STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
GEMINI LAS COLINAS LLC
TO ASSESSMENT ISSUED UNDER
LETTER ID NO. L0294038832

v. **D&O 19-30**

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER

On August 19, 2019, Hearing Officer Chris Romero, Esq., conducted a hearing on the merits of the protest of Gemini Las Colinas, L.L.C. ("Taxpayer") pursuant to the Tax Administration Act and the Administrative Hearings Office Act. Mr. Benjamin C. Roybal, Esq. (Betzer, Roybal & Eisenberg P.C.) appeared on behalf of Taxpayer, accompanied by witnesses, Mr. Matthew Clifton and Ms. Pia McBride. Mr. Bennet Johnson also appeared and testified for Taxpayer.

Mr. David Mittle, Esq. appeared on behalf of the opposing party in the protest, the Taxation and Revenue Department ("Department"), accompanied by Ms. Lizette Rivera, protest auditor who also appeared as a witness for the Department.

Taxpayer Exhibits 1 – 13 and Department Exhibits C – I were admitted into the evidentiary record by stipulation and without objection. The Department also referred to Department Exhibit A during the examination of a witness. Because the Department did not have a copy of the exhibit, counsel indicated it would be copied and submitted prior to conclusion of the hearing. However, the item identified as Department Exhibit A in the hearing was never submitted nor received into the evidentiary record.

The issue in the protest is whether Taxpayer is entitled to an abatement of assessed gross receipts tax, and associated penalty and interest by application of the deduction provided by NMSA 1978, Section 7-9-53 (1998) which affords a deduction from gross receipts for those amounts derived from the lease of real property. As expounded in greater detail below, the Hearing Officer determined that although there may be competing methods for calculating the amount of a rental deduction under the facts of the protest, Taxpayer did not prove by a preponderance of evidence that the method actually employed by the Department resulted in an incorrect assessment, or that the alternative methods proposed at the hearing were more reliable or trustworthy under the facts of this protest. Therefore, Taxpayer did not overcome the presumption of correctness that attached to the assessment and Taxpayer's protest should be denied. IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. Mr. Matthew Clifton is senior vice president and chief financial officer at Senior Star Management Company ("Senior Star"), which is an entity engaged in the business of operating independent living, assisted living, memory care, and nursing care communities across the United States. [Direct Examination of Mr. Clifton]

2. In the present protest, Senior Star manages Taxpayer, which is a single-member limited liability company organized in 2003. [Direct Examination of Mr. Clifton]

3. The single member of the limited liability company is an entity called Senior Star Investments 1, L.L.C., which is a joint venture between Welltower, Inc. which possesses a 90-percent interest, and Gemini Powers, LLC which possesses a 10-percent interest. Welltower, Inc. is a real estate investment trust, or REIT. [Direct Examination of Mr. Clifton; Taxpayer Ex. 9]

4. Taxpayer owns and operates an independent living community in Albuquerque, New Mexico, known as Las Colinas Village, situated at 500 Paisano Street NE, Albuquerque, NM 87123. [Direct Examination of Mr. Clifton]

5. Las Colinas Village offers various-sized apartments including studio, one-bedroom, and two-bedroom apartments, in addition to other various amenities. [Direct Examination of Mr. Clifton]

6. All apartments contain a "fully-functional kitchen and a standard bedroom bath." The community also provides common space dedicated to exercise, activities and dining. [Direct Examination of Mr. Clifton]

7. Las Colinas Village is an "age-restricted community." All residents are required to be 55 years of age or older, but its average age per resident is 83 years. [Direct Examination of Mr. Clifton]

8. Although Las Colinas Village retains various characteristics commonly associated with standard apartment complexes, it provides additional services and amenities devised to enhance the quality of life of its elder residents. [Direct Examination of Mr. Clifton]

9. Therefore, tenants of Las Colinas Village receive additional benefits in comparison to the tenants of standard apartment communities, including the advantages of designated space for activities, exercise or dining, and a variety of services including access to specialized staff devoted to serving the unique needs of its residents. [Direct Examination of Mr. Clifton]

10. The additional benefits permit Taxpayer to charge rents exceeding those amounts that might be common for standard apartment communities that do not provide the same types of additional benefits. [Direct Examination of Mr. Clifton]

11. Las Colinas Village leases apartments pursuant to a "Residency Occupancy Agreement" on a month-to-month term. Las Colinas Village does not utilize customary lease agreements because its agreements need to encompass more than rent, such as access to various services. [Direct Examination of Mr. Clifton; Taxpayer Ex. 11]

12. The amount of "[r]ent includes all of the services/amenities" incorporated by reference into the agreement by an attached exhibit. Additional services compensated by fees not included in the rent are also available, as similarly incorporated by reference into the agreement by a second attached exhibit. [Taxpayer Ex. 11.3]

13. Services specifically and explicitly included in the monthly rent are: 1) expanded cable; 2) dining from 7 a.m. to 6 p.m.; 3) planned community activities; 4) safety checks; 5) transportation for shopping, medical, and community activities; 6) linen services; 7) housekeeping; and 8) 24/7 front desk service. [Taxpayer Ex. 11.14]

14. Bundling specified resident services with rent is a common practice within the industry. [Direct Examination of Mr. Clifton]

15. The Department conducted an audit for the periods January 31, 2011 through September 30, 2016 in which it examined the portion of Taxpayer's receipts that were generated from resident services. The Department determined that Taxpayer was overstating its deduction for the rent of real property, resulting in a liability for unpaid gross receipts taxes. [Direct Examination of Mr. Clifton]

16. The Department issued a Notice of Assessment of Taxes and Demand for Payment under Letter ID No. L0294038832 for the sum of $724,047.43 comprised of gross receipts tax of $551,325.84, penalty of $110,265.21, and interest of $62,456.38 for the periods

January 31, 2011 through September 30, 2016. [Direct Examination of Mr. Clifton; Taxpayer Ex. 10; Administrative File]

17. Taxpayer conceded that some tax was owed, and it paid the undisputed amount prior to filing its protest. Taxpayer did not concede to the imposition of penalty because it acted "under advisement" of its "tax accountant." [Direct Examination of Mr. Clifton]

18. In computing Taxpayer's alleged tax liability, the Department significantly relied on IRS Forms 8825, reporting the income of Welltower, Inc. and Senior Star Investments 1, L.L.C., in all years reviewed during the audit, in concluding that additional tax was due and owing. The IRS Forms 8825 accompanied all IRS Forms 1065 in the same years. [Direct Examination of Mr. Clifton; Department Ex. C; Direct Examination of Ms. Rivera]

19. Taxpayer provided the IRS Forms 8825 to the Department during the audit. [Direct Examination of Mr. Clifton; Direct Examination of Ms. Rivera; Department Ex. C].

