

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

**IN THE MATTER OF THE PROTEST OF
DUSTIN R. & CLARISSA PTOLEMY
TO ASSESSMENT
ISSUED UNDER LETTER
ID NO. L1031807280**

No. 17-29

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on May 30, 2017 before Hearing Officer Chris Romero in Santa Fe, New Mexico. The Taxation and Revenue Department (Department) was represented by Mr. Marek Grabowski, Staff Attorney. Ms. Milagros Bernardo, Auditor, also appeared on behalf of the Department. Mr. Dustin R. Ptolemy and Mrs. Clarissa Ptolemy (Taxpayers) appeared in person and represented themselves. The Hearing Officer took notice of all documents in the administrative file. Department Exhibits A – C were admitted. The Taxpayers did not seek to introduce any exhibits. A more detailed description of exhibits submitted at the hearing is included on the Administrative Exhibit Coversheet. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On December 5, 2016 under Letter ID No. L1031807280, the Department assessed the Taxpayers for personal income tax, interest, and penalty for the periods from January 1, 2011 through December 31, 2015. The assessment was for \$5,710.00 in tax, \$1,028.68 in penalty, and \$307.28 in interest. [Dept. Ex. A; Testimony of M. Bernardo].
2. On February 15, 2017, the Taxpayers executed a formal protest letter which was received by the Department's Protest Office on February 28, 2017.
3. On March 13, 2017, the Department acknowledged the receipt of the Taxpayers' protest.

4. On April 26, 2017, the Department filed a Hearing Request asking that the Taxpayers' protest be scheduled for a formal administrative hearing.
5. On April 28, 2017, the Hearings Office issued a Notice of Administrative Hearing setting a hearing on the merits of the protest to occur on May 30, 2017. The hearing date was set within ninety days of the protest.
6. Taxpayers, Dustin R. Ptolemy and Clarissa Ptolemy, are married. They have been married since 2015 although they have been in a relationship during most of the periods in protest. They met at a dairy conference. [Testimony of Mr. Ptolemy].
7. Mr. Ptolemy was raised in agriculture and ranching. His parents own a feedlot and ranch in La Junta, Colorado. [Testimony of Mr. Ptolemy].
8. Since approximately age 10, Mr. Ptolemy raised cattle with his father. Mr. Ptolemy acquired knowledge in ranching and agriculture from his father. In addition to his ranching experience, his father has a degree in animal nutrition from Colorado State University and is also a drug representative for an animal pharmaceutical company. [Testimony of Mr. Ptolemy].
9. Mr. Ptolemy has an associate's degree in animal science and equine science. He interned for a veterinarian. [Testimony of Mr. Ptolemy].
10. Mr. Ptolemy also attended New Mexico State University on a rodeo scholarship where he earned a degree in finance. [Testimony of Mr. Ptolemy].
11. After graduating from NMSU in December of 2010, Mr. Ptolemy commenced employment with Farm Credit of New Mexico where he remained employed until 2017. [Testimony of Mr. Ptolemy].
12. In 2011, Mr. Ptolemy acquired and maintained cattle in Colorado and New Mexico. He devoted approximately 10 hours per week to his agricultural and ranching activities, not including

travel time to and from La Junta, Colorado to attend to his Colorado herd. General ranching tasks included branding, vaccination, and shipping. [Testimony of Mr. Ptolemy].

13. The cattle were raised for consumption, although some were leased for roping. However, even those cattle leased for roping were eventually sold for consumption. [Testimony of Mr. Ptolemy].

14. Mr. Ptolemy acknowledged that he purchased inexpensive cattle, and at least with concern for the New Mexico herd, kept them on below-average land because that is what he could afford at the time. The cattle maintained in Colorado were maintained on his family's property. [Testimony of Mr. Ptolemy].

15. Ultimately, the cattle were sold at a loss. Mr. Ptolemy acknowledged that 2011 was a learning experience. Tax year 2011 was the first year Mr. Ptolemy filed a Schedule F as a resident of New Mexico. [Testimony of Mr. Ptolemy].

16. In hindsight, Mr. Ptolemy acknowledged that for years 2011 through a portion of 2013, he did not have the time or financial resources to run a profitable cattle operation. [Testimony of Mr. Ptolemy].

