

BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST
OF KAY E. RAINES
ID No. 02-381427-00-6
ASSESSMENT NO. 2280401

No. 00-18

DECISION AND ORDER

A formal hearing on the above-referenced protest was held June 8, 2000, before Margaret B. Alcock, Hearing Officer. Kay Raines ("Taxpayer") was represented by Charles E. Buckland, Esq. The Taxation and Revenue Department ("Department") was represented by Javier Lopez, Special Assistant Attorney General. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. James A. and Kay E. Raines were married on March 17, 1994.
2. The Raines, who had known each other for ten years prior to their marriage, continued to maintain separate bank accounts and credit card accounts, but did not enter into any property agreement concerning the character of their property or earnings.
3. Both before and during the marriage, Kay Raines worked full-time as an employee of J. C. Penney.
4. Both before and during the marriage, James Raines engaged in business as an independent contractor installing appliances. Kay Raines never participated in James Raines' business activities.
5. From their respective earnings, James and Kay Raines each paid one-half of the couple's living expenses, including mortgage payments on their house, utilities and groceries.

6. Kay Raines was involved in preparing the couple's 1994 federal income tax return, which included a Schedule C, *Profit or Loss From Business*, reporting \$26,192 of gross receipts from James Raines' business.

7. James Raines did not report or pay New Mexico gross receipts tax on his 1994 business income.

8. On January 7, 1996, James Raines died.

9. On August 6, 1998, the Department issued Assessment No. 2280401 to James A. and Kay E. Raines in the amount of \$2,454.96, representing gross receipts tax, penalty and interest due on Mr. Raines' business income for tax periods January-December 1994.

10. On October 2, 1998, pursuant to an extension of time granted by the Department, Kay Raines filed a written protest to the Department's assessment.

DISCUSSION

The issue to be decided is whether Kay Raines is liable for gross receipts tax on the business income of her husband, James Raines, who died more than two years prior to the date of the Department's assessment. The Taxpayer raises the following arguments in support of her protest:

(1) Kay Raines cannot be liable for gross receipts tax because she never participated in her husband's business or personally engaged in business in New Mexico;

(2) If Kay Raines is found to have engaged in business, she is entitled to the exemption provided in Section 7-9-28 NMSA because her business activities were isolated and occasional;

(3) the Department is barred from collecting the gross receipts tax because: (a) the Department failed to file a claim against James Raines' estate; (b) the value of James Raines' estate was less than the amount of the family and personal property allowances provided by New Mexico

law; and (c) James Raines' death severed the community and so there is no community property from which the tax can be collected;

(4) the Department's failure to promptly set a hearing on Ms. Raines' protest bars the Department from pursuing collection of the protested assessment; and

(5) Kay Raines is an innocent spouse as defined in the Internal Revenue Code and is entitled to equitable relief from payment of the taxes assessed against her husband's income.

Any assessment of tax by the Department is presumed to be correct. Section 7-1-17(C) NMSA 1978. Accordingly, it is the Taxpayer's burden to present evidence and legal authority to overcome this presumption. *Archuleta v. O'Cheskey*, 84 N.M. 428, 431, 504 P.2d 638, 641 (Ct. App. 1972); *Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 741, 809 P.2d 649, 655 (Ct. App. 1991).

(1) Liability for Gross Receipts Tax on a Spouse's Business Income. Kay Raines maintains she cannot be liable for gross receipts tax because she never participated in her husband's business or personally engaged in business in New Mexico. This argument overlooks the statutory definition of "taxpayer", which includes "a person liable for payment of any tax." Section 7-1-3(V) NMSA 1978. Regulation 3 NMAC 1.1.13 provides:

A person who fits the definition of "taxpayer" under the provisions of Section 7-1-3(V) but who has not registered or been identified under provisions of Section 7-1-12 is nonetheless a "taxpayer" subject to the provisions of the Tax Administration Act.

Section 7-1-17 NMSA 1978 requires the Department to issue an assessment once it "determines that a taxpayer is liable for taxes in excess of ten dollars (\$10.00) that are due and have not been previously assessed to the taxpayer..." The issue, then, is not whether Kay Raines personally engaged in business, but whether she is liable for payment of gross receipts tax due on the income generated from her husband's business activities.