20. Taxpayer observed that the Department identified the amount of resident-service income by calculating the difference between gross rents as reported on each IRS Form 8825 and total gross receipts. [Direct Examination of Mr. Clifton]

21. Relying on IRS Forms 8825 to establish the sum of Taxpayer's receipts from the rent of real property may result in an underreporting of such income because REITs, although permitted to invest in independent living, must report an approximate triple-net income when investing in the entities that operate them. For that reason, IRS Forms 8825 may not report the actual income derived from rent. [Direct Examination of Mr. Clifton]

22. Triple net income under the present circumstances resembles the income that might be derived from a typical commercial lease in which the tenant assumes liability for

insurance, taxes, and maintenance, which results in a tenant base income that is lower than a full-service rental income. [Direct Examination of Mr. Clifton]

23. Accordingly, the IRS Forms 8825 reflect certain adjustments that tend to distort Taxpayer's receipts from rent due to the reporting requirements placed on REITs in this case, because it owns an interest in Taxpayer, the entity that operates Las Colinas Village. [Direct Examination of Mr. Clifton]

24. IRS Forms 8825 are used by partnerships and S corporations to report income and deductible expenses from rental real estate activities, including net income or losses from rental real estate activities that flow through from partnerships, estates, or trusts. [Direct Examination of Mr. Clifton; Administrative Notice of General Instructions for Form 8825, https://www.irs.gov/pub/irs-pdf/f8825.pdf]

25. IRS Forms 8825 relevant to Taxpayer's receipts reported income and deductible expenses of Senior Star Investments 1, L.L.C. from rental real estate flowing from Welltower, Inc. [Direct Examination of Mr. Clifton]

Cost Accounting

26. An alternate system of separating receipts from rent and resident services might stem from utilizing a cost-accounting method. Taxpayer developed a method consisting of the following steps:

a. Identify sources of revenue and generally sort them between ancillary income and resident income. Ancillary income is income that is readily identifiable from a direct source. Resident income is the all-inclusive amount due from residents as provided in a Resident Services Agreement.

b. Determine which portions of resident income are generated from renting real property or from providing services using a cost-accounting analysis. The process begins by categorizing all expenses into one of the following classifications: 1) services unique to assisted living communities; 2) rent expenses including expenses common among most non-service providing apartment complexes; or 3) shared services consisting of services that might fit into both categories.

c. Apply a profit margin to expenses, the sum of which represents gross receipts from those services, plus a profit.

d. The amount of allocated service is then combined with ancillary income to determine total gross receipts.

e. Taxpayer concludes by computing the amount of the rental deduction by calculating the difference between its total gross receipts from all sources and the sum of allocated services and ancillary services.

[Direct Examination of Mr. Clifton; Taxpayer Ex. 1]

27. For each year subject of the audit, but after the assessment, Taxpayer initiated its analysis by identifying and categorizing its payroll expenses and identifying the percentage of total payroll expenses that should be attributed to services unique to assisted living communities. The primary categories of services are dietary, transportation, and activities. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

28. Taxpayer also evaluated its shared payroll, meaning those expenses that could be attributed to either rent expenses or service expenses and divided those expenses between its service and rent expenses. Shared expenses primarily include housekeeping payroll as well as supplies, equipment, and uniforms. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

29. Payroll expenses attributed to rent included those portions of the shared expenses that were not attributed to services, as well as payroll expenses related to management, repair and maintenance, and leasing. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

30. The percentage of payroll and benefits expenses Taxpayer attributed to services in the relevant periods of time were:

a. 45 percent in 2011;
b. 45.9 percent in 2012;
c. 45.2 percent in 2013;
d. 48.8 percent in 2014;
e. 49.6 percent in 2015; and
f. 49.6 percent in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.1; 3.1; 4.1; 5.1; 6.1; and 7.1]

31. The identified percentage of shared payroll and benefits expenses are then allocated to the service category while the remainder are allocated to the rent category. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

32. Taxpayer next identified and categorized its non-payroll expenses into the same categories of shared expenses, service expenses, and rent expenses. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

33. Expenses categorized as shared expenses were divided into rental expenses and service expenses utilizing the same percentage identified for the allocation of payroll and benefits for the applicable period. Consequently, the following percentages of shared expenses were allocated to services in the relevant periods of time:

a. 45 percent in 2011;
b. 45.9 percent in 2012;
c. 45.2 percent in 2013;
d. 48.8 percent in 2014;
e. 49.6 percent in 2015; and
f. 49.6 percent in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.4; 3.4; 4.4; 5.4; 6.4; and 7.4]

34. The identified percentage of non-payroll expenses are then allocated to the service category while the remainder are allocated to the rent category. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

35. Payroll and benefits expenses are then merged with other expenses to determine the sum of all expenses, per category. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7]

36. Taxpayer's analysis concluded that its total expenses, which should be allocated to services in the relevant periods of time were:

a. $776,455 in 2011;
b. $803,907 in 2012;
c. $840,984 in 2013;
d. $880,804 in 2014;
e. $970,918 in 2015; and
f. $716,555 in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.5; 3.5; 4.5; 5.5; 6.5; and 7.5]

37. Taxpayer then evaluated its income from ancillary sources and resident sources, and similarly allocated it between rental income and service income. Income that Taxpayer allocated to services in the relevant periods of time were:

a. $20,371 in 2011;
b. $20,577 in 2012;
c. $25,232 in 2013;
d. $31,430 in 2014;
e. $27,084 in 2015; and
f. $21,450 in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.5; 3.5; 4.5; 5.5; 6.5; and 7.5]

38. The amounts designated as service income were then added to the amounts calculated for the costs of services, to which Taxpayer then added a profit margin. The sum of total receipts attributed to service, the allocation of services, and the added margins represent

Taxpayer's determination of the taxable gross receipts. The amounts claimed in the relevant periods of time were:

a. $828,894 in 2011;
b. $857,685 in 2012;
c. $900,948 in 2013;
d. $948,611 in 2014;
e. $1,038,101 in 2015; and
f. $767,599 in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.5; 3.5; 4.5; 5.5; 6.5; and 7.5]

39. Taxpayer then calculated its total gross income for the relevant periods of time in the following amounts:

a. $3,094,026.63 in 2011;
b. $3,120,883.48 in 2012;
c. $3,343,150.57 in 2013;
d. $3,497,877.11 in 2014;
e. $3,773,318.68 in 2015; and
f. $1,921,962.65 in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.6; 3.6; 4.6; 5.6; 6.6; and 7.6]

40. Taxpayer then calculated the difference between its total gross income and the taxable gross receipts to arrive at the claimed rental income deduction. The claimed rental deduction for each relevant period was:

a. $2,265,133.07 in 2011;
b. $2,263,198.04 in 2012;
c. $2,442,202.84 in 2013;
d. $2,549,266.46 in 2014;
e. $2,735,218.09 in 2015; and
f. $1,921,962.65 in 2016.

