

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

**IN THE MATTER OF THE PROTEST OF
ERNESTO AND NANCY HURTADO
TO THE ASSESSMENT ISSUED UNDER
LETTER ID NO. L0058191408**

D&O No. 19-03

v.

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on December 20, 2018 before Hearing Officer Dee Dee Hoxie, Esq. 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. Ernesto Hurtado (Taxpayer) appeared for the hearing with his attorney, Mr. Tracy Sprouls. The Taxpayer's brother, Mr. Elias Hurtado, was also present for the hearing. The Taxpayer, his brother, and Ms. Bernardo testified.

The parties stipulated to all exhibits. Taxpayer's exhibits 1 through 3 were admitted. The Department's exhibits "A" through "D" were admitted. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet.

References to the audio recording of the hearing shall be cited by hour, minute, and seconds as AR 00:00:00¹. The Hearing Officer took notice of all documents in the administrative file.

¹ Due to the nature of making arguments and providing testimony, many facts or ideas are mentioned or repeated multiple times throughout the hearing. Generally, only one specific reference will be provided.

The main issue to be decided is whether the Taxpayer is liable for the assessment. The Taxpayer withdrew the protest as to the amount attributable to Nancy Hurtado's business. The parties did not know how much tax, penalty, and interest should be attributed to the portion of the assessment related to Nancy Hurtado's business, but they agree that the bulk of the assessment relates to the Taxpayer's ranching operation. The parties agree that the determination on the remainder of the assessment hinges on whether the Taxpayer's ranching operation should be considered as a for-profit business or not under 26 USCS § 183. As a preliminary issue, the Taxpayer also challenges the Department's authority to recalculate the Taxpayer's federal adjusted gross income by disallowing a federal deduction when it has been accepted by the federal government. The Hearing Officer considered all of the evidence and arguments presented by both parties. The Hearing Officer finds that the Department has the authority to recalculate a person's tax. The Hearing Officer finds that the Taxpayer's ranching operation is a for-profit business. IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On September 13, 2016, the Department assessed the Taxpayer for personal income tax, penalty, and interest for the tax periods from January 1, 2009 through December 31, 2015. The assessment was for \$20,063.00 tax, \$3,676.30 penalty, and \$2,057.78 interest.
2. On October 11, 2016, the Taxpayer filed a formal protest letter.
3. On November 30, 2016, the Department filed a Request for Hearing asking that the Taxpayers' protest be scheduled for a formal administrative hearing.
4. On December 1, 2016, the Hearings Office issued a notice of telephonic scheduling hearing.

5. The telephonic scheduling hearing was conducted on December 16, 2016. The hearing was held within ninety days of the protest.
6. After the Taxpayer requested a continuance of the formal hearing, a second telephonic scheduling hearing was conducted on July 28, 2017.
7. The Taxpayer has been engaged in ranching since he was a child. (AR 00:24:24-29)
8. The Taxpayer has a full-time job working with the BLM. (AR 00:17:22-28)
9. The Taxpayer also considers his ranching operation to be a full-time job and spends several hours every week dedicated to it. (AR 00:30:00-00:32:55)
10. The Taxpayer's ranching operation primarily involves breeding cows and selling their calves. (AR 00:17:45-47)
11. The Taxpayer did not have a formal business plan for the ranching operation during the audit, but he does have a written plan now. (AR 00:56:05-39)
12. The Taxpayer's ranching operation also raises crops to help feed his cows. (AR 00:18:26-41)
13. To keep his herd healthy and genetically diverse, the Taxpayer sometimes sells the mother cows or bulls and purchases new livestock with desirable traits. (AR 00:27:04-50)
14. The Taxpayer obtained a bachelor's degree in agricultural studies in 1981. (AR 00:19:56-59)
15. The Taxpayer inherited the ranching operation and became its sole operator when his father died in 2010. (AR 00:35:10-35)
16. The Taxpayer's family and neighbors are also involved in ranching, and they regularly work together and discuss operations. (AR 00:25:33-43)

