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 24-04**

NEW MEXICO TAXATION AND REVENUE DEPARTMENT

DECISION AND ORDER ON REMAND FROM NEW MEXICO COURT OF APPEALS

On December 4, 2019, Chris Romero, Esq., Hearing Officer (Administrative Hearings Office) entered a Decision and Order (D&O 19-30) denying the protest of an assessment of Gemini Las Colinas, LLC (Taxpayer). Taxpayer appealed.

In *Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, the Court of Appeals remanded the matter for further proceedings consistent with the opinion expounded therein, leaving it to the discretion of the Hearing Officer to determine what proceedings are necessary – "whether a further hearing or briefing are required or whether the determination can be made on the record as it exists." *See Gemini*, 2023-NMCA-039, ¶ 40. The parties agreed that the matter could proceed on remand on the existing evidentiary record. The Hearing Officer concurred and permitted the parties to file supplemental briefing.

The hearing on the merits of the protest occurred on August 19, 2019. Taxpayer appeared by and through Mr. Benjamin C. Roybal, Esq. (Betzer, Roybal & Eisenberg P.C.) who was 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.

The Administrative Hearings Office is an independent agency tasked with the fair and impartial adjudication of protests under the Tax Administration Act. As explained by Regulation 22.600.1.20 C NMAC, the Hearing Officer is not “responsible to or subject to the direction of any officer, employee or agent of the taxation and revenue department[.]” *See e.g.* Regulation 22.600.1 NMAC (2018); *See also* NMSA 1978, Sections 7-1B-1 – 10.

Taxpayer Exhibits 1 – 13 and Department Exhibits C – I were admitted into the evidentiary record by stipulation without objection at the hearing occurring on August 19, 2019.

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, the method employed by the Department was reasonable under the circumstances and represented the best method available at the time of the assessment. Moreover, the evidence failed to persuade the Hearing Officer that Taxpayer’s alternative methods of computation produced a more reliable or accurate determination of Taxpayer’s gross receipts tax liability. Therefore, Taxpayer’s protest should be denied. IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

Neither party nor the Hearing Officer perceived the need to present new evidence. The Hearing Officer reexamined the evidentiary record and restates herein all previous findings of fact as stated in D&O 19-30.

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. [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.

[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. [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. [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. [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. [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 in comparison to the third-party market analysis that suggested an equivalent cumulative rental deduction of $12,977,429, a difference of 8.5 percent, or $1,199,552. [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 from rent while total receipts were computed by reference to Taxpayer's receipt registers. [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 in 2011 [Department Ex. C.1];
b. $1,558,546 in 2012 [Department Ex. C.2];
c. $1,675,811 in 2013 [Department Ex. C.3];
d. $1,479,615 in 2014 [Department Ex. C.4]; and
e. $1,974,413 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 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]

[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 – 10

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]

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

Post-Appeal Proceedings

101. On May 12, 2023, the New Mexico Court of Appeals mandated this protest for further proceeding. *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039.

102. In response to the mandate, Taxpayer on May 31, 2023, filed a Motion to Allow Supplemental Briefing on Remand Based on the Present Record. [Administrative File]

103. On June 12, 2023, the Department filed Department's Response in Opposition to Taxpayer's Motion to Allow Supplemental Briefing on Remand Based on the Present Record. [Administrative File]

104. On June 15, 2023, the Administrative Hearings Office entered an Order on Mandate and Supplemental Briefing Schedule. [Administrative File]

105. On July 17, 2023, Taxpayer filed Taxpayer's Supplemental Brief on Remand. [Administrative File]

106. On July 18, 2023, the parties filed a Joint Motion to Allow Use of Unofficial Transcript of Proceedings. [Administrative File]

107. On July 25, 2023, the Administrative Hearings Office entered an Order Granting Joint Motion to Allow Use of Unofficial Witten Transcript of Proceedings. The order specified that, "[i]n case of any discrepancy between the unofficial written transcript and the audio recording of the hearing, the audio recording shall be determinative." [Administrative File]