17. During 2012 and a portion of 2013, Mr. Ptolemy's agricultural and ranching activities were limited. His activities were restricted by his financial resources and the confines of the properties on which he was residing, although he continued to engage in his agricultural and ranching endeavors. [Testimony of Mr. Ptolemy].

18. Beginning in 2013 and through a portion of 2015, Mr. Ptolemy made adjustments to his agriculture and ranching strategy. Taxpayers began acquiring and raising Jersey/Holstein Cross calves. Calves were purchased at 100 pounds with the goal of making a profit when they could be resold at 300 to 400 pounds. [Testimony of Mr. Ptolemy].

19. Raising the calves was time intensive. Taxpayers devoted many hours per day to bottle feeding them and other tasks associated with raising them. The calves were inexpensive but required a lot of work because they were small and weak. [Testimony of Mr. Ptolemy].

20. An integral element of Taxpayers' strategy was to sell the calves when they reached 300 to 400 pounds in weight. Raising the calves beyond that range required more resources than the Taxpayers could afford. [Testimony of Mr. Ptolemy].

21. The strategy worked well until Taxpayers experienced a decrease in the price of cattle. Taxpayers' operation was profitable through most of 2014, until a downturn in the cattle market eliminated profits. [Testimony of Mr. Ptolemy].

22. After the downturn in the market in 2014, Mr. Ptolemy modified his strategy. He shifted his focus to breeding cattle. Mr. Ptolemy carefully considered various strategies before settling on breeding cattle. [Testimony of Mr. Ptolemy].

23. Oftentimes, the evaluation of various strategies was influenced by Taxpayers' available financial resources. [Testimony of Mr. Ptolemy].

24. In 2015, Mr. Ptolemy took out a loan to purchase 37 Angus heifers and two bulls with the intention of starting a cattle breeding operation. Mr. Ptolemy did not derive any significant income from his agricultural and ranching activities in 2015, but incurred all of the expenses of his purchase and other necessary expenses to establish his breeding operation. However, the herd did not produce any calves that year. [Testimony of Mr. Ptolemy].

25. Mr. Ptolemy was not required by his lender to provide a written business plan as part of obtaining his loan to purchase his cattle. This is not uncommon based on Mr. Ptolemy's experience in agriculture-based banking. [Testimony of Mr. Ptolemy].

26. Taxpayers have not filed their 2016 tax returns yet. All indications are that 2016 is profitable, but adjustments have not yet been made for depreciation. [Testimony of Mr. Ptolemy].

27. During all periods of time subject of the assessment, Mr. Ptolemy worked fulltime at Farmers Credit of New Mexico and devoted no less than 10 hours per week to his agricultural and ranching activities, with the number of hours increasing to as many as 20 hours per week.

[Testimony of Mr. Ptolemy].

28. From 2012 through 2015, Mrs. Ptolemy also devoted no fewer than 20 to 25 hours per week on average to the agriculture and ranching activities. [Testimony of Mrs. Ptolemy].

29. During the relevant periods of time, Taxpayers bought, sold, and leased property which has been used for their agricultural and ranching purposes. They have also made improvements to land for the benefit of their ranching activities which they have then placed for sale with the desire to make a profit. [Testimony of Mr. Ptolemy].

30. Taxpayers have also invested in equipment. On one occasion, Mr. Ptolemy purchased a used tractor which increased in value. The tractor was purchased at fair market value in Arkansas. However, the fair market value for the tractor in New Mexico was higher, and the Taxpayers realized an appreciation of value in the tractor. [Testimony of Mr. Ptolemy].

31. During all relevant periods, Taxpayers have employed the services of an accountant based in La Junta, Colorado. Mr. Ptolemy could not describe her qualifications to provide tax advice and could not recall any specific discussion they had regarding the subject of Taxpayers' protest. [Testimony of Mr. Ptolemy].

32. On March 10, 2017, Mr. Ptolemy left his career in banking to pursue his agricultural and ranching endeavors on a fulltime basis. Taxpayers sold their home and committed all of their financial resources to the purchase of an old dairy facility that they are now converting to a feedlot. [Testimony of Mr. Ptolemy].

33. In addition to Mr. Ptolemy's income from employment, Taxpayers have also had some income derive from an investment Mr. Ptolemy made in a local welding business operated by a friend, and Mrs. Ptolemy's part-time work in cosmetology. [Testimony of Mr. Ptolemy].

