

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

**IN THE MATTER OF THE PROTEST OF
DAVID & JANIE HOFFMAN,
TO THE ASSESSMENT ISSUED UNDER
LETTER ID NO. L0051085616**

No. 17-17

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on March 16, 2017 before Hearing Officer Dee Dee Hoxie. 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. David Hoffman and Mrs. Janie Hoffman (Taxpayers) appeared for the hearing with their representative, Mr. Douglas Mote, Enrolled Agent.

The Taxpayers failed to provide exhibits at the hearing in the proper form and format as instructed in the Scheduling Order. The Taxpayers were given one week to mail the exhibits in the correct form and format. The Taxpayers timely submitted exhibits 1 through 7 by mail. The Taxpayers also provided a two-page narrative that will be marked as exhibit 8. The Department was given one week to examine the Taxpayers' exhibits and to make objections. The Department did not oppose the admission of the Taxpayers' exhibits. Therefore, the Taxpayers' exhibits 1 through 8 are admitted. The Department's exhibits "A" through "D" were admitted at the hearing. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet. References to exhibits in this decision shall be abbreviated as Ex. followed by the number or letter and the page of the exhibit referenced, e.g. Ex. #1-2. 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 October 13, 2016, the Department assessed the Taxpayers for personal income tax, penalty, and interest for the tax periods from January 1, 2009 through December 31, 2015. The assessment was for \$7,154.00 tax, \$1,293.52 penalty, and \$552.44 interest.
2. On November 14, 2016, the Taxpayers filed a formal protest letter.
3. On December 28, 2016, the Department filed a Request for Hearing asking that the Taxpayers' protest be scheduled for a formal administrative hearing.
4. On January 4, 2017, the Hearings Office issued a notice of telephonic scheduling hearing.
5. The telephonic scheduling hearing was conducted on January 19, 2017. The hearing was held within ninety days of the protest.
6. On January 24, 2017, the scheduling order and notice of hearing was issued.
7. In 2006, the Taxpayers purchased land in Quay County, New Mexico with the intent to fulfill their lifelong dreams of owning and operating a farm.
8. The Taxpayers are both employed full-time, for which they both earn wages.
9. The Taxpayers own approximately 262 acres. (Ex. #8-1)
10. The Taxpayers purchased the land in 2006 for \$170,000. (Ex. #1)
11. An appraisal of the Taxpayers' land was done in November 2015. The appraisal estimated the value of the land at \$312,600 (Ex. #2-1 and 2-23).
12. In 2007 and 2008, the Taxpayers' farming operations turned a profit.
13. The Taxpayers then changed the operation to attempt to raise grass-fed beef.
14. In 2009, the Taxpayers were not allocated any water for irrigation. (Ex. #8-1).

15. In 2010 through 2012, the Taxpayers had some sort of partnership agreement with another person, but the details of the agreement, such as who owned what and whose land was used and how, were not provided. (Ex. #8-1).
16. The Taxpayers were allocated eight inches of water in 2010 and were allocated no water in 2011, 2012, and 2013. (Ex. #8-1)
17. In 2013, the Taxpayers borrowed money to purchase a sprinkler. (Ex. #8-1)
18. In 2014 and 2015, the Taxpayers were allocated 15 inches of water. (Ex. #8-1)
19. In 2014, the Taxpayers planted various grasses to serve as natural feed. The sprinkler is used to encourage the growth of these grasses. (Ex. #8-1).
20. The number of cattle that the Taxpayers have owned has fluctuated every year. The Taxpayers sold off most of their cattle in 2012 due to the drought, but have increased their herd every year since then. (Ex. #8-1 and Ex. #6)
21. The Taxpayers intend to introduce cows to their herd that are genetically predisposed to put on weight eating grass.
22. The Taxpayers have borrowed money and used their wages to run their operation.
23. The Taxpayers have reported farm losses in almost every year since they changed the operation to grass-fed beef. In 2009, the Taxpayers reported farm losses of \$9,478.00. In 2010, farm losses of \$18,116.00. There was no information provided on 2011. In 2012, farm losses of \$15,625.00. In 2013, farm losses of \$35,375.00. In 2014, farm losses of \$34,718.00. In 2015, farm losses of \$44,203.00. (Ex. B-8 through 13)
24. For each year a farm loss was claimed, the Taxpayers' taxable state income was significantly reduced. (Ex. B-2 through 7)

25. The Taxpayers executed a mortgage loan for \$750,000.00 on two tracts of property in Quay County, New Mexico in December 2015. (Ex. #3)
26. To secure the mortgage, an appraisal was ordered for both tracts of land, one with 286 acres and one with 160 acres. (Ex. #2-42)
27. Only one tract's appraisal was provided. (Ex. #2-1)
28. The Taxpayers both have a family history of farming and ranching. Mr. Hoffman also has a college degree in animal husbandry.
29. The Taxpayers both spend 40-45 hours per week working on their grass-fed beef operation.
30. The Taxpayers acknowledge that the operation is hard work, but also characterize it as a "labor of love".
31. The Taxpayers intend to continue the operation indefinitely and hope to leave the land to their children someday.
32. The Taxpayers do not have a written business plan. The Taxpayers claimed to have kept records, but did not produce any evidence on them. The Taxpayers did not produce any banking records except for the mortgage executed in 2015.