[Direct Examination of Mr. Clifton; Taxpayer Exs. 2.6; 3.6; 4.6; 5.6; 6.6; and 7.6]

41. Taxpayer Exhibits 2 – 7 were prepared subsequent to the assessment giving rise to the protest with the knowledge that rental income was deductible from gross receipts. [Cross Examination of Mr. Clifton]

42. The analysis contained in Taxpayer Exhibits 1 – 7 was not provided to the Department at the time of the audit, nor were its source documents. [Direct Examination of Ms. Rivera]

Third-Party Market Analysis

43. Taxpayer also retained the services of a third-party, CBRE, to perform a market study that could complement or corroborate the accuracy of its cost-accounting method by obtaining an independent analysis of the comparable properties in the local market to establish fair market values. [Direct Examination of Mr. Clifton; Taxpayer Ex. 13]

44. Mr. Bennett Johnson is a licensed commercial appraiser formerly employed by CBRE where he served as vice-president and co-practice leader of its national senior housing and care group where his group provided appraisal services in addition to other services relating to senior living. As of the date of the hearing, he was transitioning to a new employer. [Direct Examination of Mr. Johnson]

45. Mr. Johnson graduated from Northeastern University in 2006 with a degree in business. Mr. Johnson is licensed as an appraiser in several states and is a member of various organizations relevant to the field of commercial appraisal and senior living. [Direct Examination of Mr. Johnson]

46. Mr. Johnson is not licensed as an appraiser in New Mexico. [Cross Examination of Mr. Johnson]

47. Mr. Johnson performed a market analysis on Taxpayer's behalf in which he evaluated the rental value of the residential units at Las Colinas Village. [Direct Examination of Mr. Johnson; Taxpayer Ex. 13]

48. Mr. Johnson was the lead appraiser on the analysis and primary author of the Rent Analysis Summary at Taxpayer Exhibit 13, which represents a "high-level summary" of CBRE's analysis and conclusions. [Direct Examination of Mr. Johnson]

49. A market analysis evaluates comparable properties in order to identify a comparable value for the property being appraised. [Direct Examination of Mr. Johnson]

50. CBRE was engaged to provide services in May of 2019 and continued through July of 2019. [Direct Examination of Mr. Johnson]

51. A market analysis is generally initiated by locating comparable properties, meaning similar properties, in reasonable proximity as the property being appraised. An appraiser might also refer to industry resources and data. [Direct Examination of Mr. Johnson]

52. Neither Mr. Johnson nor anyone else from CBRE visited Las Colinas Village as part of performing the market analysis. [Cross Examination of Mr. Johnson]

53. The rental analysis summary, under the heading for "Assumption and Limiting Conditions" represents that "CBRE, Inc. through its appraiser (collectively, 'CBRE') has inspected through reasonable observation the subject property." [Taxpayer Ex. 13.12]

54. Mr. Johnson notes that Las Colinas Village is situated in an "inferior market location" in comparison to other properties he reviewed as part of his analysis. [Cross Examination of Mr. Johnson]

55. The CBRE market analysis confirmed that there is a premium for fair rental value for assisted living communities. [Direct Examination of Mr. Johnson]

56. The rent analysis summary contains minor errors including reference to an incorrect quantity of rental units and reference to properties more than 20 miles away, but those

errors have minimal or no effect on the conclusions of the analysis. [Direct Examination of Mr. Johnson]

57. Taxpayer retained the services of CBRE in 2019 partly in anticipation of the hearing of the protest. The summary is dated August 5, 2019. [Cross Examination of Mr. Clifton; Taxpayer Ex. 13.1]

Illustrative Comparison
Cost Accounting v. Third-Party Market Analysis

58. Taxpayer prepared an illustrative comparison to assess the results of its own cost-accounting method with the third-party market analysis. [Direct Examination of Mr. Clifton; Taxpayer Exs. 1 – 7; Exs. 12 – 13]

59. The illustrative comparison indicated that the cost-allocation method produced a larger amount of rental income, therefore producing a larger rental deduction. [Taxpayer Ex. 12]

60. The illustrative comparison suggested that in 2011, the cost-accounting method produced a rental deduction of $2,265,133 in comparison to the third-party market analysis that suggested an equivalent rental deduction of $1,771,601, a difference of 27.9 percent, or $493,532.00. [Taxpayer Ex. 12]

61. The illustrative comparison suggested that in 2012, the cost-accounting method produced a rental deduction of $2,263,198 in comparison to the third-party market analysis that suggested an equivalent rental deduction of $2,205,041, a difference of 2.6 percent, or $58,157.00. [Taxpayer Ex. 12]

62. The illustrative comparison suggested that in 2013, the cost-accounting method produced a rental deduction of $2,442,203 in comparison to the third-party market analysis that suggested an equivalent rental deduction of $2,306,868, a difference of 5.9 percent, or $135,335.00. [Taxpayer Ex. 12]

63. The illustrative comparison suggested that in 2014, the cost-accounting method produced a rental deduction of $2,549,266 in comparison to the third-party market analysis that suggested an equivalent rental deduction of $2,432,635, a difference of 4.8 percent, or $116,631.00. [Taxpayer Ex. 12]

64. The illustrative comparison suggested that in 2015, the cost-accounting method produced a rental deduction of $2,735,218 in comparison to the third-party market analysis that suggested an equivalent rental deduction of $2,461,206, a difference of 11.1 percent, or $274,012.00. [Taxpayer Ex. 12]

65. The illustrative comparison suggested that in 2016, the cost-accounting method produced a rental deduction of $1,921,963 in comparison to the third-party market analysis that suggested an equivalent rental deduction of $1,799,078, a difference of 6.8 percent, or $122,885.00. [Taxpayer Ex. 12]

66. The illustrative comparison suggested that the cumulative results of the cost-accounting method produced a total rental deduction of $14,176,981.00 in comparison to the third-party market analysis that suggested an equivalent cumulative rental deduction of $12,977,429.00, a difference of 8.5 percent, or $1,199,552.00. [Taxpayer Ex. 12; Administrative Notice of Cumulative Results]

The Audit and Assessment

67. Ms. Lizette Rivera is a tax auditor for the Department. She has been employed with the Department for approximately eight years. [Direct Examination of Ms. Rivera]

