpayers claimed \$92,878.00 in income. Taxpayers claimed a farm loss in the amount of \$53,372.00, resulting in an adjusted gross income of \$39,506.00. The Department disallowed the claimed loss. [Dept. Ex. C-009; Testimony of M. Bernardo].

31. In 2010, Taxpayers claimed \$99,480.00 in income. Taxpayers claimed a farm loss in the amount of \$46,773.00, resulting in an adjusted gross income of \$52,714.00. The Department disallowed the claimed loss. [Dept. Ex. C-010; Testimony of M. Bernardo].

32. In 2011, Taxpayers claimed \$97,614.00 in income. Taxpayers claimed a farm loss in the amount of \$48,089.00, resulting in an adjusted gross income of \$49,528.00. The Department disallowed the claimed loss. [Dept. Ex. C-011; Testimony of M. Bernardo].

33. In 2012, Taxpayers claimed \$94,476.00 in income. Taxpayers claimed a farm loss in the amount of \$52,917.00, resulting in an adjusted gross income of \$41,559.00. The Department disallowed the claimed loss. [Dept. Ex. C-012; Testimony of M. Bernardo].

34. In 2013, Taxpayers claimed \$93,319.00 in income. Taxpayers claimed a farm loss in the amount of \$54,674.00, resulting in an adjusted gross income of \$38,645.00. The Department disallowed the claimed loss. [Dept. Ex. C-013; Testimony of M. Bernardo].

35. In 2014, Taxpayers claimed \$49,198.00 in income and \$51,613.00 in retirement. Taxpayers claimed a farm loss in the amount of \$52,478.00, resulting in an adjusted gross income of \$48,333.00. The Department disallowed the claimed loss. [Dept. Ex. C-014; Testimony of M. Bernardo].

36. In 2015, Taxpayers claimed \$43,978.00 in income and \$37,520.00 in retirement. Taxpayers claimed a farm loss in the amount of \$40,124.00, resulting in an adjusted gross income of \$41,374.00. The Department disallowed the claimed loss. [Dept. Ex. C-015; Testimony of M. Bernardo].

37. In each instance in which the Department disallowed the claimed loss, the Department determined that the loss was not incurred with a for-profit motive. [Testimony of M. Bernardo].

38. As of February 23, 2017, Taxpayers' outstanding liability was \$17,803.00 in Personal Income Tax and \$2,278.81 in interest. The Department did not assess penalty. [Dept. Ex. D; Testimony of M. Bernardo].

DISCUSSION

The issue to be decided is whether the Taxpayers are liable for the assessment. The determination pivots on whether the Taxpayers ranching activities should be considered a for-profit business or not under 26 USC Sec.183. The Taxpayers acknowledge that their ranching activities have never been profitable although they express optimism that they might begin to realize a profit in 2019. The Department argues that the Taxpayers' conduct was not sufficient to show that the activity was driven by a profit motivation. In the absence of a for-profit motivation, the Department argues the Taxpayers are precluded from offsetting their ranching expenses under the given set of circumstances. The Department asserts, up to the present time and during all relevant times, that Taxpayers' ranching activities have been motivated more by family tradition and love of ranching than by business profit.

Burden of Proof.

Assessments by the Department are presumed to be correct. *See* NMSA 1978, Sec. 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, Sec. 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 Taxpayers is presumed to be correct, and it is the Taxpayers' burden to present evidence and legal argument to show that they are entitled to an abatement.

The burden is on the Taxpayers to prove that they are entitled to an exemption or deduction. *See Public Service 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, Sec. 7-2-3 (1981). New Mexico’s adjusted gross income is based on the person’s federal adjusted gross income. *See* NMSA 1978, Sec. 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 Taxpayers’ taxable income with respect to the amount of the assessment hinges upon whether the Taxpayers are allowed to deduct their losses from their ranching activities. There is a federal deduction for expenses incurred while engaging in any trade or business. *See* 26 USCS Sec. 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 Sec. 183.

For-Profit Activities.

Federal regulations provide 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 or 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.*

1) The manner in which the person carries on the activity.

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 Taxpayers had a formal business plan for their ranching activities or cattle sales. There was no evidence that the Taxpayers maintained a separate bank account for its operation. Although there was evidence that Taxpayers presently owned 24 head of cattle, there was no evidence to establish Taxpayers' plan for realizing a financial profit from the herd. Compare the same with *Hrdlicka v. Commissioner of Internal Revenue*, T.C. Memo 1985-503, 1985 Tax Ct. Memo Lexis 236, 50 T.C.M (CCH) 675, T.C.M. (RIA 85403), in which the court found this first factor to weigh against the taxpayer. In that case, the court recognized that the taxpayer kept records on each animal, but did not adhere to a strategy to sell calves when a reasonable profit potential could be realized. While the opinions of professionals with whom the taxpayer in *Hrdlicka* consulted had projected that the operation had profit potential, the court recognized that taxpayer did not make any serious effort to reverse the losses that the cattle operation was suffering.