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 Taxpayers' grass-fed beef operation should be considered as a for-profit business or not under 26 USCS § 183. The Taxpayers argue that the time and effort required to engage in the grass-fed beef business make it a for-profit activity. The Taxpayers also argue that the land's appreciation makes it a for-profit activity. The Department argues that the Taxpayers' evidence was not sufficient to show that the activity was

for-profit. The Department argues that the Taxpayers lacked records and lacked a plan for making the activity profitable. The Department argues that the Taxpayers hopes for profit are not sufficient to show that it is actually a for-profit endeavor.

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 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 a 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 Taxpayers' taxable income with respect to the amount of the assessment hinges upon whether the Taxpayers are allowed to deduct their losses from the operation of their grass-fed beef 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 determination is fact intensive. None of the nine factors alone is dispositive, nor is a majority dispositive. *See Harrington v. Comm'r of Internal Revenue*, No. 5679-00S, T.C. Summary Op. 2002-58 (non-precedential) (holding that the taxpayer's lack of business plan, lack of budget, and failure to make adjustments to operation showed that the horse-breeding was not engaged in for-profit even though the land had shown appreciation). *See Hurd v. Comm'r of Internal Revenue*, T.C. Memo 1978-113, 37 T.C.M. 449 (holding that large losses over an extended period of time

without making substantial changes in the operation to try to mitigate those losses indicated that the activity was not engaged in for-profit). *See Stephens v. Comm'r of Internal Revenue*, T.C. Memo 1990-376, 60 T.C.M. 197 (holding that keeping meticulous records, engaging in formal written contracts, extensive research, efforts to mitigate losses, and the substantial time involved indicated that the activity was engaged in for-profit). *See Davis v. Comm'r of Internal Revenue*, T.C. Memo 2000-101, 79 T.C.M. 1730 (holding that maintaining complete and accurate books and records, conducting transactions in a businesslike manner, and changing operations to try to realize a profit indicated that the activity was engaged in for-profit).

The manner in which a person engages in an activity has to do with the formality and normal business practice used. *See* 26 CFR 1.183-2. The Taxpayers did not have a formal business plan or budget. There was no evidence that they kept the funds from the operation separate from their personal funds. There was not sufficient evidence that they kept formal records and tracked the use of the money in a way that is consistent with normal business practices. There was some evidence that they had a partner at some point, but there was no evidence of a formal agreement or its terms. The Taxpayers indicated that their loan from the bank was based on a conversation and a handshake, not on any formal business strategy. The loan itself is just a mortgage on two pieces of real property, not on any business operation or its assets. 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 Taxpayers have a family history of farming and ranching. Mr. Hoffman has a college degree in animal husbandry. The Taxpayers have read articles about breeding and genetics. The Taxpayers intend to implement their studies into their operation by obtaining cows

that are genetically predisposed to gain weight on grass. Therefore, this factor weighs in favor of finding that the activity was for-profit.

The Taxpayers expend a substantial amount of time and effort in their operation. The Taxpayers each work about 40 hours a week at the operation in addition to their full-time jobs. This factor weighs in favor of finding that the activity is for-profit.

The Taxpayers hope that grass-fed beef will be profitable in the future. There is certainly a possibility that the cattle will appreciate in value, depending on several market variables. It is also possible that grass-fed beef will garner greater value than grain-fed beef. This factor weighs in favor of finding that the activity is for-profit.

The Taxpayers have never engaged in a similar business before, so they cannot demonstrate a history of success. This factor weighs against finding that the activity is for-profit.

The Taxpayers initially made a profit but changed the operation to grass-fed beef. Since then, the Taxpayers have a history of substantial losses. The appreciation of the land shows some profit potential, but it is not really related to the grass-fed beef operation. The Taxpayers have had to deal with severe drought, which can make raising cattle difficult. However, the Taxpayers' losses have continued to increase substantially, going from less than \$9,500 to over \$40,000 in less than eight years. There was no evidence that the Taxpayers were doing anything to mitigate losses beyond selling off some of the herd in one year. This factor weighs against finding that the activity is for-profit.

Even occasional small profits, when the activity generates substantial losses, are not indicative of for-profit activities. *See id.* There was no evidence presented that the Taxpayers ever made a profit on the grass-fed beef operation. This factor weighs against finding that the activity is for-profit.

The Taxpayers are not reliant on the grass-fed beef operation for their livelihood. The Taxpayers each have full-time jobs and earn wages. These wages and loans are what allow the Taxpayers to continue the operation. This factor weighs against finding that the activity is for-profit.

The Taxpayers indicated that buying a farm and raising cattle is the fulfillment of a life-long dream. The Taxpayers characterized it as a “labor of love”. This factor weighs against finding that the activity is for-profit.

Six of the nine factors weigh against finding that the Taxpayers are engaged in the grass-fed beef 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 Taxpayers consulted with Mr. Mote on their tax liability, and Mr. Mote prepared the Taxpayers’ returns. Mr. Mote is not an attorney or an accountant, but he is an Enrolled Agent. Mr. Mote advised the Taxpayers to take the deductions that have now been disallowed. Based upon the totality of the circumstances, the Taxpayers were 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 Taxpayers filed a timely written protest to assessment issued under Letter ID number L0051085616, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Taxpayers' grass-fed beef 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 Taxpayers relied on advice from an Enrolled Agent when they claimed the deductions. Therefore, the Taxpayers were not negligent. *See* 3.1.11.11 NMAC. Penalty is **HEREBY ABATED.**

D. The Taxpayers 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 Taxpayers' protest is **DENIED IN PART AND GRANTED IN PART.**

DATED: April 10, 2017.

Dee Dee Hoxie

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.