68. Performing research relevant to Senior Star, Ms. Rivera observed that Taxpayer was registered to conduct business in New Mexico but reported minimal gross receipts in the range of $15,000 to $19,000 per month. [Direct Examination of Ms. Rivera]

69. Ms. Rivera also observed that all of Taxpayer's employees were employed by Senior Star, and not directly by Taxpayer. [Direct Examination of Ms. Rivera]

70. Ms. Rivera was eventually tasked with performing an audit of Taxpayer. [Direct Examination of Ms. Rivera]

71. One of the initial undertakings of the audit was to identify Taxpayer's gross receipts through the reconciliation of various financial documents provided by Taxpayer. However, Taxpayer's records did not produce consistent or reliable figures of gross receipts nor provide a foundation for calculating an appropriate rental deduction. [Direct Examination of Ms. Rivera]

72. There were four categories of records that Ms. Rivera requested of Taxpayer, which could have been helpful to her computations, but which Taxpayer did not provide:

a. supporting documentation for service fees;
b. supporting documentation for lease of real property reported deductions;
c. supporting documentation for prepared meals calculation for reported gross receipts; and
d. tenant agreements, invoices and/or billing statements.

[Direct Examination of Ms. Rivera; Taxpayer Ex. 8.2]

73. Ms. Rivera eventually referred to IRS Forms 8825 for tax years 2011 through 2015 to identify Taxpayer's gross receipts. [Direct Examination of Ms. Rivera; Taxpayer Ex. 8]

74. Ms. Rivera found the IRS Forms 8825 to be reliable since taxpayers prepare and submit the information under penalty of federal law. [Direct Examination of Ms. Rivera]

75. IRS Forms 8825 identified gross rents for Las Colinas Village in the following amounts:

a. $3,102,008.00 in 2011 [Department Ex. C.1];
b. $1,558,546.00 in 2012 [Department Ex. C.2];
c. $1,675,811.00 in 2013 [Department Ex. C.3];
d. $1,479,615.00 in 2014 [Department Ex. C.4]; and

e. $1,974,413.00 in 2015 [Department Ex. C.5].

76. Since the amount reported for 2011 appeared to be an anomaly when compared to years 2012 through 2015, the Department disregarded the reported amount in favor of the average of the amounts reported in subsequent years. The same average was applied to the applicable portion of 2016 since income had not been yet reported for that year. [Direct Examination of Ms. Rivera]

77. Relying on the average amounts reported from 2012 through 2015, gross rents for 2011 and 2016 were computed as follows:

a. $1,672,096.20 in 2011 [Taxpayer Ex. 8.13]; and
b. $1,254,072.15 in 2016 [Taxpayer Ex. 8.15].

78. Ms. Rivera perceived the IRS Forms 8825 as the most reliable report of revenue generated from rent. [Direct Examination of Ms. Rivera]

79. Neither Taxpayer's cost-accounting analyses nor the CBRE market analysis were provided to Ms. Rivera until well after the matter had proceeded into protest. [Direct Examination of Ms. Rivera]

80. The CBRE market analysis as well as the cost-allocation analysis would have been considered and may have been helpful had they been provided earlier in the process. However, they were not available, and the audit proceeded in reliance on the best information available at the time. [Direct Examination of Ms. Rivera]

Procedural History of Protest

81. On November 1, 2017, Taxpayer, by and through its counsel of record, submitted its protest to the assessment issued under Letter ID No. L0294038832. [Administrative File]

82. On November 21, 2017, the Department acknowledged receipt of Taxpayer's protest under Letter ID No. L1978884912. [Administrative File]

83. The Department filed a Hearing Request on December 7, 2017 in which it requested a scheduling hearing. [Administrative File]

84. On December 7, 2017, the Administrative Hearings Office entered a Notice of Telephonic Scheduling Hearing which set an initial hearing on the protest for January 5, 2018. [Administrative File]

85. On January 5, 2018, an initial scheduling hearing occurred in which the parties agreed that the hearing satisfied the 90-day hearing requirement and that a second hearing should occur after the parties have had an opportunity to meet and confer. [Administrative File]

86. On January 12, 2018, the Administrative Hearings Office entered a Second Notice of Telephonic Scheduling Conference which set a hearing for April 6, 2018. [Administrative File]

87. On April 6, 2018, after a hearing to address scheduling, the Administrative Hearings Office entered a Scheduling Order and Notice of Administrative Hearing. [Administrative File]

88. On September 10, 2018, Mr. Mittle substituted as counsel for the Department's previous attorney of record. [Administrative File]

89. On October 2, 2018, Taxpayer served Protestant's First Set of Interrogatories and First Request for Production on the Department. [Administrative File]

90. On October 22, 2019, the Department served Department's Responses to Protestant's First Set of Interrogatories and Request for Production of Documents. [Administrative File]

91. On November 1, 2018, Taxpayer served Protestant's Second Set of Interrogatories and Second Request for Production on the Department. [Administrative File]

92. On November 27, 2018, Taxpayer filed a Motion for Continuance[1] of the merits hearing set for January 14, 2019. [Administrative File]

93. On November 28, 2018, the Department served Department's Responses to Protestant's Second Set of Interrogatories and Second Request for Production of Documents. [Administrative File]

94. On December 6, 2018, the Administrative Hearings Office entered a Continuance Order, Amended Scheduling Order and Notice of Administrative Hearing setting a hearing on the merits of Taxpayer's protest for February 26, 2019. [Administrative File]

95. On February 6, 2019, Taxpayer filed Protestant's Prehearing Statement. [Administrative File]

96. On February 7, 2019, the Department filed an Unopposed Motion for Continuance. [Administrative File]

97. On February 15, 2019, the Administrative Hearings Office entered an Order Vacating Hearing on Merits and Notice of Telephonic Scheduling Hearing, which converted the merits hearing on February 26, 2019 to a telephonic scheduling hearing. [Administrative File]

98. On February 26, 2019, the Administrative Hearings Office reset the scheduling hearing and entered a Notice of Telephonic Scheduling Hearing because the Department did not appear. [Administrative File]

99. On April 24, 2019, the Administrative Hearings Office entered a Scheduling Order and Notice of Administrative Hearing which in addition to other deadlines, set a hearing on the merits of Taxpayer's protest for August 19, 2019. [Administrative File]

[1] The motion for continuance stated that Taxpayer "moves the Department's Hearing Officer" for the requested relief. Just for clarification, neither the Administrative Hearings Office nor its presiding hearing officer are affiliated with the Department. *See* NMSA 1978, Sections 7-1B-1 to – 9

100. On July 29, 2019, Taxpayer filed Protestant's Prehearing Statement and the Department filed Department's Prehearing Statement. [Administrative File]

DISCUSSION

The facts of this case are unique because they present competing methods for determining the amount of gross receipts that an assisted living community might be entitled to deduct as deriving from the lease of real property pursuant to NMSA 1978, Section 7-9-53. Yet, the Hearing Officer would be remiss not to also emphasize that the most critical issue is not necessarily which method is best, but whether Taxpayer proved by a preponderance of evidence that the product of the Department's method was an incorrect assessment. Therefore, the following analysis will first examine the method employed by the Department, and then evaluate the methods proposed by Taxpayer, and determine what, if any effect the alternative methods have on the correctness of the method which produced the assessment central to this protest.