34. Mr. Ptolemy estimated paying approximately \$100,000 in income from his employment toward Taxpayers' ranching activities during the years in protest. [Testimony of Mr. Ptolemy].

35. Mr. Ptolemy maintains his ranching records separately from his family's personal records. [Testimony of Mr. Ptolemy].

36. Although Mr. Ptolemy derives pleasure from ranching, pleasure is not derived without incurring significant amounts of pressure and stress. [Testimony of Mr. Ptolemy].

37. Mr. Ptolemy is involved in various agriculture and ranching associations, including the New Mexico Cattlegrower's Association. He also has participated in the New Mexico Agricultural Leadership Program, and has taken various animal handling classes. In addition to educational benefits of such activities, Mr. Ptolemy also engages in the activities for networking opportunities. [Testimony of Mr. Ptolemy].

38. In 2011, Mr. Ptolemy asserted a farm loss of \$4,718.00. The department denied the deduction and assessed \$227.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A].

39. In 2012, Mr. Ptolemy asserted a farm loss of \$11,497.00. The Department denied the deduction and assessed \$563.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A].

40. In 2013, Mr. Ptolemy asserted a farm loss of \$18,198.00. The Department denied the deduction and assessed \$892.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A].

41. In 2014, Mr. Ptolemy asserted a farm loss of \$24,373.00. The Department denied the deduction and assessed \$1,195.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A].

42. In 2015, Mr. Ptolemy asserted a farm loss of \$55,220.00. The Department denied the deduction and assessed \$2,833.00 in personal income tax. [Testimony of Ms. Bernardo; Dept. Ex. A].

43. Taxpayers' ranching activities were not profitable during any year subject of the protest. [Testimony of Ms. Bernardo; Dept. Ex. B].

44. As of May 30, 2017, the Taxpayers' updated liability was \$5,710.00 in personal income tax, \$1,142.00 in penalty, and \$419.24 in interest for a total due of \$7,271.24. [Testimony of Ms. Bernardo; Dept. Ex. C].

DISCUSSION

The issue to be decided is whether the Taxpayers are liable for the assessment. The determination pivots on whether the Taxpayers' ranching activities should be considered a for-profit business or not under 26 USC Sec. 183. The Taxpayers acknowledge that their ranching activities have never been profitable although they express optimism that they might begin to realize a profit in 2016. In the absence of a for-profit motivation, the Department argues the Taxpayers are precluded from offsetting their ranching expenses.

However, the Department expressed reluctance during its closing argument to assert that the Taxpayers had failed to establish a profit motive beginning with tax year 2013, the year in which they began raising Jersey/Holstein Cross calves, through 2015. The Department's reluctance, based on the evidence presented, was reasonable.

Burden of Proof.

Assessments by the Department are presumed to be correct. *See* NMSA 1978, Sec. 7-1-17. Tax includes, by definition, the amount of tax principal imposed and, unless the context otherwise requires, "the amount of any interest or civil penalty relating thereto." NMSA 1978, Sec. 7-1-3. *See also El Centro Villa Nursing Ctr. v. Taxation and Revenue Department*, 1989-NMCA-070, 108 N.M. 795. Therefore, the assessment issued to the Taxpayers is presumed to be correct, and it is the

Taxpayers' burden to present evidence and legal argument to show that they are entitled to an abatement.

The burden is on the Taxpayers to prove that they are entitled to an exemption or deduction. *See Public Service Co. v. N.M. Taxation and Revenue Dep't.*, 2007-NMCA-050, ¶ 32, 141 N.M. 520. *See also Till v. Jones*, 1972-NMCA-046, 83 N.M. 743. "Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer." *Sec. Escrow Corp. v. State Taxation and Revenue Dep't.*, 1988-NMCA-068, ¶ 8, 107 N.M. 540. *See also Wing Pawn Shop v. Taxation and Revenue Dep't.*, 1991-NMCA-024, ¶ 16, 111 N.M. 735. *See also Chavez v. Commissioner of Revenue*, 1970-NMCA-116, ¶ 7, 82 N.M. 97.

Personal Income Tax.

New Mexico imposes a personal income tax upon the net income of every resident. *See* NMSA 1978, Sec. 7-2-3 (1981). New Mexico's adjusted gross income is based on the person's federal adjusted gross income. *See* NMSA 1978, Sec. 7-2-2 (2014). However, the Department has the authority to examine and recalculate a person's taxable income. *See Holt v. N.M. Dep't. of Taxation and Revenue*, 2002-NMSC-034, ¶ 23, 133 N.M. 11.