108. On July 31, 2023, Taxpayer filed Taxpayer's Submission of Unofficial Transcript of the Merits Hearing. [Administrative File]

109. On August 9, 2023, the Department filed Department Motion to Extend Deadline to File Response to Gemini's Supplement Brief on Remand. [Administrative File]

110. On August 21, 2023, Taxpayer filed Taxpayer's Response in Opposition to the Department's Motion for 90-day extension of time to File Supplemental Brief on Remand. [Administrative File]

111. On August 22, 2023, the Administrative Hearings Office entered an Order Permitting Reply. The order specified that, "[a]lthough the tribunals' rules of procedure provide no right of reply, the Hearing Officer upon review of the Response determined that his decision on the underlying motion may nevertheless be assisted by a brief reply." [Administrative File]

112. On August 24, 2023, the Department filed Department Reply in Response to Gemini's Objection to Extension of Deadline to Respond to Gemini's Supplemental Brief on Remand. [Administrative File]

113. On August 29, 2023, the Administrative Hearings Office entered an Order Enlarging Time to File Response to Gemini's Supplemental Brief on Remand. [Administrative File]

114. On September 5, 2023, the Department filed Department Motion for Reconsideration of Order Enlarging Time to File Response to Gemini's Supplemental Brief on

Remand. [Administrative File]

115. On September 25, 2023, the Administrative Hearings Office entered a Second Order Enlarging Time to File Response to Gemini's Supplemental Brief on Remand. [Administrative File]

116. On September 29, 2023, the Department filed Department's Response to Taxpayer's Supplemental Brief on Remand. [Administrative File]

117. On October 30, 2023, Taxpayer filed Taxpayer's Supplemental Reply Brief on Remand. [Administrative File]

DISCUSSION

The parties agree that the issues before the Hearing Officer on remand from the Court of Appeals are reduced to the questions of: (1) whether the Department satisfied its burden of production in response to the Court of Appeals' determination that Taxpayer rebutted the presumption of correctness; and (2) if so, whether Taxpayer has satisfied the burden of persuasion on the merits of the protest.

A Clarified Way Forward

As explained by the Court of Appeals, Taxpayer's appeal presented two legal issues related to the tax protest's procedural framework:

> (1) what must a taxpayer do to overcome the presumption of correctness and whether, at this juncture, the hearing officer acts in their fact-finding capacity; and (2) if a taxpayer overcomes the presumption, what type of burden shifts to the department, and—relatedly—which party bears the ultimate burden of persuasion.

See Gemini, 2023-NMCA-039, ¶ 18.

The Court of Appeals recognized that answering these questions was "no easy task" and that it involved issues of first impression. *See Gemini*, 2023-NMCA-039, ¶ 13, ¶19. It ultimately clarified the framework within which a hearing officer is to evaluate the presumption of correctness

in a protest.

"[D]etermining whether the taxpayer has overcome the presumption of correctness is the first step in resolving a tax protest, and that it will only be the last step if the taxpayer fails to overcome the presumption." *See Gemini*, 2023-NMCA-039, ¶ 23. "[T]he presumption of correctness assessment is made by the hearing officer in a purely legal capacity." *See Gemini*, 2023-NMCA-039, ¶ 25.

"The regulation's call for 'some countervailing evidence' that 'tend[s]' to dispute the assessment, 3.1.6.12(A) NMAC, is merely a threshold requirement for evidence, and that evidence need not be credible or ultimately persuasive." *See Gemini*, 2023-NMCA-039, ¶ 25. "[I]f the taxpayer has not overcome the presumption, the protest may simply be denied. In this scenario, there is no need for the department to present any evidence." *See Gemini*, 2023-NMCA-039, ¶ 23.

In this protest, because the Court of Appeals determined that Taxpayer overcame the presumption of correctness, this discussion will commence with the burden that is consequently placed on the Department *after* a Taxpayer satisfies this threshold burden.