17. The Taxpayer is a member of the Farm Bureau. (AR 00:25:09)
18. The Taxpayer consults with Farm Service agents and County Extension agents about his ranching operation. Topics that the Taxpayer has received help with include varieties of hay, fencing, and other ranch improvements. (AR 00:25:02-17)
19. To mitigate feed costs, the Taxpayer purchased 20 acres of irrigated land in 2012 that he uses to grow hay to feed his cattle. (Exhibit 1; AR 00:43:49-59)
20. To mitigate losses, the Taxpayer also carries insurance on his cattle. (AR 00:26:07-10)
21. The Taxpayer maintains a separate bank account for the ranching operation. (AR 01:28:52-58)
22. The Taxpayer keeps records of his ranching operation. (Exhibit 1; AR 00:23:43-51; AR 01:04:15-38)
23. The Taxpayer did not share most of the ranching records with the Department because the Department did not ask for them. (AR 00:24:00)
24. The Taxpayer offered to allow the Department's auditor to come to the ranch and review its operations in-person. (AR 00:21:27-31)
25. The Taxpayer has spent a considerable amount of money on land, livestock, and equipment to improve his ranching operation. (Exhibit 1; AR 00:35:00-00:36:42)
26. The Taxpayer has grazing leases with the federal government. (AR 00:50:18-30)
27. The Taxpayer has gross income from the ranching operation that varies every year, from approximately \$15,000 to more than \$100,000. (Exhibits 2, C, and D; AR 00:45:12-22)
28. The Taxpayer pays for the ranching operation's expenses through the gross income that the ranching operation makes every year. (AR 00:45:22-29)

29. The Taxpayer sometimes funds major purchases for the ranching operation through contracts that are essentially loans or installment agreements. (AR 00:58:05-45)
30. The Taxpayer considers the ranching operation to be successful because the sales of cattle allow him to make purchases, such as land and equipment, that lead to greater efficiency in the ranching operation. (AR 00:37:50-57)
31. The Taxpayer believes the ranching operation has increased in value due to the capital expenditures and improvements he has made. (AR 00:38:32-34)
32. The Taxpayer's ranching operation is generally considered to be successful by his family and neighbors. (AR 00:46:13-36)
33. The Taxpayer uses a software program to file his taxes, but he does not really understand how or why the program does what it does. (AR 00:47:09-00:48:10)
34. The bulk of the Taxpayer's reported losses on the ranching operation are due to the capital expenditures and depreciation that are allowed to be deducted. (AR 01:27:40-01:28:13)
35. The Taxpayer enjoys ranching. (AR 00:44:43-45)
36. The Taxpayer anticipates making a profit in the future when he does not have to keep buying new equipment and taking the capital expenditure deductions. (AR 00:44:53-00:45:15)

DISCUSSION

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 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 and authority to recalculate.

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)*. The Taxpayer argues that the Department has not been granted the authority by the Legislature to recalculate a Schedule F deduction. The Taxpayer argues that the *Holt* case is limited to instances of extremely obvious error. The holding in *Holt* is not so narrow. *See Holt v. N.M. Dep't. of Taxation and Revenue*, 2002-NMSC-034, 133 N.M. 11. The court ultimately concludes, without qualification, "that the Department has the authority to examine information or evidence in order to determine or establish an individual's tax liability." *See id.* at ¶ 25. Moreover, the court finds that the

reference to federal adjusted gross income in the statute “requires an analysis of federal law in order to effectuate the intent of our Legislature for purposes of state taxation. In other words, our statutes require, for purposes of determining state tax liability, the taxpayers’ *correct* federal adjusted gross income.” *See id.* at ¶ 23. Consequently, the Department has the authority to recalculate a Schedule F deduction. *See id.*