Presumption of Correctness

Under NMSA 1978, Section 7-1-17 (C) (2007), the assessment issued in this case is presumed correct. "The presumption exists even if the secretary has issued assessments using alternative methods of reconstruction of a tax or has estimated the tax." *See N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8, 336 P.3d 436. Consequently, Taxpayer has the burden to overcome the assessment. *See Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶11, 84 N.M. 428, 504 P.2d 638. 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-021, ¶13, 133 N.M. 217, 62 P.3d 308.

Unless otherwise specified, for the purposes of the Tax Administration Act, "tax" is defined to include interest and civil penalty. *See* NMSA 1978, Section 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-050, ¶16, 139 N.M. 498, 134 P.3d 785 (agency regulations interpreting a statute are presumed proper and are to be given substantial weight).

Gross Receipts and Applicable Deductions

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, Section 7-9-4 (2002). Under NMSA 1978, Section 7-9-3.5 (A) (1) (2007), the term "gross receipts" is 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*.
>
> (Emphases Added)

Under the Gross Receipts and Compensating Tax Act, there is a statutory presumption that all gross receipts of a person engaged in business are taxable. *See* NMSA 1978, Section 7-9-5 (2002). Despite the general presumption of taxability, taxpayers may also avail themselves of the benefits of various applicable deductions. However, any computation must begin with the presumption that *all* gross receipts are taxable.

Only after reporting its total gross receipts may Taxpayer then assert entitlement to applicable deductions. Stated mathematically, Taxpayer's gross receipts less applicable deductions equal taxable gross receipts, or in this protest, Section 7-9-5 minus Section 7-9-53 equals Taxpayer's taxable gross receipts.

The relevant deduction in this protest permits taxpayers to deduct from gross receipts those amounts derived from the lease of real property. Thus, where a taxpayer's receipts are derived from

a mixture of leasing property and provision of services, disagreements have arisen regarding the methods employed by taxpayers to extract the deductible portion of its receipts from its total gross receipts. *See e.g., In the Matter of SSC Albuquerque Operating Company LLC*, D&O No. 18-16 (May 30, 2018) (non-precedential).

This quandary represents the crux of the issue in this protest in which the parties quarrel over methods that most accurately extricate Taxpayer's deductible gross receipts from its total gross receipts pursuant to Section 7-9-53 (A), which provides in relevant part that, "[r]eceipts from … lease of real property … may be deducted from gross receipts."

The parties do not dispute the applicability of Section 7-9-53 and the Hearing Officer agrees that Taxpayer is clearly engaged in the business of leasing real property and is entitled to deduct from its gross receipts those amounts deriving from that business activity. However, those observations do not resolve the protest because the dispute centers on the methods used to compute the *amount* of the deduction.

The Department has never promulgated rules establishing a specific methodology for calculating the amount of the deduction under Section 7-9-53 in situations where, as in the present case, a taxpayer's receipts from leasing property are blended, or comingled, with receipts from providing services. However, it has generally adhered to the same policy for more than 25 years, as memorialized in a series of revenue rulings.

In 1998, the Department acknowledged the uniqueness of assisted living facilities, which although not entirely equivalent to assisted living communities, share common traits rendering its remarks meaningful to the present scenario. In Revenue Ruling 440-98-2, the Department observed that "[a]ssisted living facilities occupy a middle position on a continuum extending from apartment buildings at one end and nursing homes on the other. In a typical lease of an

apartment unit, little if any personal service is provided by the landlord. Nursing homes provide care for the individual, who is more a patient than a resident; nursing home receipts are predominantly from providing services."

Therefore, an assisted living community like Las Colinas Village, related to an assisted living facility, is similarly situated between the opposite poles described in the ruling, perhaps somewhere between assisted living facilities and apartment buildings. Under the specific facts provided in the ruling, a taxpayer sought the Department's concurrence with a proposed methodology for calculating the deductible portion of its gross receipts under Section 7-9-53. The Department summarized the taxpayer's methodology as follows:

> R calculates the value of the rental portion of the monthly charge by multiplying the square footage of each apartment (adjusted for a proportionate share of the square footage of the common areas) by a square footage rental rate that is comparable for the market. The computed rental amount is then subtracted from the total monthly charge to determine R's gross receipts from the services component.

The Department approved the proposed methodology and explained it was more reasonable than alternative methods which might consist of characterizing all "receipts as deriving totally from leasing of real property versus providing services based on whether the calculated value of the real property lease exceeds the calculated value of the services provided[.]"

The approved methodology was consistent with the general view the Department memorialized approximately four years earlier in Revenue Ruling 430-94-2, in which it similarly recognized that assisted living entities derive receipts from blending leasehold interests in real property with attendant services. The Department refrained from imposing any specific method for apportioning receipts, and only required that a taxpayer employ some *reasonable basis* for its apportionment. It stated:

> The receipts from the rental of real property are deductible and the receipts from meals, housekeeping and other services are taxable. Separate stating of taxable and nontaxable items is not required. To clarify its billings and reporting, X may separately state the amount of taxable and nontaxable items in its billings and accounts. Alternatively, without separately stating taxable and nontaxable items in its billings, *X may apportion its receipts using some reasonable basis to determine the portion attributable to the lease of real property and the portion attributable to the sale of meals, housekeeping and other services.*
>
> (Emphasis Added)

In 2000, the Department again considered similar facts in Revenue Ruling 430-00-5, and maintained that a taxpayer "may apportion its receipts using some reasonable basis to determine the portion attributable to the deductible receipts from the lease of real property and the portion attributable to the taxable receipts from the sale of meals and services."

In this protest, Taxpayer presents two methodologies for calculating the amount of its asserted deduction and disputes the correctness of the methodology employed by the Department, which ultimately gave rise to the assessment. Because the first issue to consider is whether the Taxpayer overcame the presumption of correctness that attached to the assessment, the Department's methodology will be examined first, recognizing that at the time of the audit and subsequent assessment, Taxpayer had not offered either its cost-accounting analysis or its third-party market analysis for consideration.