<u>The Department's Burden under *Gemini*</u>

If Taxpayer rebuts the presumption of correctness, the burden that shifts to the Department is a burden of production. The "burden of production" consists of "evidence to justify [the Department's] assessment" as opposed to "ultimately prov[ing] the correctness of its assessment to the hearing officer by a preponderance of evidence (burden of persuasion)." *See Gemini*, 2023-NMCA-039, ¶ 26.

"To overcome this burden, the department must put forth evidence to show the correctness of its assessment—that is, evidence sufficient to make the correctness of the department's assessment a question of fact." *See Gemini*, 2023-NMCA-039, ¶ 29. "[S]tatements

about burden shifting in [*New Mexico Taxation & Revenue Dept. v. Casias Trucking*, 2014-NMCA-099] and [*MPC Ltd. v. New Mexico Taxation & Revenue Dept.*, 2003-NMCA-021] refer to the burden of production, and that the burden of persuasion remains with the taxpayer throughout the proceedings." *See Gemini*, 2023-NMCA-039, ¶ 28.

"[T]he [D]epartment cannot simply rely on the unreliability or incredibility of the [T]axpayer's evidence. Instead, the [D]epartment must produce evidence to justify its assessment." *See Gemini*, 2023-NMCA-039, ¶ 29.

Taxpayer argued on remand that the Department "did not produce such evidence and therefore failed to advance this proceeding to the merits stage." *See* Taxpayer's Supplemental Brief on Remand, Page 3. The Hearing Officer respectfully disagrees. The evidence was presented in the form of cross examination, direct examination, and reference to both Taxpayer's and the Department's admitted exhibits.

As background, Taxpayer originally came to Ms. Rivera's attention in connection with work she was performing on another matter around 2013 or 2014. In performing research in connection with that matter, she had observed the existence of at least two apparently related but separate entities that appeared to be engaging in business from the same location. Taxpayer was one of the entities. In reference to Taxpayer, Ms. Rivera recalled observing what she perceived to be "minimal reporting as taxable" consisting primarily of "food costs" in the range of $15,000 to $19,000 per month. The other entity was not registered with the Department. She also observed that Senior Star maintained Taxpayer's employees, but that there was some confusion attributable to the fact that Taxpayer as well as the second entity also apparently claimed the same employees on their respective payrolls. The Department subsequently commenced an audit of Taxpayer and the other entity.

One of the first steps was to gather Taxpayer's records with which Ms. Rivera could compute Taxpayer's gross receipts tax liability, including records that would allow for the computation of its deduction under Section 7-9-53. Over a period of time, Taxpayer provided income statements, receipt registers, and IRS Forms 1065 for Senior Star Investments 1, LLC.

Ms. Rivera observed that the data contained in the various documents Taxpayer provided could not be reconciled or confirmed against Taxpayer's CRS-1 reports in the relevant tax periods. Ms. Rivera eventually determined that Taxpayer's receipts could be computed from Taxpayer's receipt registers, but the same records proved undependable for calculating Taxpayer's deduction for rent under Section 7-9-53. Ms. Rivera observed that information from Taxpayer's register indicating the amounts of receipts generated from providing services were contradictory to other documents which should have but did not reconcile with the register.

In addition to the shortcomings in records Taxpayer provided, Ms. Rivera also recalled her efforts being hindered by Taxpayer's inconsistent computation methodologies, failure to provide all requested records, as well as what Ms. Rivera perceived as Taxpayer's lack of full disclosure.

Ms. Rivera noted at Taxpayer Ex. 8.5:

> [T]axpayer is required to have appropriate supporting documentation for deductible gross receipts under NMSA 1978, [Section] 7-9-53 (A), for the Lease of Real Property. The [T]axpayer did not provide supporting documentation to support all reported deductions on the CRS-1 report. The taxpayer provided Senior Star Investments I LLC's federal form 1065 U.S. Return of Partnership Income, form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation, for the tax years of 2011 through 2015, which provided gross rent amounts derived from the NM location.

Thus, given the challenges presented by the lack of complete and reliable records, Ms. Rivera identified what she concluded to be the best method under the circumstances of

computing Taxpayer's gross receipts liability for the years in question. Ms. Rivera determined that IRS Forms 8825, which reported Senior Star Investments 1, LLC's gross rents from Las Colinas Village represented the most reliable report of receipts from rent and therefore, a trustworthy evaluation of Taxpayer's potential deduction under Section 7-9-53.