The parties agree that the Taxpayers' taxable income with respect to the amount of the assessment hinges upon whether the Taxpayers are allowed to deduct their losses from their ranching activities. There is a federal deduction for expenses incurred while engaging in any trade or business. *See* 26 USCS Sec. 162. However, the deduction of losses in excess of profits is disallowed when the activity engaged in is not a for-profit activity. *See* 26 USCS Sec. 183.

For-Profit Activities.

Federal regulations provide nine nonexclusive factors to aid in determining whether an activity is a for-profit activity or not. *See* 26 CFR 1.183-2. These factors are: 1) the manner in which the person carries on the activity; 2) the expertise of the person and his or her advisors; 3) the time and effort put into the activity; 4) the expectation that assets may appreciate in value; 5) the person's success in carrying on similar or dissimilar activities; 6) the history of income or loss with respect to the activity; 7) the amount of profits earned; 8) the financial status of the person; and 9) the elements of personal pleasure and recreation. *See id.*

1) The manner in which the person carries on the activity.

The manner in which a person engages in an activity has to do with the formality and normal business practice used. *See id.* There was no evidence that the Taxpayers had a formal written business plan for their ranching activities or cattle sales. However, the Hearing Officer was persuaded that although the Taxpayers' business plan was unwritten, Mr. Ptolemy credibly articulated a plan that had been carefully considered, and remained subject to reconsideration and further scrutiny as required by market variables.

Mr. Ptolemy's breadth of knowledge in ranching was impressive. It was apparent to the Hearing Officer that Mr. Ptolemy's plan, although unwritten, existed since at least 2011. The plan required that Mr. Ptolemy begin his cattle operation with his existing resources which as early as 2011 and 2012, were admittedly minimal. Although Mr. Ptolemy would reflect during the hearing that he lacked the resources to be profitable in the years 2011 through 2013, the Hearing Officer was persuaded that he did not also lack the motive to be profitable. His motive was apparent as he reevaluated and reconsidered various strategies for increasing his profits. His plan would eventually evolve into the ranching activity that the Department would nearly concede during closing arguments as being profit motivated.

Although there was no evidence that the Taxpayers maintained separate bank accounts for the cattle operation, there was evidence that Taxpayers maintained separate records and a spreadsheet for their ranching income and expenses. Taxpayers' accounting methods are also advancing, as Mr. Ptolemy said he is preparing to implement new accounting software to improve his record keeping.

Compare the matter at hand with *Hrdlicka v. Commissioner of Internal Revenue*, T.C. Memo 1985-503, 1985 Tax Ct. Memo Lexis 236, 50 T.C.M (CCH) 675, T.C.M. (RIA 85403), in which the court found this first factor to weigh against the taxpayer. In that case, the court recognized that the taxpayer kept records on each animal, but did not adhere to a strategy to sell calves when a reasonable profit potential could be realized. While the opinions of professionals with whom the taxpayer in *Hrdlicka* consulted had projected that the operation had profit potential, the court recognized that taxpayer did not make any serious effort to reverse the losses that the cattle operation was suffering. In this case, the Hearing Officer was persuaded that the evolution of Taxpayers' unwritten business plan over the years was intended to maximize profit potential, and reverse the losses that Taxpayers' operation had been enduring, unlike the situation observed in *Hrdlicka*.

Taxpayers' facts are analogous to *Mullins v. U.S.A.*, 334 F.Supp.2.d 1042 (D.Tenn 2004) in which the court, finding in favor of the taxpayer, recognized that the taxpayer's experimentation was intended to improve profitability, and demonstrated profit motivation. As in *Mullins*, Taxpayers in the present case have constantly reevaluated their operation and adapted their plans to improve profitability and reverse losses, which the Hearing Officer found to be persuasive in demonstrating their profit motivation.

Also similar to *Mullins* is the issue regarding the separation of bank accounts and maintenance of records. The court in *Mullins* observed that the taxpayer did not maintain separate bank accounts. However, it noted that the taxpayer maintained records to separate his personal finances from the finances of the cattle operation. Accordingly, the court did not disapprove of the

taxpayer maintaining a single account where the taxpayer maintained proper records. Similar to *Mullins*, the Taxpayers did not indicate that they maintained a ranching account separate from their personal account, but Mr. Ptolemy did explain his accounting method that consisted of maintaining a spreadsheet itemizing the finances of the cattle operation.

