STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF **No. 17-31**
DAVID B. GRAHAM
TO ASSESSMENT
ISSUED UNDER LETTER
ID NO. L0879829296

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on June 8, 2017 before Hearing Officer Chris Romero in Santa Fe, New Mexico. 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 B. Graham (Taxpayer) appeared in person and represented himself. The Hearing Officer took notice of all documents in the administrative file. Department Exhibits A – B and Taxpayer Exhibit 1 were admitted. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On December 13, 2016 under Letter ID No. L0879829296, the Department assessed the Taxpayer for personal income tax, interest, and penalty for the periods from January 1, 2009 through December 31, 2015. The assessment was for $12,188.00 in tax, $2,254.08 in penalty, and $757.12 in interest.

2. On March 3, 2017, the Taxpayer executed a formal protest letter which was received by the Department's Protest Office on March 10, 2017.

3. On March 29, 2017, the Department acknowledged the receipt of the Taxpayer's protest.

4. On May 10, 2017, the Department filed a Hearing Request asking that the Taxpayer's protest be scheduled for a formal administrative hearing.

5. On May 11, 2017, the Administrative Hearings Office issued a Notice of Administrative Hearing setting a hearing on the merits of the protest to occur on June 6, 2017. The hearing date was set within ninety days of the protest.

6. On May 16, 2017, the Department requested a continuance of the hearing on the merits. The Taxpayer did not oppose the Department's request.

7. On May 17, 2017, the Administrative Hearings Office issued an Amended Notice of Administrative Hearing setting a hearing on the merits of the protest to occur on June 1, 2017. The hearing date was set within ninety days of the protest.

8. On May 31, 2017, the Taxpayer requested a continuance to a date after June 6, 2017. The Department did not oppose the Taxpayer's request.

9. On June 1, 2017, the Administrative Hearings Office issued a Second Amended Notice of Administrative Hearing setting a hearing on the merits of the protest to occur on June 8, 2017.

10. The hearing in this matter occurred on June 8, 2017 and was within 90 days of the Taxpayer's protest.

11. The Department's assessment of personal income taxes for 2009 and 2011 was in error because those years were not within the applicable statute of limitations. The assessments were not brought within the general three-year limit and did not come within the extended six-

year period for taxpayers understating their liability by 25 percent or more. *See* NMSA 1978, Sec. 7-1-18 (A) & (D). [Testimony of Ms. Bernardo].

12. The Department did not assess any taxes for tax year 2010. [Dept. Ex. A-001].

13. In 2011, Taxpayer acquired a mare[1] which successfully produced a foal[2] in 2012. This represented the beginning of Taxpayer's horseracing activities ultimately giving rise to the issues in protest. Taxpayer presently owns four mares, six foals, and one yearling[3]. [Testimony of Mr. Graham].

14. Although he has previously been involved with horseracing, including as an investor, it is only since 2012 that he has been engaged with his present activity. Taxpayer's experience as an investor generated modest returns, but Taxpayer enjoys the overall control he has as an owner. He is a licensed owner in the State of New Mexico. [Testimony of Mr. Graham].

15. Taxpayer was raised around horseracing. His parents trained horses and he frequently worked summers at horse racing tracks while in his youth. After high school, Taxpayer acquired a degree in business administration and served approximately 13 years in the military. After completing his military career, Taxpayer commenced employment in the auto sales and service industry. He is presently employed by an automobile dealership in Roswell where he earns a good income. [Testimony of Mr. Graham].

16. Taxpayer's average income from wages, salaries, and tips, from 2012 through 2015 as reported on IRS Form W-2 was $100,665.00. [Dept. Ex. A-012 – A-015].

[1] A female horse or other equine animal especially when fully mature or of breeding age.
[2] A young animal of the horse family under one year.
[3] An animal one year old or in the second year of its age or a racehorse between January 1 of the year after the year in which it was foaled and the next January 1.