Ms. Rivera noted, also on Taxpayer Ex. 8.5:

> Pursuant to NMSA 1978, [Section] 7-1-10; Regulation 3.1.5.8 (C) (3) NMAC, the Department may use tax return information to compute or estimate tax due. The taxpayer failed to provide sufficient supporting documentation for reported deductions under NMSA 1978, [Section] 7-9-53 (A), lease of real property; therefore, the auditor utilized the taxpayer provided form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation, for the tax years of 2011 through 2015.

Ms. Rivera's determination that IRS Forms 8825 represented the best evidence available to her of Taxpayer's deduction under Section 7-9-53 was reasonable.

Similar to observations made by Ms. Rivera, the Hearing Officer also observed through 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), as cited by Ms. Rivera, it was reasonable for the Department to rely on the IRS Forms 8825 as the most reliable and trustworthy indicators of Taxpayer's receipts from rent.

The fact that the forms are filed under penalty of perjury is not dispositive, but it provides significant weight in assuring the auditor in an audit, or a fact finder in a protest, that the forms were prepared with care and due diligence, and for that reason, are reliable and trustworthy. That is why it was reasonable for Ms. Rivera to rely on the IRS Forms 8825 in the absence of more

[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.

reliable documentation.

Taxpayer did not dispute the accuracy of the forms for their intended purpose, but asserts they are an unreliable indicator of rental income for computing Taxpayer's tax liability because they have undergone certain adjustments.

However, if the IRS Forms 8825 are accurate for their intended purpose, but unreliable for the purpose of computing Taxpayer's deduction from rent because of certain adjustments, then it would be reasonable to infer that any adjustment reflected in the form could be reversed to reveal a pre-adjusted and presumably more precise figure. Such a task is likely within the expertise of an accounting or tax professional, provided there are supporting records to substantiate the adjustments and support their subsequent reversal. Yet, it is the shortage of supporting documentation that caused the Department to rely on the forms in the first place.

In the absence of records, "[t]he 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 (Emphasis Added). Ms. Griego credibly testified and established to the satisfaction of the Hearing Officer that her audit, and resulting assessment of tax, was based on the best information available.

In this regard, Judge Sutin's observation in *Archuleta v. O'Cheskey*, 1972-NMCA-165, ¶ 16, 84 N.M. 428, 431, 504 P.2d 638, 641, is profound. He said, "[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." S*ee also Waldroop v. O'Cheskey*, 1973-NMCA-146, 85 N.M. 736, 516 P.2d 1119. Judge Sutin's observation is germane to the facts underlying this protest. The dispute

stems from, and ultimately teeters on a lack of records, in which case the law provides for the Department to adopt an alternative method of computing Taxpayer's liability. That is what the Department did in the present matter.

At this stage in the proceedings, the Department's burden is one of production in which "the [D]epartment must produce evidence to justify its assessment." *See Gemini*, 2023-NMCA-039, ¶ 29. The Hearing Officer was persuaded and satisfied that the Department "put forth evidence to show the correctness of its assessment—that is, evidence sufficient to make the correctness of the department's assessment a question of fact." *See Gemini*, 2023-NMCA-039, ¶ 29. Therefore, the case is ready for resolution on the merits. "[T]he burden of persuasion remains with the [T]axpayer[.]" *See Gemini*, 2023-NMCA-039, ¶ 28.

<u>The Merits</u>

"If the [D]epartment's evidence creates a question of fact about the correctness of the assessment, it has fulfilled its burden of production, and the case is ripe for the hearing officer to resolve factual disputes and decide the protest on the merits." *See Gemini*, 2023-NMCA-039, ¶ 29. "[I]f the evidence is in equipoise, the hearing officer should deny the taxpayer's protest." *See Gemini*, 2023-NMCA-039, ¶ 29.