New Mexico courts have consistently held that income earned from the labor of either spouse during marriage is community property. This is true even when the business which generates the income is the separate property of one of the spouses. More than sixty years ago, the New Mexico Supreme Court held that “the community owns the earning power of the husband, and when it is used in the conduct of his separate business, the portion of the earnings attributable to his personal activities and talent is community property.” *Katson v. Katson*, 43 N.M. 214, 217, 89 P.2d 524, 526 (1939). *See also, Laughlin v. Laughlin*, 49 N.M. 20, 33, 155 P.2d 1010, 1018 (1944) (the labor of the parties belongs to the community rather than to the individuals); *DeTevis v. Aragon*, 104 N.M. 793, 798, 727 P.2d 558, 563 (Ct. App. 1986) (earnings attributable to labor and talent of spouses during marriage are community property).

Gross receipts tax due on community earnings is a community debt. Section 40-3-9 NMSA 1978 defines a "community debt" as “a debt contracted or incurred by either or both spouses during marriage which is not a separate debt.” A “separate debt” is defined as follows:

- (1) a debt contracted or incurred by a spouse before marriage or after entry of a decree of dissolution of marriage;
- (2) a debt contracted or incurred by a spouse after entry of a decree entered pursuant to Section 40-4-3 NMSA 1978, unless the decree provides otherwise;
- (3) a debt designated as a separate debt of a spouse by a judgment or decree of any court having jurisdiction;
- (4) a debt contracted by a spouse during marriage which is identified by a spouse to the creditor in writing at the time of its creation as the separate debt of the contracting spouse;
- (5) a debt which arises from a tort committed by a spouse before marriage or after entry of a decree of dissolution of marriage or a separate tort committed during marriage; or
- (6) a debt declared to be unreasonable pursuant to Section 2 [40-3-10.1 NMSA 1978] of this act.

The gross receipts tax liability at issue in this case arose from Mr. Raines’ 1994 business activities.

For the period January 1 1994 through March 16, 1994, the income from the business was Mr.

Raines' separate property and the tax imposed on that income was his separate debt. Beginning with the date of his marriage, the income earned from the business was community property, and the gross receipts tax imposed on Mr. Raines' income for the period March 17, 1994 through December 31, 1994 was a community debt for which both spouses were liable.

(2) **Isolated and Occasional Sales.** Ms. Raines argues that if she is found to have engaged in business in New Mexico, her business activities were isolated and occasional and she is entitled to the exemption from gross receipts tax provided in Section 7-9-28 NMSA 1978. As discussed in Section (1), above, Ms. Raines' liability for gross receipts tax is based on the community character of the income earned by her husband. There is no evidence that James Raines' appliance installation services were isolated or occasional, and the exemption provided in Section 7-9-28 NMSA 1978 does not apply to the income from those services.

(3) **Effect of James Raines' Death on the Department's Collection Activities.** Ms. Raines maintains the Department is barred from collecting the gross receipts tax because: (a) the Department failed to file a claim against James Raines' estate; (b) the value of James Raines' estate was less than the family and personal property allowances provided by New Mexico law; and (c) James Raines' death severed the community and so there is no community property from which the tax can be collected.

(a) *Failure to File a Claim.* At the hearing, the Department maintained that its failure to file a claim against the estate of James Raines was not relevant because the Department is pursuing collection only against Ms. Raines. The failure to file a claim is relevant, however, to determining what property now held by Kay Raines is subject to payment of the couple's community tax debt.

Section 40-3-11 NMSA 1978 sets out the following priorities for the satisfaction of community debts while both spouses are living:¹

A. Community debts shall be satisfied first from all community property and all property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common, excluding the residence of the spouses. Should such property be insufficient, community debts shall then be satisfied from the residence of the spouses, except as provided in Subsection B of this section or Section 42-10-9 NMSA 1978. Should such property be insufficient, only the separate property of the spouse who contracted or incurred the debt shall be liable for its satisfaction. If both spouses contracted or incurred the debt, the separate property of both spouses is jointly and severally liable for its satisfaction.