In contrast, the court in *Mullins v. U.S.A.*, 334 F.Supp.2.d 1042 (D.Tenn 2004) weighed this factor in favor of a taxpayer when it recognized the activity had been operated with the formality of the taxpayer's previous business venture which had been profitable for more than 25 years. The taxpayer in *Mullins* experimented with various strategies to improve profitability and retained the services of accounting professionals to maintain his personal funds separately from his ranching funds.

Taxpayer in the present protest did not adhere to any business plan to improve profit potential, or present evidence to establish that any effort was being made to reverse the serious losses

that the cattle operation was incurring. Although there was evidence that the Taxpayers kept track of their expenses and kept receipts for those transactions, there was no further evidence to suggest the activity was pursued with the formality or practices of a profit-motivated business. Based upon the totality of the evidence, this factor weighs against finding that the operation was intended for-profit.

2) The expertise of the person and his or her advisors.

Preparation, study, and consultation of experts can indicate that the activity is engaged in for-profit. *See id.* Mr. Salazar's family was actively engaged in cattle ranching since his childhood. Mr. Salazar has also supplemented his family knowledge of ranching with high school programs or activities and by conferring with other ranchers, but there was no evidence that the Taxpayer engaged in extensive formal study or expert consultation. Compare the facts to the scenario in *Hrdlicka*, in which the court found that this factor would weigh against the taxpayer. In *Hrdlicka*, the court determined that the taxpayer consulted with his father-in-law and others who had extensive experience in farming and ranching in the initial planning phases of commencing his operation. However, the taxpayer in *Hrdlicka* did not continue to seek expert advice during the course of the operations or hire specialized workers to help manage the ranch. Although the taxpayer did occasionally hire help, it was not the sort of engagement that would provide the type of expertise that was necessary to make the operation profitable.

The court in *Mullins* found this factor to weigh in favor of the taxpayer. In *Mullins*, the court observed that the taxpayer regularly sought the advice of experts in ranching, regularly read ranching publications, attended seminars and meetings of ranching associations, and received regular assistance from the local agriculture extension agent and veterinarian.

Similar to the scenario in *Hrdlicka*, the Taxpayers in this case have informally consulted family members and other ranchers, but there was no evidence to establish that the advice approached what the court in *Mullins* found persuasive on this factor. In this case, there was not any

ongoing consultation directed specifically toward making the operation profitable. Therefore, this factor weighs against finding that the activity was for-profit.

3) The time and effort put into the activity.

With respect for the time and effort expended by the Taxpayer in carrying on the activity, the evidence established that Mr. Salazar spends significant time personally attending to the ranching activities and traveling to and from the property where those activities are based. The time devoted to the ranch exceeded 40 hours per week during all relevant times, including those periods of time when Mr. Salazar also maintained full-time employment. Mr. Salazar suggested that he occasionally employs day laborers to perform work on the ranch, but there was no evidence that the Taxpayers had regular employees to work on the ranch or manage its operation. This factor weighs in favor of finding that the activity is for-profit.

4) The expectation that assets may appreciate in value.

There was no evidence to establish that Taxpayers' herd had increased in size or appreciated in value. Mr. Salazar acknowledged that the value of his herd could fluctuate based on a number of market variables. There is also no evidence to suggest the land had appreciated in value despite Taxpayers clearly expressing their intention to keep the property in the family and eventually pass it on to their children. Given the foregoing, there is certainly a possibility that the cattle will appreciate in value, depending on several market variables. There is also a possibility that the herd will increase in size. This factor weighs in favor of finding that the activity is for-profit.

5) The person's success in carrying on similar or dissimilar activities.

With respect to the success of the Taxpayers in carrying on other similar or dissimilar business activities, this factor weighs against finding that the activity is for-profit, because although Mr. Salazar has decades of experience in ranching, there is a lack of evidence to establish that the activity has ever been successful from a profit perspective. Nor is there evidence to establish that Mr.

Salazar has experience in operating a profitable business activity, unlike *Mullins*, in which the court recognized the taxpayer as a successful businessman of more than 25 years before commencing his ranching activities.

6) The history of income or loss with respect to the activity.