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)

1 The Gross Receipts and Compensating Tax Act imposes a statutory presumption that all
2 gross receipts of a person engaged in business are taxable. *See* NMSA 1978, Section 7-9-5 (2002).
3 However, taxpayers may reduce their gross receipts liability through the application of relevant
4 deductions and exemptions. The difference between total gross receipts and applicable deductions
5 and exemptions represents a taxpayer's taxable gross receipts.

6 The applicable deduction in this protest permits taxpayers to deduct from gross receipts
7 those amounts derived from the lease of real property. It provides, in relevant part that, "[r]eceipts
8 from … lease of real property … may be deducted from gross receipts." *See* Section 7-9-53 (A).
9 Thus, where a taxpayer's receipts are derived from a mixture of leasing property and provision of
10 services, disagreements have arisen regarding the methods employed by taxpayers to extract the
11 deductible portion of its receipts from its total gross receipts to determine its taxable portion of
12 receipts. *See e.g., In the Matter of SSC Albuquerque Operating Company LLC*, D&O No. 18-16
13 (May 30, 2018) (non-precedential).

14 In evaluating the claim to a deduction, well established law in New Mexico explains "when
15 a deduction is claimed by a taxpayer, the statute is to be strictly construed in favor of the taxing
16 authority, and the right to the deduction must be clearly and unambiguously expressed." *See Sec.*
17 *Escrow Corp. v. State Taxation & Revenue Dept.*, 1988-NMCA-068, ¶ 20, 107 N.M. 540, 545, 760
18 P.2d 1306, 1311. Moreover, the taxpayer must show that it is clearly entitled to the statutory
19 deduction. *Id.*; *TPL, Inc. v. New Mexico Taxation & Revenue Dept.*, 2003-NMSC-007, ¶ 9, 133
20 N.M. 447, 451, 64 P.3d 474, 478.

21 All taxpayers are responsible for self-reporting and paying their tax obligations. *See* NMSA
22 1978, Section 7-1-13 B. This responsibility includes the initial task of calculating one's total gross
23 receipts and the secondary task of accurately computing one's deductions to arrive at one's taxable

gross receipts. In this regard, NMSA 1978, Section 7-1-10 A requires that, "every taxpayer shall maintain books of account or other records in a manner that will permit the accurate computation of state taxes or provide information required by the statute under which the person is required to keep records."

The Department does not disagree that Taxpayer generates receipts from the lease or rent of real property within the meaning of Section 7-9-53. Disagreement over how to compute the amount of the deduction represents the crux of the issue.

As already discussed, the Department determined that the most reliable method, considering the quantity and quality of Taxpayer's records, was by reference to IRS Forms 8825. Taxpayer disputed the propriety of that method and proposed two alternatives at the hearing. The question on the merits may then be summarized as which method produces the most reliable computation of Taxpayer's gross receipts tax liability.

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 alternative methodologies for calculating the amount of its asserted deduction and disputes the reasonableness of the methodology employed by the Department, which ultimately gave rise to the assessment.

<u>Cost-Accounting Methodology</u>

At the hearing, Mr. Clifton testified quite knowledgeably regarding the advantages of a cost-accounting methodology for determining the gross receipts derived from certain services based on the corresponding cost of providing those services. This method was not presented to the Department before it conducted its audit and Mr. Clifton acknowledged that Taxpayer Exhibits 1 – 7, all of which were presented during his discussion of the methodology, were prepared after the assessment was issued.

Observing the timeliness of the analysis represented in Taxpayer Exhibits 1 – 7 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. Ms. Rivera explained that had it been presented, she would have given it due consideration so long as it was

accompanied by supporting documentation. This point not only relates back to Ms. Rivera's determination of what method was best at the time she performed the audit, but it also highlights an ongoing issue in the protest: the lack of records.

Despite Mr. Clifton's testimony, Taxpayer Exhibits 1 – 7 were not accompanied by any underlying or supporting documentation, which if available, might have corroborated the figures grounding the analysis and increased the persuasiveness of the testimony and subsequent arguments regarding its reliability. In contrast, the analysis lacks the sort of records that could enhance its persuasive value.