Prior to James Raines' death, his one-half interest in community property and all of his separate property was liable for payment of gross receipts tax due on his business income. Kay Raines' one-half interest in community property was also subject to payment of the tax. Ms. Raines' separate property could not have been reached by the Department because she did not incur the tax debt attributable to the business activities of her husband.

After James Raines' death in January 1996, collection of the Raines' community debts became subject to the provisions of New Mexico's Uniform Probate Code. Section 45-2-805 NMSA 1978 establishes the following priorities for satisfaction of community debts and the separate debts of a deceased spouse:

B. Upon the death of either spouse, the entire community property is subject to the payment of community debts. The deceased spouse's separate debts and funeral expenses and the charge and expenses of administration are to be satisfied first from his separate property, excluding property held in joint tenancy. Should such property be insufficient, then the deceased spouse's undivided one-half interest in the community property shall be liable.

¹ Section 40-3-11(D) NMSA 1978 states: "This section shall apply only while both spouses are living and shall not apply to the satisfaction of debts after the death of one or both spouses."

Section 45-3-803 NMSA 1978 states that all claims against a decedent's estate "including claims of the state and any subdivision of the state" are barred against the estate, the personal representative and the heirs and devisees of the decedent unless presented within the time limits set out in the statute. Although claims may be cut off earlier if actual notice is given to creditors, all claims are barred if not presented within one year of the decedent's death. Because the Department failed to file its claim for gross receipts tax against the estate of James Raines, his separate property and his one-half interest in community property is no longer subject to payment of the tax. Nor is the property Kay Raines received as an heir or devisee of her husband's estate subject to payment of the tax.

(b) Family and Personal Property Allowances. Ms. Raines argues that the Department is barred from collecting the gross receipts tax because the value of James Raines' estate was less than the amount of the family and personal property allowances provided in the Uniform Probate Code. Pursuant to Sections 45-2-402 and 45-2-403 NMSA 1978, a decedent's surviving spouse is entitled to a family allowance of \$30,000 and a personal property allowance of \$10,000. Both of these allowances are exempt from and have priority over all claims against the decedent's estate. Accordingly, even if the Department had a legitimate claim against James Raines' estate, the Department could not collect payment from property used to satisfy Kay Raines' family and personal property allowances.

(c) Severance of the Community. Although the Department is barred from taking collection action against property that passed to Kay Raines from her husband's estate, the Department may collect the gross receipts tax from Kay Raines' own interest in community property. Section 45-2-805 NMSA 1978 states that upon the death of either spouse "one-half of the community property belongs to the surviving spouse, and the other half is subject to the testamentary disposition of the

decedent....” The surviving spouse’s interest in community property is not part of the decedent’s estate. Claims against the survivor’s property are not barred by Section 45-3-803 NMSA 1978, nor is the property subject to the family and personal property allowances.

Ms. Raines argues that her husband’s death severed the community and there is no longer any community property from which community debts can be collected. This argument overlooks the language of Section 45-2-805 NMSA 1978, which provides: “Upon the death of either spouse, the entire community property is subject to the payment of community debts.” The death of one spouse does not relieve the surviving spouse from his or her obligation for payment of community debts. As stated by the court in *Carpenter v. Lindauer*, 12 N.M. 388, 395, 78 P. 57 (1904):

The entire estate of Samuel P. Carpenter being community property, Ormeda C. Carpenter was equally liable with her husband for the Lindauer debt, it being a community debt. She was no less liable after the death of her husband....

This conclusion is consistent with the federal court’s decision in *Moucka v. Windham*, 483 F.2d 914, 916-917 (10th Cir. 1973), which held that community property remains liable for payment of community debts, even after the community has been severed by divorce:

[U]nder New Mexico law, a community debt incurred prior to the dissolution of the marital community, and for the benefit thereof, would properly be payable out of "community" funds notwithstanding the fact that such "community" property had been transmuted into "separate" property by virtue of a decree of divorce....

...

Thus, assuming that the "community" funds now in Peggy V. Windham's possession can be traced and identified as such, they are subject to the payment of the amount due on the promissory note to Jean Moucka. *See Eaves v. United States*, 433 F.2d 1296 (10th Cir.), and cases cited therein.

To the extent the community property of James and Kay Raines can be traced, Kay Raines’ one-half interest in that property is subject to the Department’s assessment of gross receipts tax due for the period March 17, 1994 through December 31, 1994.