17. From 2012 through 2015, Taxpayer has incurred a variety of expenses in pursuing his racing activities which have contributed to losses that he has reported on IRS Form Schedule F. Taxpayer claimed the losses as deductions against his income. Examples of expenses have included breeding fees, feed, trimming, shoeing, veterinary fees, breaking fees, training fees, and futurity and derby payments. [Testimony of Mr. Graham; Taxpayer Ex. 1].

18. Taxpayer testified and submitted a written plan explaining the purpose of his activities which are to breed, raise, break, train, and race horses. His written plan provides that the "[s]ole purpose of this business is to produce a stable of horses that can compete at a high level." Taxpayer's plan goes on to explain that "[t]he goal is to breed my mares to quality proven studs that have high win [percentages] with [their] offspring." Taxpayer's business plan was prepared in anticipation of the hearing. [Testimony of Mr. Graham; Taxpayer Ex. 1].

19. Taxpayer's primary objective is to generate income from winning purses and eventually support himself in retirement with his winnings. The value of a purse can vary. Taxpayer estimated that a standard purse ranges in value from $15,000 to $100,000. [Testimony of Mr. Graham; Taxpayer Ex. 1].

20. Although a possibility may exist to generate income from selling horses or providing stud services in the future, Taxpayer's present activity derives no income from selling services or goods. Horses that he has sold, or which he intends to sell at the present time, may be sold for little or no profit. His primary intention when selling a horse is not profit, but to assure that the horse is provided with a good home. [Testimony of Mr. Graham].

21. For tax year 2012, Taxpayer claimed a Schedule F loss in the amount of $46,393. The Department disallowed the loss and assessed $2,200.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A-012; A-005; A-001].

22. For tax year 2013, Taxpayer claimed a Schedule F loss in the amount of $19,707. The Department disallowed the loss and assessed $935.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A-013; A-006; A-001].

23. For tax year 2014, Taxpayer claimed a Schedule F loss in the amount of $83,264. The Department disallowed the loss and assessed $4,078.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A-014; A-007; A-001].

24. For tax year 2015, Taxpayer claimed a Schedule F loss in the amount of $92,565. The Department disallowed the loss and assessed $4,588.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A-015; A-008; A-001].

25. In addition to Taxpayer's income from wages, salaries, and tips, Taxpayer has also supplemented his income with distributions from Individual Retirement Accounts (IRAs). From 2012 through 2015, Taxpayer's average IRA distribution was $7,348.75. [Dept. Ex. A-012 – A-015].

26. Taxpayer obtained the distributions from his IRAs when his finances required. [Testimony of Mr. Graham].

27. Taxpayer's horseracing activity was not profitable in tax years 2012 through 2015. The combined losses reported on Taxpayer's Schedule Fs was $241,929.00. [Testimony of Mr. Graham; Dept. Ex. A-012 – A-015].

28. Although not subject of this protest, Taxpayer incurred a loss in 2016 of approximately $92,000. [Testimony of Mr. Graham].

29. Taxpayer does not have any formal education in horseracing or training. All of his experience has been acquired while engaging in the activity at the stables and track. [Testimony of Mr. Graham].

30. Despite the history of losses, Taxpayer is optimistic that his activities will be profitable in 2017. He expects favorable results from horses that he is preparing to race and he also intends to reduce the number of horses he owns which should decrease expenses. [Testimony of Mr. Graham].

31. Despite Taxpayer's optimism for 2017 and beyond, he recognizes that horseracing is inherently risky. He has had horses fail to meet expectations or suffer injuries or illnesses which permanently affected their performance, or even required euthanization. [Testimony of Mr. Graham].

32. Except for his receipts of expenses, Taxpayer does not maintain financial records for his horseracing activities. [Testimony of Mr. Graham].

33. Taxpayer devotes no less than three hours per day and 30 hours per week to attending to his horses. Tasks include feeding, watering, halter breaking, petting, activities to get the horses to move, activities to keep them tame, and attending to their overall wellbeing. [Testimony of Mr. Graham].