The Hearing Officer was persuaded that the Taxpayers in the present protest adhered to a business plan, although unwritten, to improve profit potential. Mr. Ptolemy credibly articulated strategies and activities to reverse the losses that the cattle operation was incurring. There was also evidence that the Taxpayers kept track of their expenses and maintained records as would be expected from an activity pursued with the formality or practices of a profit-motivated business. Based upon the totality of the evidence, this factor weighs in favor of finding that the operation was intended for-profit.

2) The expertise of the person and his or her advisors.

Preparation, study, and consultation of experts can indicate that the activity is engaged in for-profit. *See id.* As previously explained, Mr. Ptolemy's knowledge in ranching was impressive. In addition to his informal education in agriculture and ranching, he has an associate's degree in animal science and equine science and experience as an intern in veterinary medicine. Although his bachelor's degree is in finance, he applied his degree in the area of agriculture and ranching through his employment with Farm Credit of New Mexico. Accordingly, his experience extends from the range to the bank and his qualifications indicate that he is well-suited to manage a successful cattle operation.

Mr. Ptolemy is also a member of various agriculture and ranching organizations, such as the New Mexico Cattlegrower's Association, and has participated in animal handling classes and the New Mexico Agricultural Leadership Program. He also attends agriculture and ranching conferences.

The benefits, as Mr. Ptolemy explained, are educational in addition to increased networking opportunities.

Mr. Ptolemy has also relied on the services of professionals, for example, in the areas of veterinary medicine and artificial insemination which are incurred at a cost to Taxpayers.

Compare the facts to *Hrdlicka*, in which the court found that this factor would weigh against the taxpayer. In *Hrdlicka*, the court determined that the taxpayer consulted with his father-in-law and others who had extensive experience in farming and ranching in the initial planning phases of commencing his operation. However, the taxpayer in *Hrdlicka* did not continue to seek expert advice during the course of the operations or hire specialized workers to help manage the ranch.

In contrast, the court in *Mullins* found this factor to weigh in favor of the taxpayer. In *Mullins*, the court observed that the taxpayer regularly sought the advice of experts in ranching, regularly read ranching publications, attended seminars and meetings of ranching associations, and received regular assistance from the local agriculture extension agent and veterinarian.

Analogous to *Mullins*, Mr. Ptolemy has regularly engaged the services of professionals, including veterinarians, and regularly avails himself of educational and networking opportunities through various organizations and programs focusing on agriculture and ranching. He has incurred costs in acquiring the services of artificial insemination specialists with the intention of maximizing profits through improving the genetic qualities of his cattle. This factor weighs in favor of finding that the activity was for-profit.

3) The time and effort put into the activity.

With respect for the time and effort expended by the Taxpayers in carrying on the activity, the evidence established that Taxpayers spend significant time personally attending to the ranching activities. In reflecting on the early years of his operation, Mr. Ptolemy acknowledged, in hindsight, that he lacked the necessary time to devote to making his cattle operation profitable. Mr. Ptolemy

was working fulltime and devoted 10 hours per week to his operation, not including travel time to and from La Junta, Colorado where he maintained some of his cattle. Those hours increased over the audit period to as many as 20 hours per week, with Mrs. Ptolemy also contributing an additional 20 to 25 hours per week beginning in 2012. As of 2015, Taxpayers were devoting more than 40 hours per week on average to their cattle operation. Although 2016 and 2017 are not subject of the protest, it is illustrative of Taxpayers' motives to also recognize that they are now devoted fulltime to their ranching activities. Mr. Ptolemy recently left his employment with Farm Credit of New Mexico to devote his full attention to his cattle operation. Mrs. Ptolemy continues to work in cosmetology on a part-time basis, but that schedule is also dictated by the demands of the cattle operation to which she also devotes significant amounts of time. This factor weighs in favor of finding that the activity is for-profit.

4) The expectation that assets may appreciate in value.

There was no evidence to establish that Taxpayers' herd has increased in size or appreciated in value, although the desire for growth and appreciation is contained in Mr. Ptolemy's informal business plan. Mr. Ptolemy credibly testified that his intentions during all years in protest were to acquire cattle at a reasonable cost and raise them to a weight where they could be sold at a profit. He explained the expectation that profit potential, and the value of his cattle will fluctuate based on a number of market variables. Mr. Ptolemy also acknowledged that maximizing profit potential has also sometimes been limited by Taxpayers' resources.