In fact, neither alternative was presented until well after the Taxpayer had been assessed, and in the case of the third-party market analysis, not until August 5, 2019, 14 days before the hearing and more than two years after the assessment.

Methodology Underlying the Assessment

The Department asserted that Taxpayer's records were deficient for various reasons. Ms. Rivera credibly testified that she was required to rely on an assortment of documents to compute

Taxpayer's purported liability, and not all the records that could have been helpful to her computations were provided to her. The first page of Ms. Rivera's audit narrative makes reference to four categories of records that she requested, but which the Taxpayer did not provide: 1) "supporting documentation for service fees[;]" 2) "supporting documentation for lease of real property reported deductions[;]" 3) "supporting documentation for prepared meals calculation for reported gross receipts[;]" and 4) "tenant agreements, invoices and/or billing statements."

It appeared that even the most basic calculation of Taxpayer's gross receipts was not without its challenges. The auditor was required to calculate Taxpayer's gross receipts from an assortment of records which ultimately did not reconcile with Taxpayer's prior CRS-1 returns [Taxpayer Ex. 8.4]. Even after the close of evidence, the Hearing Officer observed a lack of accord among the various exhibits, which might be relied upon to establish Taxpayer's total gross receipts. This observation is significant because that is the starting point for determining any taxpayer's potential gross receipts tax liability. *See* NMSA 1978, Section 7-9-5 (2002) ("all receipts" are taxable).

Nevertheless, the Department in reliance on the records that Taxpayer did provide, calculated Taxpayer's total gross receipts. Those records included, among others, IRS Forms 8825, which reported Senior Star Investments 1, LLC's gross rents from Las Colinas Village. The Department relied on the IRS Forms 8825 to assist in computing Taxpayer's gross receipts as well as for establishing the amount of Taxpayer's rental deduction.

However, Taxpayer challenges the use of the IRS Forms 8825 for establishing the amount of Taxpayer's rental deduction because those forms purportedly reflect adjustments which in turn, understate its income from gross rents, and therefore, understate the amount of its

rental deduction. Theoretically, Taxpayer could have, but did not attempt to demonstrate the effects of those adjustments which supposedly made the IRS Forms 8825 unreliable or inaccurate for the purpose of calculating gross receipts or the amount of any potential rental deduction. One could infer that merely reversing any adjustments reflected in the IRS Forms 8825 would reveal the pre-adjusted income from rent, illustrate the degree of the purported variance, or perhaps, identify figures that the parties could agree upon. Instead, Taxpayer concentrated its efforts on establishing the reasonableness of its own methods, which were all duly considered, but left the Hearing Officer to surmise how substantial the adjustments reflected in IRS Forms 8825 could have actually been, or not.

Superficial allegations that the IRS Forms 8825 were unreliable due to the alleged necessity of certain adjustments, without additional evidence to demonstrate the alleged inaccuracy, represent the sort of unsubstantiated statements that our courts have perceived as insufficient for overcoming the correctness of an assessment. *See N.M. Taxation & Revenue Dep't v. Casias Trucking*, 2014-NMCA-099, ¶8.; *see also MPC Ltd.*, 2003-NMCA-021, ¶13.

The evidence established that the IRS Forms 8825 reflected the most reliable information regarding Taxpayer's rental income. "The Department is authorized to use any method or combination of methods to reconstruct or verify taxpayers' records, including but not limited to utilizing bank deposits, comparison to industry standards, and assessment of taxes based on the best information available." *See Casias*, 2014-NMCA-099, ¶7.

Income reported in IRS Form 8825 is generally incorporated into a taxpayer's IRS Form 1065 or 1120-S depending on the circumstances at hand. In this case, the evidence established that the information contained in the IRS Forms 8825 accompanied the IRS Forms 1065 filed by Welltower, Inc. The Hearing Officer took administrative notice that IRS Forms 1065 in all

relevant years[2] required that the partner or limited liability company member signing the return do so under penalty of perjury. Accordingly, in the absence of more reliable records, such as those contemplated by Section 7-1-10 (A) (2007), it was entirely reasonable for the Department at the time of the audit, and the Hearing Officer at the present time, to find that the IRS Forms 8825 represented the most reliable and trustworthy indicators of Taxpayer's receipts from rent.

The Hearing Officer recalls Judge Sutin's special concurrence in *O'Cheskey*, where he declared, "[t]he taxpayer has a duty to provide the commissioner with books and records upon which to establish a standard for taxation as provided by law. If he fails to do so, he cannot complain of the best methods used by the commissioner." *See O'Cheskey*, 1972-NMCA-165, ¶16; *see also Waldroop v. O'Cheskey*, 1973-NMCA-146, 85 N.M. 736, 516 P.2d 1119.

The method selected and utilized by the Department in this protest, which relied on the IRS Forms 8825, was wholly reasonable given the apparent lack of records available for employing other reasonable methods, including the alternatives proposed by Taxpayer at the hearing. The Hearing Officer is unable to conclude based on the evidence presented that the Department's determination of Taxpayer's liability was incorrect.

The Hearing Officer will proceed with a discussion of Taxpayer's alternative methods of computing its liability, and in doing so, evaluate how, or if, they might now affect the correctness of the Department's assessment.

Cost-Accounting Methodology

Mr. Clifton testified quite effectively regarding the benefits of a cost-accounting methodology for determining the gross receipts derived from certain services based on the corresponding cost of providing those services. However, this method was not presented as an

[2] The hearing officer took administrative notice of the signature fields for IRS Form 1065 for each relevant year. Forms for years preceding 2019 are accessible at https://apps.irs.gov/app/picklist/list/priorFormPublication.html.

available option for the Department at the time it conducted its audit. Mr. Clifton acknowledged that Taxpayer Exhibits 1 – 7 were all prepared after the assessment was issued.

Observing the timeliness of the analysis represented in those exhibits is pertinent for several reasons. Neither the analysis nor any supporting documents were provided to the Department during the audit or at any other time prior to the assessment, meaning the Department did not have the benefit of the analysis at the time it conducted its audit or issued its assessment. But more significantly, however, is the fact that it is still not presently accompanied by any underlying or supporting documentation which would permit some degree of scrutiny to verify that the figures upon which the analysis is grounded are accurate and reliable, and not subconsciously influenced by the desire to reduce or eradicate the assessed liability.

