STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
TILLER DESIGN **No. 16-38**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0894277680

DECISION AND ORDER

A protest hearing occurred on the above captioned matter on May 2, 2016 before Brian VanDenzen, Esq., Chief Hearing Officer, in Santa Fe. At the hearing, William Schmidt appeared *pro se* for Tiller Design ("Taxpayer"). Staff Attorney Peter Breen appeared representing the State of New Mexico Taxation and Revenue Department ("Department"). Protest Auditor Nicholas Pacheco appeared as a witness for the Department. Taxpayer Exhibits #1-12 (though many of the exhibits either involve legal argument or provide statutory, regulatory, or case law authority rather than presentation of a facts) and Department Exhibits A-C were admitted into the record. All exhibits are more thoroughly described in the Administrative Exhibit Coversheet. The record was left open to May 20, 2016 to allow Taxpayer to produce any evidence of long-term leases, which Taxpayer was unable to provide. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On November 3, 2015, under letter id. no. L0894277680, the Department assessed Taxpayer for $8,704.46 in gross receipts tax, $1,740.90 in penalty, and $789.68 in interest for the CRS reporting periods between January 1, 2012 and December 31, 2012.

2. On January 29, 2016, Taxpayer protested the Department's assessment.

3. On February 9, 2016, the Department's protest office acknowledged receipt of a valid protest.

4. On March 18, 2016, the Department filed a request for hearing in this matter with the Administrative Hearings Office.

5. On March 21, 2016, the Administrative Hearings Office sent Notice of Administrative Hearing, scheduling this matter for a merits hearing on May 2, 2016, within 90-days of the Department's acknowledgment of receipt of a valid protest.

6. William Schmidt and his wife Sandra Tiller have two homes in Albuquerque that they rented through Vacation Rental By Owner (VRBO.com)/HomeAway during the relevant period (one home called the Sandia Mountain Home and another called the Cottonwood Casita).

7. The VRBO.com advertisement for Taxpayer's homes indicated a rental fee amount for a minimum five-night stay (plus an additional per day fee thereafter), plus an additional cleaning fee of $250 and a tax rate of 7%. [Dept. Ex. A-10 through 11].

8. The VRBO.com advertisement for the homes provided an extensive list of accommodations and facilities provided with the rental. [Dept. Ex. A-12 through 14].

9. Each property is a single family home, rented in its entirety for a minimum of three days, with an average rental of five-to-seven days.

10. The families renting the property signed a rental agreement with Taxpayer.

11. The rental agreements were titled "Vacation Rental Home Agreement." [Taxpayer. Ex. #11 & #12].

12. The rental agreements specified in a "Check-in Date," and a "Check-out Date." [Taxpayer. Ex. #11 & #12].

13. One of the rental agreements for the Cottonwood Casita home further specified a check-in time of 4:00 p.m. and a check-out time of 12:00 noon. [Taxpayer. Ex. #11].

14. The rental agreements required a partial deposit to reserve the rental dates, with a subsequent payment of the remaining balance 60-days before arrival, a cancelation fee, and a firm deadline to cancel the agreement or risk full payment under the agreement. [Taxpayer. Ex. #11 & #12].

15. The rental agreements allowed for additional charges for damages to the house and cost of cleaning beyond normal expectations. [Taxpayer. Ex. #11 & #12].

16. The rental agreements prohibited smoking inside the homes, required that the home be left in same condition as the renter found it, and imposed a guest occupancy limitation. [Taxpayer. Ex. #11 & #12].

17. Additionally, the rental agreement for the Sandia Mountain prohibited pets without prior arrangement and prohibited large gatherings without prior arrangement and payment of applicable venue fees. [Taxpayer Ex. #12].

18. The rental agreements were otherwise silent on the renters' dominion or lack thereof over the property during the rental period. [Taxpayer. Ex. #11 & #12].

19. The rental agreements were silent on Taxpayer's rights to enter the premise during the rental period, to inspect the premise, to cancel or terminate the agreement or otherwise take possession of the property upon notice or eviction. [Taxpayer. Ex. #11 & #12].