Despite observations regarding the scarcity of supporting records, the cost-accounting analysis in this case shares similarities with the analysis employed in *SSC of Albuquerque*. In that protest, the Department claimed that the taxpayer's methodology was not reasonable because it failed to consider the fair market value of the rental property in computing the amount of the rental deduction.

SSC of Albuquerque observed that taxpayer's methodology 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 (such as receipts generated from services) 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 not associated with 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.

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 supporting evidence 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 1 – 7 lacks the sort of footing that might establish it as reliable, trustworthy, and ultimately persuasive.

For these reasons, the cost-allocation analysis in this protest, although presenting an alternative for computing Taxpayer's liability, falls short of persuading the Hearing Officer that it is superior and more reliable than the methodology adopted by the Department on account of Taxpayer's scarcity of supporting records.

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 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 flaws and shortcomings 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 and subsequent persuasive value of the analysis is diminished.

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

9 Nevertheless, Taxpayer argues that the third-party market analysis corroborates the
10 outcome of the cost-allocation analysis where, for the most part, the differences between their
11 conclusions might be perceived as insignificant. The comparisons are illustrated at Taxpayer
12 Exhibit 12 where in 2011, Taxpayer's cost-accounting methodology identified rental income of
13 $2,265,133 in contrast with the market analysis, which identified rental income of $1,771,601, or
14 a difference of 27.9 percent. Taxpayer does not necessarily dispute the striking difference
15 between the results but directs the Hearing Officer's attention to the subsequent years where
16 there is less disparity between the outcomes.

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

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

23 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; the difference in 2012 was $58,157; the difference in 2013 was $135,335; the difference in 2014 was $116,631; the difference in 2015 was $274,012; and the difference in 2016 was $122,885. 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, which as Ms. Rivera testified, was the best method available to her at the time of the audit. *See* FOF 75 – 78.

Once more, this Decision and Order should not be construed as endorsing or impugning any methodology. In fact, and once again, Ms. Rivera testified that she was amenable to considering other methodologies provided they were accompanied by supporting records. The Hearing Officer cannot now or at the time of the original decision fault the Department's reliance on IRS Forms 8825 when they represented the most trustworthy source of information.

Regulation 3.1.5.8 A NMAC, provides that "[t]he adequacy or inadequacy of taxpayer records is a matter of fact to be determined by the secretary or secretary's delegate." When, as in

this case, the Department determined Taxpayer's records to be inadequate, it concluded to compute Taxpayer's liability using alternative methods, which under Regulation 3.1.5.8 C (3) NMAC permitted reliance on "federal returns and other governmental reports" among other methods.

Under this structure, the Hearing Officer is persuaded that the most trustworthy information on the question of receipts deriving from rent was contained in the IRS Forms 8825. Federal income tax returns are typically prepared with considerable attention to detail and care and are signed under penalty of law, which to the Hearing Officer, enhances their reliability. Reliance on the forms may not represent a perfect method of computing Taxpayer's gross receipts tax liability, but as Ms. Rivera explained, they provided the best method at the time of audit, and the Hearing Officer is unable to find based on the evidence presented at the hearing that other methods presented by Taxpayer were superior.

For this reason, the Hearing Officer is unable to find that Taxpayer's methods were superior to the method employed by the Department in reliance on IRS Forms 8825. To the extent this decision might be read as suggesting the evidence is in equipoise, because none of the methods presented is beyond reproach, then Taxpayer's protest must be denied and the Department's assessment must stand. *See Gemini*, 2023-NMCA-039, ¶ 29.

To reiterate the sentiments expressed by Judge Sutin, "[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. In this case, the Department identified what it believed to be the best method given the information available to it. Taxpayer, as Judge Sutin observed, cannot now complain of the best methods used.

Taxpayer failed to persuade the Hearing Officer that it should prevail on the merits of its protest.

Penalty

The Court of Appeals did not consider the issue of penalty, but the issue will be addressed again since the Department's presumption of correctness extends to the imposition of penalty and interest. *See* Regulation 3.1.6.13 NMAC.