Nevertheless, although not entirely analogous with the facts in the protest of *SSC of Albuquerque,* the Hearing Officer observes that the outcome of the cost-accounting analysis in this case shares similarities with the analysis employed in that protest. In *SSC of Albuquerque,* the Department claimed that the taxpayer's methodology was not reasonable because it failed to consider the fair market value of the real property, which should be the principal variable to which a taxpayer's methodology is fixed in pursuing the benefit of a deduction under Section 7-9-53. Yet, that protest also involved a scenario in which a taxpayer was asserting entitlement to a refund. Therefore, the reasonableness of taxpayer's selected methodology in support of its claim for refund was the principal issue in dispute. *SSC of Albuquerque* did not arise from an assessment like the case now at hand, so it did not consider the correctness of a method employed by the Department.

SSC of Albuquerque found that taxpayer's methodology was unreasonable because it overlooked the fact that tax is imposed on all receipts less applicable deductions (*e.g.*, Section 7-

9-5 minus Section 7-9-53 equals taxable gross receipts). In contrast, the computation suggested by the taxpayer in *SSC of Albuquerque* calculated the amount of the claimed deduction as the difference between all receipts and purported taxable gross receipts (*e.g.*, Section 7-9-5 minus taxable gross receipts equals deduction under Section 7-9-53). *SSC of Albuquerque* determined this method was unreasonable because the amount of the claimed deduction was determined by variables unrelated to the value of the real property.

In this protest, Taxpayer's cost-accounting methodology resembles the approach employed in *SSC of Albuquerque* and is similarly indifferent to the value of the real property within the calculation. Taxpayer Exhibits 1 – 7 confirm that the analysis makes no reference to the value of the real property central to the asserted deduction.

Momentarily setting aside this observation, the Hearing Officer emphasizes that it is not the objective of this discussion to endorse or impugn the trustworthiness of a cost-accounting methodology. Cost accounting may be reasonable under appropriate circumstances if accompanied by adequate supporting records as contemplated by Section 7-1-10, but that is not the case in this protest. As Ms. Rivera explained, the records provided during the audit were unreconcilable among other records she reviewed, and the evidence presented at the hearing similarly lacked any records establishing the sources of the figures provided in the spreadsheets detailing Taxpayer's analyses. Without some supporting records, the analysis contained in Taxpayer Exhibits 2 – 7 lacks the sort of footing that might establish it as reliable and trustworthy.

The cost-allocation analysis in this protest, although presenting an alternative for computing Taxpayer's liability does not prove that the Department's methodology and resulting

assessment was incorrect, nor can the Hearing Officer find based on the evidence presented that it is more accurate at the present time than the method relied upon to generate the assessment.

Third-Party Market Analysis

In 2019, Taxpayer retained the services of CBRE and Mr. Johnson to perform a rent analysis to "estimate the market rent levels for [Las Colinas Village]." The introduction to the analysis summary explained that "[t]his analysis is to be used in connection with the State of New Mexico tax audit." Mr. Johnson testified that the summary was completed approximately two weeks before the scheduled hearing consistent with the date appearing on the cover page of Taxpayer Exhibit 13.

Mr. Clifton testified that the intended purpose of the analysis was to analyze and perhaps validate the conclusions of its cost-accounting analysis, as well as address the potential perception that the cost-accounting analysis was indifferent to the fair market value of the real property central to the deduction. The Hearing Officer noted that the cost-allocation analysis was prepared separately and without reference to the subsequent third-party market analysis.

The Department's opposition to the market analysis was primarily established through cross-examination. Although Taxpayer emphasized that the Department did not present a competing expert witness, the Hearing Officer perceived its cross-examination of Mr. Johnson as highly effective at emphasizing the weaknesses in the analysis. One point that Mr. Johnson acknowledged was that neither he nor anyone else associated with CBRE ever visited Las Colinas Village. Even if not a requirement of the applicable Uniform Standards of Professional Appraisal Practice, this fact tends to diminish the reliability of the analysis.

Referring to that analysis, the reader should note, at Taxpayer Ex. 13.12, the first statement under the section entitled "Assumption and Limiting Conditions[,]" states that the

appraiser "has inspected through reasonable observation the subject property." Yet, the evidence revealed potential contradictions of that statement with respect to whether an "inspection" occurred and whether it was based on "reasonable observation."

This is significant especially in reference to those factors that might be affected by personal inspection, such as the "age/condition adjustment" or the "quality of construction adjustment" at Taxpayer Ex. 13.3. To be clear, the Hearing Officer does not necessarily find that the adjustments were unwarranted, but that the reliability of the evidence justifying those adjustments is undercut by the fact that Mr. Johnson never personally examined the property, nor did anyone else from CBRE. For that reason, the overall reliability of the analysis is diminished.

The Department also emphasizes an assortment of potential errors in the summary that may not in fact be detrimental to the analysis. For example, the summary references at least two comparable properties located no less than 20 miles away in Rio Rancho, New Mexico [Taxpayer Ex. 13.3] and an incorrect number of residential units [Taxpayer Ex. 13.8]. Those errors when viewed in the surrounding circumstances, even if minor, tend to further diminish the overall reliability of the analysis because they suggest that the analysis was hastily prepared without sufficient attention to accuracy or detail.

Nevertheless, Taxpayer argues that the third-party market analysis corroborates the outcome of the cost-allocation analysis where, for the most part, the difference between their conclusions might be perceived as insignificant. The comparisons are illustrated at Taxpayer Exhibit 12 where in 2011, Taxpayer's cost-accounting methodology identified rental income of $2,265,133 in contrast with the market analysis, which identified rental income of $1,771,601, or a difference of 27.9 percent. Taxpayer does not necessarily dispute the striking difference between the results but directs the Hearing Officer's attention to the subsequent years where

there is less variance between the outcomes.

In 2012, Taxpayer's cost-accounting methodology identified rental income of $2,263,198 in contrast with the market analysis, which identified rental income of $2,205,041, or a difference of 2.6 percent, which is indeed significantly less than the previous year.

In 2013, Taxpayer's cost-accounting methodology identified rental income of $2,442,203 in contrast with the market analysis, which identified rental income of $2,306,868, or a difference of 5.9 percent.

In 2014, Taxpayer's cost-accounting methodology identified rental income of $2,549,266 in contrast with the market analysis, which identified rental income of $2,432,635, or a difference of 4.8 percent.

In 2015, Taxpayer's cost-accounting methodology identified rental income of $2,735,218 in contrast with the market analysis, which identified rental income of $2,461,206, or a difference of 11.1 percent.

In 2016, Taxpayer's cost-accounting methodology identified rental income of $1,921,963 in contrast with the market analysis, which identified rental income of $1,799,078, or a difference of 6.8 percent.