20. Mr. Schmidt and Ms. Tiller provided the renters with a set of keys to rented home during the rental period.

21. Mr. Schmidt and Ms. Tiller had a mortgage on both homes at the time, maintained insurance on the homes, and kept a set of keys for the homes.

22. Mr. Schmidt and Ms. Tiller assisted the family that rented that property with any issues that arose during their rental, such as fixing wi-fi internet service or any maintenance issues that arose during the occupancy.

23. As of the date of hearing, Taxpayer owed $8,704.46 in gross receipts tax, $1,740.90 in penalty and $918.94 in interest for a total outstanding liability of $11,364.30. [Dept. Ex. C].

DISCUSSION

The issue in this case is whether Taxpayer's short-term rental of two homes through VRBO.com are subject to gross receipts tax. Taxpayer argues that under Regulation 3.2.116.10 NMAC, Taxpayer is not subject to gross receipts tax because Taxpayer has less than three rental units. The Department argued that Taxpayer was subject to gross receipts tax under NMSA 1978, Section 7-9-53 (B) (1998) because rental of a vacation home is similar to hotels, motels, and guest ranches and because rental of a vacation home constitutes a license to use real property rather than a lease of real property.

Presumption of Correctness.

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessment issued in this case is presumed correct. Consequently, Taxpayer has the burden to overcome the assessment. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428. Accordingly, it is Taxpayer's burden to present some countervailing evidence or legal argument to show that it is entitled to an abatement, in full or in part, of the assessment issued against it. *See N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8. "Unsubstantiated statements that the assessment is incorrect cannot overcome the presumption of correctness." *See MPC Ltd. v. N.M. Taxation & Revenue Dep't*, 2003-NMCA-21, ¶13, 133 N.M. 217; *See also* Regulation 3.1.6.12 NMAC.

Moreover, "[w]here 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." *Wing Pawn Shop v. Taxation and Revenue Department*, 1991-NMCA-024, ¶16, 111 N.M. 735 (internal citation omitted); *See also TPL, Inc. v. N.M. Taxation & Revenue Dep't*, 2003-NMSC-7, ¶9, 133 N.M. 447. Because Taxpayer is claiming a deduction from gross receipts tax, Taxpayer must establish its right to claim the deduction.

Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, §7-1-3 (X) (2013). Under Regulation 3.1.6.13 NMAC, the presumption of correctness under Section 7-1-17 (C) extends to the Department's assessment of penalty and interest. *See Chevron U.S.A., Inc. v. State ex rel. Dep't of Taxation & Revenue*, 2006-NMCA-50, ¶16, 139 N.M. 498, 503 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight). When a taxpayer presents sufficient evidence to rebut the presumption, the burden shifts to the Department to show that the assessment is correct. *See MPC Ltd.*, 2003 NMCA 21, ¶13.

Gross Receipts Tax and the Leasing and/or Licensing of Real Property.

For the privilege of engaging in business, New Mexico imposes a gross receipts tax on the receipts of any person engaged in business. *See* NMSA 1978, § 7-9-4 (2002). Under NMSA 1978, Section 7-9-3.5 (A) (1) (2007), the term "gross receipts" is broadly defined to mean

> the total amount of money or the value of other consideration received from selling property in New Mexico, from leasing or licensing property employed in New Mexico, from granting a right to use a franchise employed in New Mexico, from selling services performed outside New Mexico, the product of which is initially used in New Mexico, or from performing services in New Mexico.

"Engaging in business" is defined as "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit." NMSA 1978, § 7-9-3.3 (2003). Gross receipts applies to the leasing or licensing of property employed in New Mexico. *See* NMSA 1978, § 7-9-3.5 (2007). Under the Gross Receipts and Compensating Tax Act, there is a statutory presumption that all receipts of a person engaged in business are taxable. *See* NMSA 1978, § 7-9-5 (2002).

In this case, Taxpayer is claiming an exemption from gross receipts taxation under NMSA 1978, 7-9-28. Again, under *Wing Pawn Shop*, Taxpayer carries the burden to establish entitlement to a claimed deduction. Exempt from gross receipts tax under Section 7-9-28 are

> …the receipts from the isolated or occasional sale of or leasing of property or a service by a person who is neither regularly engaged nor holding himself out as engaged in the business of selling or leasing the same or similar property or service.