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. 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 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.

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 entitlement 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. "[D]etermining whether the taxpayer has overcome the presumption of correctness is the first step in resolving a tax protest, and that it will only be the last step if the taxpayer fails to overcome the presumption." *Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 23, 531 P.3d 622, 629.

G. "[T]he presumption of correctness assessment is made by the hearing officer in a purely legal capacity." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 25, 531 P.3d 622, 630.

H. "The regulation's call for 'some countervailing evidence' that 'tend[s]' to dispute the assessment, 3.1.6.12(A) NMAC, is merely a threshold requirement for evidence, and that evidence need not be credible or ultimately persuasive." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 25, 531 P.3d 622, 630.

I. "[T]he hearing officer's determination does not involve fact-finding tasks such as making credibility determinations and weighing evidence." *See Gemini Las Colinas, LLC v. New*

Mexico Taxation & Revenue Dep't, 2023-NMCA-039, ¶ 25, 531 P.3d 622, 630.

J. "[I]f the taxpayer has not overcome the presumption, the protest may simply be denied. In this scenario, there is no need for the department to present any evidence." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 23, 531 P.3d 622, 629.

K. "[I]f the taxpayer has overcome the presumption, the outcome of the protest, at that point, remains undetermined. The taxpayer has overcome its initial hurdle, but further legal and factual assessments remain before the hearing officer can determine whether to grant or deny the protest." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 23, 531 P.3d 622, 629.

L. "If the taxpayer rebuts the presumption, the department must be given an opportunity to present evidence to support its assessment, and the hearing officer may not grant or deny the protest without, at the very least, determining whether the department has carried its burden." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 24, 531 P.3d 622, 629–30.

M. "[I]f a taxpayer rebuts the presumption of correctness, the burden that shifts to the department is a burden of production." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 29, 531 P.3d 622, 631.

N. "[T]he burden that shifts to the department is a burden of production" and "the burden of persuasion is ultimately borne by the taxpayer." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 26, 531 P.3d 622, 630.

O. The "burden of production" is "evidence to justify [the Department's] assessment" as opposed to "ultimately prov[ing] the correctness of its assessment to the hearing

officer by a preponderance of evidence (burden of persuasion)." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 26, 531 P.3d 622, 630.

P. "To overcome this burden, the department must put forth evidence to show the correctness of its assessment—that is, evidence sufficient to make the correctness of the department's assessment a question of fact." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 29, 531 P.3d 622, 631.

Q. "Likewise, the existence of this burden means that the department cannot simply rely on the unreliability or incredibility of the taxpayer's evidence. Instead, the department must produce evidence to justify its assessment." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 29, 531 P.3d 622, 632.

R. "If the department's evidence creates a question of fact about the correctness of the assessment, it has fulfilled its burden of production, and the case is ripe for the hearing officer to resolve factual disputes and decide the protest on the merits." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 29, 531 P.3d 622, 632.

S. "[I]f the evidence is in equipoise, the hearing officer should deny the taxpayer's protest. Cf. UJI 13-304 NMRA (noting that "[e]venly balanced evidence is not sufficient" to carry the burden of persuasion)." *See Gemini Las Colinas, LLC v. New Mexico Taxation & Revenue Dep't*, 2023-NMCA-039, ¶ 29, 531 P.3d 622, 632.

T. 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.

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

V. "Every person required by the provisions of any statute administered by the

department to keep records and documents and every taxpayer shall maintain books of account or other records in a manner that will permit the accurate computation of state taxes or provide information required by the statute under which the person is required to keep records." *See* NMSA 1978, Section 7-1-10 (A).

W. "The adequacy of a taxpayer's books and records is a question of fact." *See* *Waldroop v. O'Cheskey*, 1973-NMCA-146, ¶ 5, 85 N.M. 736, 738, 516 P.2d 1119, 1121.

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: February 5, 2024

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 February 5, 2024, a copy of the foregoing Decision and Order on Remand was submitted to the parties listed below in the following manner:

First Class Mail *Interagency Mail*

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