However, the percentages used to describe the similarities also tend to distract from their differences: the difference in 2011 was $492,532.00; the difference in 2012 was $58,157.00; the difference in 2013 was $135,335.00; the difference in 2014 was $116,631.00; the difference in 2015 was $274,012.00; and the difference in 2016 was $122,885.00. The cumulative difference is $1,199,552 or 8.5 percent. This difference is significant and lends substantial credence to the reasonableness of the Department's conclusion that the most reliable information for computing Taxpayer's liability was contained in the IRS Forms 8825.

Of course, neither methodology suggested by Taxpayer was proposed to the Department at the time it conducted its audit, and it has previously been noted that Taxpayer's supporting documents were inadequate under Section 7-1-10 (A). But, if both methodologies had been presented as alternatives to the Department's methodology, it would have still been reasonable under the circumstances (lack of trustworthy and reliable records) of this protest, for the Department to rely on the income reported in IRS Forms 8825 in lieu of meandering between various methodologies reaching divergent results.

As previously stated, this Decision and Order should not be construed as endorsing or disparaging any particular methodology. In fact, Ms. Rivera testified that she was amenable to considering other methodologies, including those discussed herein, provided they were accompanied by supporting documentation. However, neither method was presented as an alternative during the audit and Ms. Rivera was quite clear regarding Taxpayer's inability to provide records that would have enabled her to verify the amount of a potential rental deduction. Eventually, she referred to and relied on the IRS Forms 8825 as the most trustworthy and reliable records available at the time.

The Hearing Officer is unable to find based on a preponderance of evidence that this method resulted in an incorrect assessment and remains unpersuaded based on the evidence presented that either alternate method, at the present time, either on its own or in conjunction with the other, overcomes the presumption of correctness.

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.
>
> (Emphasis Added)

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." *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 that a provision is mandatory absent clear indication to the contrary).

Regulation 3.1.11.10 NMAC defines negligence in three 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 because it failed to accurately compute, report and pay its gross receipts tax obligations under A, B, and C, but perhaps mostly through inadvertence or erroneous belief.

On occasions where a taxpayer might fall under the definition of civil negligence generally subject to penalty, Section 7-1-69 (B) provides a limited exception in that "[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."

Mr. Clifton made fleeting reference to reliance on Taxpayer's tax accountant, yet there was no other evidence explaining Taxpayer's general assertion that its actions or inactions relevant to this protest were founded on an informed judgment or determination based on reasonable grounds. *See C & D Trailer Sales v. Taxation & Revenue Dep't*, 1979-NMCA-151, ¶¶8-9, 93 N.M. 697, 604 P.2d 835 (penalty upheld where there was no evidence that the taxpayer

"relied on any informed consultation" in deciding not to pay tax). For example, Mr. Clifton did not explain the tax accountant's qualifications, the information upon which the tax accountant provided advice, or how that advice was allegedly erroneous. Consequently, there is insufficient evidence in the record to establish that the mistake of law provision of Section 7-1-69 (B) should provide for an abatement of penalty in this case.

Further grounds for abatement of civil negligence penalty are provided by Regulation 3.1.11.11 NMAC. That regulation establishes eight indicators of non-negligence where penalty may be abated. Based on the argument of Taxpayer and the evidence presented, only one factor under Regulation 3.1.11.11 NMAC is potentially applicable in this proceeding:

> D. the taxpayer proves that the failure to pay tax or to file a return was caused by reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts; failure to make a timely filing of a tax return, however, is not excused by the taxpayer's reliance on an agent[.]

Yet, as explained above, Taxpayer made only a brief reference to being "under advisement" of its "tax accountant" but provided no other evidence to establish that the "tax accountant" was minimally competent (*i.e.*, certified public accountant) or that subsequent reliance on his or her advice was reasonable after full disclosure of relevant facts.

During Taxpayer's closing argument, it described a brief portion of Ms. Rivera's testimony as yielding to the assertion that Taxpayer was "under advisement" of a "tax accountant" for justifying the abatement of penalty. Yet, that characterization of Ms. Rivera's statement as an admission is unreasonable. Ms. Rivera testified only that she had been communicating with a specific individual, but her point of contact changed when Taxpayer reportedly determined that some of the advice that individual provided was erroneous. Ms. Rivera's testimony was not a concession that penalty should be abated, or even a confirmation

that the information that Taxpayer allegedly relied upon was erroneous. Instead, it merely explained her understanding of why her communications were redirected from one individual to another.

It is Taxpayer's duty to ascertain the tax consequences of its actions. *See Tiffany Construction Co.*, 1976-NMCA-127, ¶5. Taxpayers cannot "abdicate this responsibility [to learn of tax obligations] merely by appointing an accountant as its agent in tax matters." *See El Centro Villa Nursing Center v. Taxation and Revenue Department*, 1989-NMCA-070, ¶14, 108 N.M. 795.

The Department does not allege that Taxpayer's actions or inactions were intended to evade or defeat a tax. But even if arising from inadvertence or erroneous belief, *El Centro Villa Nursing* provides that civil negligence penalty is appropriate and Regulation 3.1.11.11 (D) NMAC offers no basis for the abatement of penalty.

Taxpayer's protest should be DENIED. The evidence failed to establish that the Department's assessment was incorrect.

CONCLUSIONS OF LAW

A. Taxpayer filed a timely, written protest to the Department's Notice of Assessment of Taxes and Demand for Payment under Letter ID No. L0294038832, and jurisdiction lies over the parties and the subject matter of the protest.

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

C. Taxpayer carries the burden to present countervailing evidence or legal argument to show that it is entitled to an abatement of an assessment. *See Casias Trucking*, 2014-NMCA-099, ¶8.

D. "The presumption exists even if the secretary has issued assessments using alternative methods of reconstruction of a tax or has estimated the tax." *Id*.

E. "Unsubstantiated statements that the assessment is incorrect cannot overcome the presumption of correctness." *MPC Ltd.*, 2003-NMCA-021, ¶13.

F. If a taxpayer presents sufficient evidence to rebut the presumption, then the burden shifts to the Department to re-establish the correctness of the assessment. *See id*.

G. Taxpayer did not overcome the statutory presumption of correctness that attached to the assessment under NMSA 1978, Section 7-1-17.

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

I. Under NMSA 1978, Section 7-1-69 (2007), Taxpayer is liable for civil negligence penalty.

For the foregoing reasons, Taxpayer's protest **IS DENIED.** Taxpayer shall be liable for the outstanding portions of the assessment in addition to penalty and interest accruing until paid in full.

DATED: December 4, 2019

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.

CERTIFICATE OF SERVICE

On December 4, 2019, a copy of the foregoing Decision and Order was submitted to the parties listed below in the following manner:

First Class Mail *Interagency Mail*

INTENTIONALLY BLANK

John Griego
Legal Assistant
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