Under the plain language of this statute, Taxpayer is not entitled to an exemption from taxation. Taxpayer in this matter regularly advertised the properties through VRBO.com, promoted the properties through VRBO.com, and rented the properties repeatedly during the period for direct financial benefit. All these activities clearly show that Taxpayer was both holding itself out and regularly engaged in the business of renting its vacation homes for financial benefit. Thus, Taxpayer was not a person "neither regularly engaged nor holding himself out as engaged in the business of selling or leasing the same or similar property or service."

This conclusion is further supported by Regulation 3.2.116.8 NMAC, which addresses criteria used in determining isolated or occasional sales. Under Regulation 3.2.116.8 NMAC,

> The department will use the following criteria, but not exclusively, in determining whether or not a transaction involves only an "isolated or occasional" sale or lease:
> A. the nature of the service or property;
> B. the nature of the market for the service or property sold or leased;
> C. the number of sales or leases made within a given period;
> D. the regularity of the sales;
> E. the duration of the sales or leasing activity;

F. any promotional activity such as advertising or telephone yellow page listings; and
G. any holding out as being in business by the seller or lessor.

Without repeating the discussion in the previous paragraph, factors (B), (C), (D), and (F) support that Taxpayer was not engaged in isolated or occasional sales for the purposes of Section 7-9-28 and thus not exempt from gross receipts tax.

The Department also cites NMSA 1978, Section 7-9-53 (1998) as a basis for the assessment. Generally, under Section 7-9-53, receipts from the sale or lease of real property may be deducted from gross receipts. However, under Section 7-9-53 (B),

> [r]eceipts received by hotels, motels, rooming houses, campgrounds, guest ranches, trailer parks or similar facilities, except receipts received by trailer parks from the rental of a space for a manufactured home or recreational vehicle for a period of at least one month, from lodgers, guests, roomers or occupants are not receipts from leasing real property for the purposes of this section.

In other words, the receipts identified in subsection (B) are not included in the general deduction of lease receipts permitted under Section 7-9-53. Moreover, under Regulation 3.2.205.20 NMAC, "[h]otels, motels, inns, rooming house and similar facilities are engaged in the business of granting a license to use real and tangible personal property." Similarly, receipts by operators of rooming houses from "occupants" are not receipts from leasing real property under Regulation 3.2.211.8 (F) NMAC. The Department argues that short-term rentals of a vacation home for less than 30-days meets the "similar facilities" language under Section 7-9-53 (B) and that rather than constituting a lease, such vacation rentals amount to a license to use the property for a limited duration. Under Regulation 3.2.211.17, "[r]eceipts derived from a license to use real property may not be deducted from gross receipts tax under

Section 7-9-53…(the exception mentioned in that regulation is not applicable to the facts of this case." The Department's argument is persuasive.

Under the Gross Receipts and Compensating Tax Act, the term "leasing" is defined to mean "an arrangement whereby, for a consideration, property is employed for or by any person other than the owner of the property, except that the granting of a license to use property is licensing and is not a lease." NMSA 1978, Section 7-9-3 (E) (2007). The New Mexico Court of Appeals has generally found that a lease is "an agreement under which the owner gives up the possession and use of his property for a valuable consideration and for a definite term." *See Quantum Corp. v. State Taxation & Revenue Dep't,* 1998-NMCA-050, ¶9, 125 N.M. 49 (internal citations omitted). The term "license" is not specifically defined under the Gross Receipts and Compensating Tax Act or under the Tax Administration Act. *See Quantum Corp.*, 1998-NMCA-050, ¶10. In the absence of a statutory definition, the New Mexico Court of Appeals turned to Black's Law Dictionary to define "license" as "[a] permission, by a competent authority to do some act which without such authorization would be illegal or would be a trespass or a tort…" *N.M. Sheriffs & Police Ass'n v. Bureau of Revenue,* 1973-NMCA-130, ¶7, 85 N.M. 565; *See also Quantum Corp*., ¶10. As the Court of Appeals indicated, *id*., "[a] license does not create an interest in land; it is similar to a tenancy at will." When determining whether a lease or a license is at issue, courts analyze the contents of the instrument employed, the subject matter, and the surrounding circumstances to determine the intention of the parties. *See Quantum Corp*., ¶12 (internal citations omitted).