34. Taxpayer occasionally seeks breeding advice from breeders, trainers, and jockeys. However, Taxpayer has not sought advice or consultation on how to reduce his losses in his racing activities or otherwise operate at a profit. [Testimony of Mr. Graham].

35. Taxpayer will continue to engage in horseracing, even at a loss, unless or until he can no longer finance the activity through other sources of income, including employment income or retirement savings. [Testimony of Mr. Graham].

36. Taxpayer prepares his own taxes. He has never directly consulted a tax professional regarding the issues subject of the protest, although he did confer with his brother who is also engaged in a similar activity. His brother, in turn, consulted with his accountant.

However, Taxpayer cannot recall the specifics of any conversations regarding the subject matter of his protest. [Testimony of Mr. Graham].

37. As of the date of the hearing, Taxpayer's liability for tax years 2012 – 2015 was $11,801 in personal income tax, $2,360.20 in penalty, and $909.28 in interest, for a total of $15,070.48. [Testimony of Ms. Bernardo; Dept. Ex. B].

DISCUSSION

The issue to be decided is whether the Taxpayer is liable for the assessment. The determination depends on whether the Taxpayer's horseracing activities should be considered a for-profit business or not under 26 USC Sec. 183. The Taxpayer acknowledges that his racing activities have not been profitable although he is confident that 2017 will produce favorable racing results which will be followed by profits. In the absence of a for-profit motivation, the Department argued the Taxpayer is precluded from offsetting his racing expenses from other sources of income.

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 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 the Taxpayer to prove that he is 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 reexamine 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 depends on whether the Taxpayer is allowed to deduct his losses from his horseracing 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.

The list of factors is not exclusive, and other factors may be considered in determining whether an activity is engaged in for profit. No single factor is dispositive. *See Golanty v. Commissioner*, 72 T.C. 411, 426 (1979), *affd. without published opinion* 647 F.2d 170 (9th.Cir. 1981). The determination of profit does not depend on counting the number of favorable or unfavorable factors. *See Dunn v. Commissioner*, 70 T.C. 715, 720 (1978), *affd. on other grounds* 615 F.2d 578 (2nd.Cir.1980).

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. Although the Taxpayer prepared a written business plan, he readily acknowledged that it was prepared in anticipation of the hearing. There was no evidence that the Taxpayer had a formal written business plan for his racing activities until the days leading up to the hearing. The plan was consistent with Taxpayer's testimony. It articulated Taxpayer's intentions to generate income from achieving favorable results in horseracing, specifically winning purses ranging from $15,000 to $100,000. The plan does not include the intent to derive income from other potential sources of revenue, such as sales of services or goods relating to horseracing.

With a degree in business administration, the Taxpayer is educated in the operation of businesses. However, Taxpayer admitted that he does not maintain records with the same formality observed in for-profit business activities. He acknowledged that he keeps receipts of expenses, but otherwise maintains his financial records only in his mind. When pressed on

whether or not individual horses have ever shown profit despite the losses of the overall activity, Taxpayer's responses were speculative and unreliable.

Courts have recognized the benefits of complete and accurate books of an activity for the purposes of cutting expenses, increasing profits, and assessing the overall performance of the operation. *See Meaney v. Commissioner of Internal Revenue*, T.C. Memo 1994-91, 1994 Tax Ct. Memo Lexis 92, 67 T.C.M (CCH) 2299. The court in *Meaney* suggested the types of records that could be useful in assessing the profit motivation of a horse breeding and racing operation. Specifically, the court suggested that "contemporaneous records" of the dates on which foals were born or sold, or of the purses won by each racehorse could have been useful to its determination. Otherwise, there was no adequate recordkeeping system which could be utilized to assess the financial status of the activity. Similar to *Meaney*, Taxpayer maintained no contemporaneous records detailing the financial aspects of his racing activities. Therefore, there was no accurate way of evaluating methods of reducing expenses and increasing profit. This is inconsistent with a profit motivated activity operated in a business-like manner. Rather, the lack of records is akin with an activity that is motivated by pleasure over profit.