The Taxpayers have a history of substantial losses with respect to the ranching activities and cattle sales. Mr. Salazar agreed that he incurs between \$40,000 and \$50,000 in expenses with cattle sales ranging from \$6,000 to \$10,000 per year. Although, it is not unusual for a business to experience substantial losses and little profits when it is in the start-up phase and it can take several years to increase the size of a herd, the losses in this protest have been continuous over many years. Department Exhibit I established that the Taxpayers have been engaging in this activity since 1991. This factor weighs against finding that the activity is for-profit.

Compare the foregoing with *Hrdlicka* in which the court found that a history of losses with a lack of corrective efforts was inconsistent with a profit motivation. The taxpayer in *Mullins* also had a history of cumulative losses, but the court found the evidence sufficient to be persuaded that the taxpayer had an actual and honest intention to make a profit, which included making adjustments to the business plan to increase profit potential.

7) The amount of profits earned.

Mr. Salazar acknowledged that the activity has not been profitable. Mr. Salazar is optimistic that it may become profitable in 2019 when he expects Taxpayers to relocate their residence to their ranch. Mr. Salazar testified that profit potential would increase when he is able to eliminate the costs associated with commuting 120 miles per day. However, there was no evidence presented to show that the Taxpayers have actually earned any profits from the activity. 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.

8) The financial status of the person.

The Taxpayers are not reliant on the ranching activity for their livelihood. The Taxpayers have relied on their income from employment and retirement for their support. This factor weighs against finding that the activity is for-profit.

9) The elements of personal pleasure and recreation.

Mr. Salazar spoke passionately about his love of ranching and the enjoyment he has from riding horses and attending to his ranching tasks. Although it is not uncommon for one to be passionate about their activities, whether motivated by profit or not, the evidence established that Mr. Salazar's personal enjoyment and maintaining his family tradition were the primary motivating factors in conducting the ranching activities, not profit. This factor weighs against finding that the activity is for-profit.

Seven of the nine factors weigh against finding that the Taxpayers are engaged in the ranching activities or cattle sales for-profit. Therefore, the Department's disallowance of the deduction was reasonable, and the Taxpayers failed to overcome the presumption that the assessment is correct. *See* NMSA 1978, Sec. 7-1-17.

Tax Principal, Penalty, and Interest.

Numerous times during the hearing, Mr. Salazar made reference to the reliance he placed on his tax preparer. Whether or not a taxpayer relied on the advice of a tax professional is relevant to the issue of penalty.

Penalty "*shall* be added to the amount assessed" when a tax is not paid on time due to negligence. *See* NMSA 1978, Sec. 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). In this case, the Department presumably determined that the Taxpayers' conduct was not negligent because it did not assess a penalty. Ms. Bernardo was not

able to specifically state why the Department elected to forego the assessment of penalty, but inferred there had been a determination that Taxpayers were not negligent, perhaps on the reliance they placed on their tax preparer.

However, reasonable reliance on a tax professional will not absolve Taxpayers' liability for tax or interest. It is the Taxpayers' duty under *Tiffany Construction Co.*, 1976-NMCA-127, ¶5, to ascertain the tax consequences of his or her actions. A taxpayer cannot "abdicate this responsibility [to learn of tax obligations] merely by appointing an accountant as its agent in tax matters." *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶14, 108 N.M. 795. In this protest, Taxpayers are liable for the tax due despite any reliance they placed on their tax preparer.

The same is true for the assessment of interest which "shall be paid" on taxes that are not paid on or before the date on which the tax is due. NMSA 1978, Sec. 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.

Taxpayers' protest should be denied.

CONCLUSIONS OF LAW

A. The Taxpayers filed a timely written protest to assessment issued under Letter ID No. L1796980272, and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing in this matter was held within the requisite 90 days from the date the protest was received as required by NMSA 1978, Sec. 7-1B-8 (A).

C. The Taxpayers' ranching activities were not engaged in as a for-profit activity. *See* 26 CFR 1.183-2. Therefore, the deductions were properly disallowed. *See* 26 USCS Sections 162 and 183. *See also* NMSA 1978, Sections 7-2-2 and 7-2-3.

D. The Taxpayers failed to overcome the presumption of correctness. *See* NMSA 1978, Sec. 7-1-17.

For the foregoing reasons, the Taxpayers' protest is **DENIED**.

DATED: March 14, 2017



Chris Romero
Hearing Officer
Administrative Hearings Office
P.O. Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), 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. If an appeal is not timely filed with the Court of Appeals within 30 days, this Decision and Order will become final. Rule of Appellate Procedure 12-601 NMRA articulates the requirements of perfecting an appeal of an administrative decision with the Court of Appeals. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may begin preparing the record proper. The parties will each be provided with a copy of the record proper at the time of the filing of the record proper with the Court of Appeals,

which occurs within 14 days of the Administrative Hearings Office receipt of the docketing statement from the appealing party. *See* Rule 12-209 NMRA.