The parties agree that the assessment hinges upon whether the Taxpayer is allowed to deduct his losses from his ranching operation. 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 Taxpayer did not have a formal business plan at the time of the audit, but he has developed one now. The Taxpayer contracts with other property owners and the federal government for grazing rights. The Taxpayer buys land and equipment with formal loan or payment installment agreements. The Taxpayer maintains a separate bank account for the ranching operation. The Taxpayer pays for ranch improvements with the income brought in by the ranching operation. The Taxpayer contributes time and effort to support his family and neighbors' operations, and they likewise contribute to his ranching operation. The Taxpayer maintains records on his ranching operation. Therefore, this factor weighs in favor of 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 has a family history of ranching. The Taxpayer has a bachelor's degree related to agriculture. The Taxpayer is a member of the Farm Bureau and consults regularly with Farm Service agents and County Extension agents. The Taxpayer also

consults regularly with others who are engaged in similar ranching ventures. Therefore, this factor weighs in favor of finding that the activity was for-profit.

The Taxpayer spends a substantial amount of time and effort in his ranching operation. The Taxpayer considers the ranching operation to be a second full-time job. This factor weighs in favor of finding that the activity is for-profit.

The Taxpayer expects that his assets will appreciate in value. There is certainly a possibility that the cattle and land will appreciate in value, depending on several market variables. The Taxpayer believes that his ranching operation is more valuable now than when he inherited it based on his purchases of additional land and capital expenditures on equipment. This factor weighs in favor of finding that the activity is for-profit.

The Taxpayer did not demonstrate success in carrying on a similar or dissimilar activity. This factor weighs against finding that the activity is for-profit.

The Taxpayer makes income on the ranching operation, but the deductions taken for expenses have led to a net loss in recent years. The Taxpayer pays for the ranching operation with the income from the ranching operation as well as credit. This factor weighs in favor 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.* As previously noted, the Taxpayer has reported net losses in recent years, and there was no evidence that the sales of cattle ever resulted in profit, as opposed to just income. This factor weighs against finding that the activity is for-profit.

The Taxpayer is not reliant on the ranching operation for his livelihood. The Taxpayer has a full-time job and earns wages. However, the Taxpayer does not use his wages to finance

the ranching operation. The ranching operation is self-sustaining through its income and credit. This factor weighs neutrally.

The Department argues that the Taxpayer is primarily involved in ranching as a matter of “family tradition”, and that “family tradition” means that the ranching is not a for-profit activity. “Family tradition” is not one of the factors, but the argument seems most closely related to the factor of personal pleasure and recreation. The Taxpayer admitted that he enjoys ranch work, but he considers it to be very hard work. So, the Taxpayer clearly enjoys an element of personal pleasure through his ranching operation, but he does not treat it as recreation. Instead, he dedicates several hours every week to learning, to improving, and to working on the ranch. This factor weighs neutrally.

Five of the nine factors weigh in favor of finding that the Taxpayer is engaged in the ranching operation for-profit. Therefore, the Taxpayer has overcome the presumption that the assessment is correct. *See* NMSA 1978, § 7-1-17.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely written protest to assessment issued under Letter ID number L0058191408, and jurisdiction lies over the parties and the subject matter of this protest.

B. The Taxpayer’s ranching operation was engaged in as a for-profit activity. *See* 26 CFR 1.183-2. Therefore, the deductions are allowed. *See* 26 USCS §§ 162 and 183. *See also* NMSA 1978, §§ 7-2-2 and 7-2-3.

C. The Taxpayer overcame the presumption that the assessment was correct as to the ranching operation. *See* NMSA 1978, § 7-1-17.

D. The Taxpayer withdrew the protest as to the portion of the assessment related to Nancy Hurtado's business, so that portion of the assessment is still presumed to be correct and remains due. *See id.*

For the foregoing reasons, the Taxpayer's protest is **DENIED IN PART AND GRANTED IN PART**. The Department is HEREBY ORDERED TO ABATE the portion of the assessment related to the Taxpayer's ranching operation. The Taxpayer is HEREBY ORDERED TO PAY the remaining balance of the assessment related to the wife's business.

DATED: January 17, 2019.

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.

CERTIFICATE OF SERVICE

I hereby certify that I mailed the foregoing Order to the parties listed below this 17th day of January, 2019 in the following manner:

First Class Mail

Interoffice Mail

INTENTIONALLY BLANK

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