Rather than possessing the typical markings of a lease, similar to hotels, motels and guest ranches, a vacation rental by owner is a short-term license to use the property for a limited duration, particularly in light of the specific rental agreements in this case. The rental

agreements specify a check-in and check-out date, limit the number of guests allowed at the property, require preapproval and additional fees for large gatherings, require permission for bringing pets, allow a deposit to confirm the rental and cancellation of the rental, and require that the premise be returned in the same condition as found at the beginning of the rental period. Additionally, the VRBO.com listing provides detailed amenities provided with the rental, which is more consistent with hotel, motel, guest ranch than with the typical lease of real property. Taxpayer also provided maintenance service-type of activities during the rentals. The rental agreements are silent on any transfer of the underlying property interest, do not give the renters any specific ability to exclude Taxpayer from its property, and do not limit Taxpayer's ability to enter, inspect, cancel the agreement, or otherwise retake possession of the property during the period of rental. These agreements are far closer to the license that a hotel, motel, or guest ranch issues to a lodger than a lease between a landlord and tenant. Consequently, these agreements amount to the granting of license rather than a lease under the definition contained in Section 7-9-3 (E) and are not subject to the deduction under under Section 7-9-53 (B).

Nevertheless, Taxpayer cites Regulation 3.2.116.10 NMAC to challenge the assessment. Regulation 3.2.116.10 NMAC reads

> Any person who rents or leases three or fewer rental units of real property is not regularly engaged in the business of leasing real property for the purposes of Sections 7-9-28 and 7-9-53 NMSA 1978. Such a person need not register with the taxation and revenue department for gross receipts tax purposes nor report the receipts if there are no other receipts, but the person may be required to register to report another tax.

Although Taxpayer seemed to believe that this language was part of the statute, the language represents a regulation rather than direct legislative statutory authority contained in either

Section 7-9-28 or Section 7-9-53. While regulations may be presumed to be proper interpretations of statutes, they are not statutes themselves and are of lesser legal authority than the actual statute. Reading this regulation in conjunction with the primary, controlling statutory provisions of Section 7-9-28 and Section 7-9-53, as well as the statutory definition of leasing that excludes licensing of real property under Section 7-9-3 (E), the only way Regulation 3.2.116.10 NMAC could be a valid interpretation of the statutory provisions is if it applies only to those who *lease* three or fewer rental units. In order to still give effect to the provisions of Section 7-9-53, this regulation cannot apply to those who rent three or fewer units through issuance of a license, as that would result in most hotels, guest ranches, campgrounds, rooming houses[1] being exempt from gross receipts tax, which would be contrary to the clear statutory intent the legislature clearly expressed in the plain language of Section 7-9-53. This view is supported by the language of the regulation itself, which states "…not regularly engaged in the business of *leasing* real property…" Regulation 3.2.116.10 NMAC (emphasis added). Thus, the regulation in question does not relieve someone actively engaged in the licensing of vacation home rentals, like Taxpayer in this instance, from gross receipts tax.

Interest.

When a taxpayer fails to make timely payment of taxes due to the state, "interest *shall* be paid to the state on that amount from the first day following the day on which the tax becomes due...until it is paid." NMSA 1978, § 7-1-67 (2007) (italics for emphasis). Under the statute, regardless of the reason for non-payment of the tax, the Department has no discretion in the

[1] Except perhaps for chain hotels, it would be rare for any person or entity to own more than three of any of these types of facilities, meaning that if Regulation 3.2.116.10 NMAC was applicable in the manner Taxpayer argues, notwithstanding the clearly contrary provisioin of the of the controlling Section 7-9-53, none of those entities would have to pay gross receipts tax.

imposition of interest, as the statutory use of the word "shall" makes the imposition of interest mandatory. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24. The language of Section 7-1-67 also makes it clear that interest begins to run from the original due date of the tax until the tax principal is paid in full. In this case, the Department has no discretion under Section 7-1-67 and must assess interest against Taxpayer from when the tax was originally due until Taxpayer paid the gross receipts tax principal in this matter.