It is not uncommon or unreasonable to find that a new business' growth will be limited by the resources available to it. Despite Taxpayers' limited resources, Mr. Ptolemy demonstrated impressive knowledge of market variables and strategies, and an ability to adapt to them with limited resources. Given the foregoing, there is a possibility that the cattle will appreciate in value, depending on market variables. There is also a likelihood that the herd will increase in size.

Taxpayer has also bought land, made improvements to land, and resold land as his operation has evolved since 2011. Although there was no evidence that Taxpayers made any significant profit from the sale of land, Mr. Ptolemy expressed knowledge for the value of the improvements he has made to property which he has utilized in his operation, and the desire to obtain a profit from its sale.

Taxpayers have also benefited from appreciation of equipment. On one occasion, Mr. Ptolemy located and purchased a used tractor in Arkansas. The fair market value of the tractor in Arkansas was less than the fair market value of the same tractor in New Mexico. He purchased the tractor in Arkansas and returned it to New Mexico where its value increased.

This factor weighs in favor of finding that the activity is for-profit.

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

With respect to the success of the Taxpayers in carrying on other similar or dissimilar business activities, this factor potentially weighs against finding that the activity is for-profit, because although Taxpayers' have experience in ranching, there is a lack of evidence to establish that the activity has ever been successful from a profit perspective. Nor is there evidence to establish that Taxpayers have any experience in operating a profitable business activity, unlike in *Mullins*, where the court recognized the taxpayer as a successful businessman of more than 25 years before commencing his ranching activities.

On the other hand, Taxpayers are in the start-up phase of their operation which commenced after Mr. Ptolemy graduated from NMSU in December of 2010. The first period in protest begins January 1, 2011. The Hearing Officer was persuaded that the lack of evidence to establish a track record of success derives from an insufficient opportunity to establish such track record. The Hearing Officer is not inclined to penalize the Taxpayers for a lack of immediate success and therefore finds that this factor neither favors nor disfavors a finding that the activity is intended for profit.

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

The Taxpayers have a brief history of losses with respect to their ranching activities and cattle sales. However, that history coincides with the start-up phase of Taxpayers' cattle operation. As pointed out in the previous section, Mr. Ptolemy graduated from NMSU in December of 2010. The first period in protest began on January 1, 2011.

It is not unusual for a business to experience substantial losses and little profits when it is in a start-up phase, and it can take several years to increase the size of a herd, or make a profit given the volatility of a market and its variables.

Hrdlicka is instructive because it found that a history of losses with a lack of corrective efforts was inconsistent with a profit motivation. In contrast, the taxpayer in *Mullins* also had a history of cumulative losses, but the court found the evidence sufficient to be persuaded that the taxpayer had an actual and honest intention to make a profit, which included making adjustments to the business plan to increase profit potential.

Over the course of the period in protest, Taxpayers have reassessed and modified their strategy to address their history of losses. That history, however, also overlaps with the start-up phase of the cattle operation. As stated in the previous section, the Hearing Officer is not inclined to penalize the Taxpayers' for a lack of immediate success. Similar to the logic in *Mullins*, the Hearing Officer was persuaded that the Taxpayers had an actual and honest intention to make a profit, which included making adjustments to the business plan to increase profit potential. The Hearing Officer finds that this factor neither favors nor disfavors a finding that the activity is intended for profit.

7) The amount of profits earned.

Mr. Ptolemy acknowledged that the cattle operation has not been profitable. As stated in the previous section however, it is not unusual for a business to experience substantial losses and little profits when it is in a start-up phase, and it can take several years to realize a profit. Mr. Ptolemy credibly testified that Taxpayers' operation may have been profitable in 2016, although he has yet to

close the books on the year. In fact, he has left his employment in order to devote all of his attention and efforts to the cattle operation. It would be unlikely that Mr. Ptolemy would leave his employment to concentrate on his cattle operation if he had an expectation of incurring further losses.

The Hearing Officer is once again not inclined to penalize the Taxpayers' for a lack of immediate success. Based on the foregoing, the Hearing Officer finds this factor to be neutral because the Taxpayers have not had a sufficient opportunity to establish a history of profits.