There was also no evidence to establish that the Taxpayer maintained separate financial accounts for his personal funds and his racing activities. There was also no evidence that the Taxpayer held his activity out to the public as a business providing goods or services. However, Taxpayer acknowledged that his activity did not have customers, but relied instead on favorable racing results to generate income from purses.

This factor weighs against finding that the activity was 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. Taxpayer's exposure to horseracing started in childhood. He worked summers at horse tracks where he cleaned stalls and performed a variety of tasks. Taxpayer matured, earned a college degree in business administration, served more than a decade in the military, and gained employment in the auto sales and service industry. In 2012, after some modest success investing in racehorses, Taxpayer assumed the role of an owner. Since becoming an owner, the Taxpayer has had discussions with other owners, breeders and jockeys regarding the sport, but there was little evidence to suggest that the discussions Taxpayer described might be considered formal expert consultations or educational activities aimed at making his horseracing activities profitable. Taxpayer has also engaged the services of veterinarians, trainers, and farriers[4].

In *Meaney*, the court recognized that the taxpayer "went to great lengths to gain knowledge of and develop expertise in that endeavor." It recognized that the taxpayer sought and followed the advice of experienced horse breeders and trainers, and immersed himself in books and articles on topics such as horse breeding. He sought advice from breeding experts, nutrition experts, and read publications on various topics in order to develop expertise in the areas of breeding and racing. In the present case, Taxpayer had conversations with breeders, trainers, jockeys, and family members to gain knowledge and insight in areas that might promote his goals of developing faster racehorses. However, the Hearing Officer was not convinced that the conversations Taxpayer described arose to the level of what might be considered expert consultations similar to what *Meaney* found persuasive. Nevertheless, the Hearing Officer is not inclined to disregard the efforts that Taxpayer described to gain knowledge in the area of his activity. Weight should be given to his experience, conversations with others in the area of

[4] A person who shoes horses.

horseracing, and the services he has relied on in pursuing his activity including veterinarians, trainers, and farriers.

However, the Hearing Officer was not convinced that this factor should weigh in favor of either profit or pleasure because Taxpayer's efforts in this regard were also consistent with one engaging in an activity for pleasure over profit. Consequently, this factor shall be considered neutral.

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 Taxpayer spends significant time personally attending to the welfare of his horses. Activities include feeding and watering them, encouraging movement, and petting them to keep them domesticated. Taxpayer estimated spending no less than three hours per day and 30 hours per week with his horses.

In addition, Taxpayer has engaged the services of others when he is unable to perform the services himself. For example, Taxpayer does not have experience trimming or shoeing, he is not a veterinarian, and he is not physically capable of assuming the dangerous activity of breaking a horse.

These activities, while representing a significant investment of time, may be consistent with a profit motivated activity. However, they are also consistent with one's dedication to their pleasure-motivated hobby. The Hearing Officer was not persuaded that the factor favors or disfavors a finding that the activity is for profit.

4) The expectation that assets may appreciate in value.

Taxpayer's primary assets are his horses. Taxpayer's expectation that his horses might appreciate in value depends on how they perform at the track. Not only do favorable results

generate income from purses, but they may also increase the value of a horse for breeding or sale. Considering the foregoing, the Hearing Officer finds that the expectation of even a slight possibility of increasing assets weighs in favor of finding that the activity is for-profit.

Although he owns equipment that he uses in the activity, Taxpayer downplayed its value and did not express any expectation that it would appreciate in value.

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

With respect to the success of the Taxpayer in carrying on other similar or dissimilar business activities, this factor weighs against finding that the activity is for-profit, because although Taxpayer has experience in racing, there is a lack of evidence to establish that the activity has ever been successful from a profit perspective. Taxpayer did have marginal success as an investor. Prior to owning his own horses, he invested $10,000 or $11,000 and obtained a modest return of his original investment plus approximately $2,000 to $3,000. Otherwise, there is no evidence to establish that Taxpayer has any experience in operating a profitable business activity.