Penalty.

When a taxpayer fails to pay taxes due to the State because of negligence or disregard of rules and regulations, but without intent to evade or defeat a tax, NMSA 1978 Section 7-1-69 (2007) requires that

> there *shall* be added to the amount assessed a penalty in an amount equal to the greater of: (1) two percent per month or any fraction of a month from the date the tax was due multiplied by the amount of tax due but not paid, not to exceed twenty percent of the tax due but not paid.

(*italics* added for emphasis).

The statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meets the legal definition of "negligence." *See Marbob Energy Corp* , ¶22 (use of the word "shall" in a statute indicates provision is mandatory absent clear indication to the contrary).

Regulation 3.1.11.10 NMAC defines negligence in three separate ways: (A) "failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;" (B) "inaction by taxpayer where action is required"; or (C) "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." In this case, Taxpayer was negligent under Regulation 3.1.11.10 (B) & (C) NMAC because Taxpayer failed to take action to report and pay gross receipts on the receipts attributable to the licenses sold.

In instances where a taxpayer might otherwise fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception: "[n]o penalty shall be assessed against a taxpayer if the failure to pay an amount of tax when due results from a mistake of law made in good faith and on reasonable grounds." Here, in light of the language of Regulation 3.2.116.10 NMAC, Taxpayer's failure to pay gross receipts tax on the licenses issued was a mistake of law made in good faith and on reasonable grounds. Therefore, civil negligence penalty shall be abated.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Department's assessment, and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing was timely set and held within 90-days of protest under NMSA 1978, Section 7-1B-8 (2015).

C. Taxpayer's short-term rental of vacation homes to vacationers on VRBO.com for limited, defined periods with check-in and check-out dates, specific restrictions on the number of guests, limitations on the use of the property, requirement that property be returned in the same condition, and absence of any information giving the renter exclusive dominion or restricting Taxpayer's access, constituted a license of real property subject to gross receipts tax under NMSA 1978, Section 7-9-53(1998) rather than a lease of real property.

D. Vacation homes rented to vacationers on VRBO.com on a short-term basis are similar facilities to hotels, motels, rooming houses, campgrounds, guest ranches, and trailer parks under NMSA 1978, Section 7-9-53 (1998).

E. Taxpayer's ongoing sale of licenses on two homes actively listed and advertised on VRBO.com were not isolated and occasional sales of licenses under the plain language of NMSA 1978, Section 7-9-28.

F. Because Regulation 3.2.116.10 NMAC applies only to the question of whether someone is actively engaged in the leasing of property and does not apply to the sales of a license to use property, that regulation does not apply to Taxpayer in this circumstance.

G. Taxpayer did not overcome the presumption of correctness on the assessed tax and interest under NMSA 1978, Section 7-1-17 (C) (2007), NMSA 1978, §7-1-3 (X) (2013), Regulation 3.1.6.13 NMAC, and *Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428.

H. Under NMSA 1978, Section 7-1-67 (2007)'s mandatory "shall" language, Taxpayer is liable for accrued interest under the assessment. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶22, 146 N.M. 24.

I. Under NMSA 1978, Section 7-1-69 (2007), Taxpayer is not liable for civil negligence penalty because in light of Regulation 3.2.116.10 NMAC, Taxpayer made a mistake of law in good faith and on reasonable grounds.

For the foregoing reasons, the Taxpayers' protest **IS PARTIALLY DENIED AND PARTIALLY GRANTED**. **IT IS ORDERED** that the Taxpayer is liable for the assessed tax of $8,704.46 and interest of $918.94. Interest continues to accrue until tax principal is satisfied. However, **IT IS ORDERED** that the Department abate $1,740.90 in penalty.

DATED: July 21, 2016.

Brian VanDenzen

Chief 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. *See* Rule 12-601 NMRA. If an appeal is not filed within 30 days, this Decision and Order will become final. 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 being preparing the record proper.