8) The financial status of the person.

Taxpayers during the relevant period of time were not reliant on the ranching activity for their livelihood. Instead, the Taxpayers relied on their income from employment for their support. Mr. Ptolemy also explained that, as personal finances allowed, he invested his extra money into the initial phases of the cattle operation.

The operation has evolved from 2011, as would be expected in the start-up phase of a business. At the present time, Mr. Ptolemy is no longer employed and is devoting all of his efforts to the cattle operation. This factor weighs in favor of finding that the activity is for-profit.

9) The elements of personal pleasure and recreation.

Mr. Ptolemy spoke fondly of ranching. He also acknowledged tremendous amounts of stress that accompanies the cattle operation. Although it is not uncommon for one to enjoy their work, whether motivated by profit or not, the evidence established that Mr. Ptolemy's motivations are not strictly for pleasure. He has experienced moderate to severe stress which has diminished the pleasure of the cattle operation at times. This factor weighs in favor of finding that the activity is for-profit.

Summary of Factors

Six of the nine factors weigh in favor of finding that the Taxpayers are engaged in their ranching activities for-profit. The remaining three factors are neutral, but even had the Hearing Officer weighed them against the Taxpayer, the majority of the factors continue to favor a finding

that the Taxpayers' have engaged in their agriculture and ranching activities with a motive to make a profit. Therefore, the Department's disallowance of the deduction was not reasonable, and the Taxpayers overcame the presumption that the assessment is correct. *See* NMSA 1978, Sec. 7-1-17.

As previously stated, the Department hesitated at the conclusion of the hearing to assert that the Taxpayers' operation for 2013 through 2015 was not motivated by profit. The Hearing Officer agrees that the Department's hesitation, in light of the evidence, was justified and reasonable. Counsel for the Department is complimented for acknowledging the strengths and weakness of the evidence in this protest.

Even if the Department outright conceded its position on the issue of profit motivation for tax years 2013 through 2015, the Hearing Officer views those activities as evolving directly from the activities in 2011 and 2012. For that reason, it would be irrational to consider 2011 and 2012 apart from 2013, 2014, and 2015. Without qualm, the activities in 2011 and 2012, even if untried or inexperienced, developed into the activities that the Department reasonably acknowledged were supported by evidence of profit motivation.

The Hearing Officer finds that Taxpayers' protest should be granted because the Taxpayers have established that the agriculture and ranching activities in which they were engaged during every year in protest under the assessment were motivated by profit. The Taxpayers' protest should be granted and the tax principal, penalty, and interest for those periods in protest should be abated.

CONCLUSIONS OF LAW

A. The Taxpayers filed a timely written protest to assessment issued under Letter ID No. L1031807280, and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing in this matter was held within the requisite 90 days from the date the protest was received as required by NMSA 1978, Sec. 7-1B-8 (A).

C. The Taxpayers' ranching activities were engaged in as a for-profit activity. *See* 26 CFR 1.183-2. Therefore, the deductions are properly allowed. *See* 26 USCS Sections 162 and 183. *See also* NMSA 1978, Sections 7-2-2 and 7-2-3.

D. The Taxpayers overcame the presumption of correctness. *See* NMSA 1978, Sec. 7-1-17.

For the foregoing reasons, the Taxpayers' protest is **GRANTED. IT IS ORDERED** that the assessed tax, penalty, and interest are abated.

DATED: June 21, 2017



Chris Romero
Hearing Officer
Administrative Hearings Office
P.O. Box 6400
Santa Fe, NM 87502

NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), the parties have the right to appeal this decision by *filing a notice of appeal with the New Mexico Court of Appeals* within 30 days of the date shown above. If an appeal is not timely filed with the Court of Appeals within 30 days, this Decision and Order will become final. Rule of Appellate Procedure 12-601 NMRA articulates the requirements of perfecting an appeal of an administrative decision with the Court of Appeals. Either party filing an appeal shall file a courtesy copy of the appeal with the Administrative Hearings Office contemporaneous with the Court of Appeals filing so that the Administrative Hearings Office may begin preparing the record proper. The parties will each be provided with a copy of the record proper at the time of the filing of the record proper with the Court of Appeals, which occurs within 14 days of the Administrative Hearings Office receipt of the docketing statement from the appealing party. *See* Rule 12-209 NMRA.