This factor weighs against finding that the activity was for-profit.

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

The Taxpayer has a brief, but significant history of losses with respect to his racing activities. Although a winning streak at the track could potentially eliminate that history of losses, such a streak has yet to materialize. Rather, Taxpayer continues to endure significant losses which he funds through his employment and through cashing in his retirement savings. Through the present date, Taxpayer has incurred losses approaching $334,000 without any substantial steps to reduce expenses or utilize existing assets to generate additional income that might offset losses.

The Hearing Officer was not persuaded that a profit-motived activity would rely so much on chance. In other words, the Taxpayer has not made any efforts to reduce expenses or offset losses by generating income from associated activities, such as horse sales. Efforts to reverse losses have instead focused on achieving better results in the next race. This strategy has yet to produce a profit.

This factor weighs against finding that the activity was for-profit.

7) The amount of profits earned.

Despite Taxpayer's optimism that 2017 will be the year he will begin to make a profit, there is little evidence to suggest that this is supported by more than positive thinking. Through the date of this hearing, Taxpayer estimates nearly $334,000 in losses. However, the period in protest also overlaps with what Taxpayer has identified as his start-up phase in which it is common for new business to incur losses. The Hearing Officer recognizes that a series of losses during the initial state of an activity does not necessarily indicate that the activity is not motivated by profit. There may also be unforeseen or fortuitous circumstances that are beyond the control of the Taxpayer. Taxpayer has had high hopes for some of his horses, but for various reasons beyond his control, the results were less favorable than what he anticipated.

Based on the foregoing, the Hearing Officer finds this factor to be neutral because the Taxpayer has not had a sufficient opportunity to establish a history of profits despite the significant losses.

8) The financial status of the person.

Taxpayer during the relevant period of time was not reliant on his racing success for his livelihood. Taxpayer relied on his income from employment and his retirement savings. Taxpayer acknowledged that he makes a good income from his employment. He also indicated

that when his finances required, he withdrew funds from retirement savings accounts. The amount of retirement savings withdrawn was approximately $29,000. This is significant because it demonstrated that withdrawing retirement savings, which is presumably set aside and intended for retirement, was preferred over reducing expenses or liquidating assets of the activity.

This factor weighs against finding that the activity is for-profit.

9) The elements of personal pleasure and recreation.

Taxpayer spoke enthusiastically about horseracing and his passion for the sport was undeniable. He acknowledged enjoyment and exhibited pride in his involvement. Although it is not uncommon for one to enjoy their work, whether motivated by profit or not, the evidence established that Taxpayer's love of the sport takes priority over profit.

This was evident as Taxpayer admitted that he would continue engaging in horseracing, even at a loss, so long as his income and retirement savings would permit. Only when he could no longer fund his horseracing activity would he consider stopping. This perspective exemplified that pleasure, not profit, inspired Taxpayer's activity. Consequently, the Hearing Officer was persuaded that Taxpayer's passion for the sport, over the profit, must weigh heavily against finding that the activity is profit motivated.

Summary of Factors

The majority of factors weigh against finding that the Taxpayer is engaged in horseracing for-profit, but the Hearing Officer finds the final factor especially compelling. Taxpayer indicated that he would continue with his horseracing activities, even at a loss, so long as he could continue to support the activity with income from his employment, and presumably, retirement savings. This perspective fails to demonstrate a good-faith profit motive. In contrast, it demonstrates passion for a hobby that one will enjoy without regard for the costs incurred. This

at-all-cost approach is inconsistent with a profit-motivated activity. It represents a motive which is not influenced by money at all, but rather the love of the activity itself. Taxpayer's passion for horseracing is admirable, and his optimism is palpable, but the Hearing Officer was not persuaded that he overcame the presumption of correctness and established a claim to a deduction of his asserted losses.

Interest and Penalty

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, Section 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 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, 32 (use of the word "shall" in a statute indicates the provision is mandatory absent clear indication to the contrary). The language of the statute also makes it clear that interest begins to run from the original due date of the tax and continues until the tax principal is paid in full. The Department has no discretion under Section 7-1-67 and must assess interest against Taxpayers from the time the tax was due but not paid until the tax principal liability is satisfied. Therefore, the assessment of interest is mandatory and the Department is without legal authority to abate it.

With concern for 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).

As discussed above, the statute's use of the word "shall" makes the imposition of penalty mandatory in all instances where a taxpayer's actions or inactions meet the legal definition of "negligence" even if Taxpayer's actions or inactions were unintentional.

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 (A), (B) & (C) NMAC because of Taxpayer's inaction in failing to pay taxes when due resulting from an erroneous belief that losses from pleasure-motivated activities were properly deductible.

In instances where a taxpayer might 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." Further, Regulation 3.1.11.11 NMAC establishes several examples of non-negligence in which penalty may be abated. Taxpayer did not present any facts that would tend to establish a good-faith mistake of law or non-negligence entitling him to an abatement of penalty.

To the extent Taxpayer may have consulted with an accountant, he admitted that he had no recollection of any advice he received regarding any issue subject of this protest. It logically follows that any reliance placed on that advice, which Taxpayer cannot recall, shall not form the basis for an abatement of penalty based on a mistake of law made in good faith and on reasonable ground or non-negligence.

The Department did not allege that the Taxpayer's claims were made with the intent to evade or defeat a tax. Nevertheless, *El Centro Villa Nursing* established that the civil negligence penalty is appropriate even for inadvertent error and Regulation 3.1.11.11 NMAC does not provide grounds for abatement of the penalty in this case. Therefore, Taxpayer did not overcome the presumption of correctness and failed to establish that he is entitled to an abatement of penalty in this matter.

Therefore, the Department's disallowance of the deduction for tax years 2012 – 2015 was reasonable and the Taxpayer did not overcome the presumption of correctness for those years. *See* NMSA 1978, Sec. 7-1-17. The Hearing Officer therefore finds that Taxpayer's protest as to tax years 2012 – 2015 should be denied because the Taxpayer has not established that his horseracing activities were motivated by profit and because there is no basis upon which to abate penalty or interest. Because the Department conceded that it lacked authority under the applicable statute of limitations to assess taxes prior to 2012, the Taxpayer's protest with regard for tax years 2009 – 2011 should be granted.

CONCLUSIONS OF LAW

A. The Taxpayer filed a timely written protest to the assessment issued under Letter ID No. L0879829296, 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 Department is barred by the statute of limitations from assessing personal income taxes for years 2009 – 2011. *See* NMSA 1978, Sec. 7-1-18 (A).

D. The Taxpayer did not overcome the presumption of correctness for tax years 2012 – 2015. *See* NMSA 1978, Sec. 7-1-17.

E. The Taxpayer's horseracing activities in 2012 – 2015 were not engaged in as a for-profit activity. *See* 26 CFR 1.183-2. The Department properly disallowed the deductions in those years. *See* 26 USCS Sections 162 and 183. *See also* NMSA 1978, Sections 7-2-2 and 7-2-3.

F. Under NMSA 1978, Section 7-1-67 (2007), Taxpayer is liable for accrued interest under the assessment for tax years 2012 – 2015. Interest continues to accrue until the tax principal is satisfied.

G. Under NMSA 1978, Section 7-1-69 (2007), Taxpayer is liable for civil negligence penalty for tax years 2012 – 2015.

For the foregoing reasons, the Taxpayer's protest is **GRANTED IN PART AND DENIED IN PART**. The Department is **ORDERED** to abate personal income tax principal, penalty, and interest for tax years 2009 – 2011. **IT IS FURTHER ORDERED** that Taxpayer be liable for personal income tax principal, penalty, and interest for tax years 2012 – 2015. As of the date of the hearing in this protest, Taxpayer's liability for tax years 2012 – 2015 was $11,801 in personal income tax, $2,360.20 in penalty, and $909.28 in interest, for a total of $15,070.48.

DATED: June 29, 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.