(4) Delay in Setting a Hearing. Section 7-1-24(D) NMSA 1978 states: "Upon timely receipt of a protest, the department or hearing officer shall promptly set a date for hearing and on that date hear the protest or claim." Ms. Raines' protest was received by the Department in October 1998. The hearing date was set in April 2000, eighteen months after the protest was filed. Ms. Raines asks the hearing officer to find that the Department's failure to promptly set a hearing on her protest bars the Department from pursuing collection of the protested assessment.

The argument that a taxpayer who does not receive a prompt hearing is relieved of her tax obligations to the state has already been considered—and rejected—by the courts. In *In re Ranchers-Tufco Limestone Project Joint Venture*, 100 N.M. 632, 638, 674 P.2d 522, 528 (Ct. App.), *cert. denied*, 100 N.M. 505, 672 P.2d 1136 (1983), the court of appeals addressed this issue as follows:

Assuming, but not deciding, that the tax collector violated Section 7-1-24(D), how does a taxpayer benefit from the violation? The statute says nothing as to the consequence of a violation. The general rule is that tardiness of public officers in the performance of statutory duties is not a defense to an action by the state to enforce a public right or to protect public interests. *State, ex rel. Dept. of Human Services v. Davis*, 99 N.M. 138, 654 P.2d 1038 (1982). The general rule is applicable in these cases unless Section 7-1-24(D) makes it inapplicable. Section 7-1-24(D) does not make the general rule inapplicable.

The Department's delay in setting a hearing on Ms. Raines' protest does not provide a basis for dismissing the protest or prohibiting the Department from taking action to collect its assessment.

(5) Equitable Relief. Ms. Raines contends she is an "innocent spouse" as defined in the Internal Revenue Code and is entitled to equitable relief from payment of the gross receipts tax assessed against her husband's business income. The administration and enforcement of state taxes is not governed by federal law. See, *El Centro Villa Nursing Center v. Taxation and Revenue Department*, 108 N.M. 795, 797, 779 P.2d 982, 984 (Ct. App. 1989) (standard of negligence used by

IRS not applicable to state taxes); *State v. Long*, 121 NM 333, 335, 911 P.2d 227, 229 (Ct. App.), *cert. denied*, 121 N.M. 119, 908 P.2d 1387 (1995) (in tax cases, New Mexico courts follow federal law only to the extent they find it persuasive). New Mexico has no law comparable to the federal law providing equitable tax relief to innocent spouses, and the hearing officer has no authority to grant such relief to Ms. Raines.

CONCLUSIONS OF LAW

1. Kay Raines filed a timely, written protest to Assessment No. 2280401, and jurisdiction lies over the parties and the subject matter of this protest.
2. The gross receipts tax imposed on James Raines' business income for the period January 1, 1994 through March 16, 1994 is a separate debt for which Kay Raines has no liability.
3. The gross receipts tax imposed on James Raines' business income for the period March 17, 1994 through December 31, 1994 is a community debt for which Kay Raines is also liable.
4. The Department is barred from pursuing collection of its assessment against property Kay Raines received as a family or personal property allowance.
5. The Department is barred from pursuing collection of its assessment against property Kay Raines received as an heir or devisee of her husband's estate.
6. To the extent the community property of James and Kay Raines can be traced, Kay Raines' one-half interest in that property is subject to the Department's assessment of gross receipts tax due for the period March 17, 1994 through December 31, 1994.
7. The Department's delay in setting a hearing on Ms. Raines' protest does not provide a basis for dismissing the protest or prohibiting the Department from taking collection action against Ms. Raines.

8. Ms. Raines is not entitled to equitable relief from payment of state tax obligations based on innocent spouse or other equitable provisions of federal law.

For the foregoing reasons, the Taxpayer's protest GRANTED IN PART AND DENIED IN PART.

The Department is ordered to abate the amount of gross receipts tax, penalty and interest assessed against Kay Raines for the period January 1, 1994 through March 16, 1994 and to restrict its collection of gross receipts tax, penalty and interest due for the period March 17, 1994 through December 31, 1994 to property that can be traced to Ms. Raines' one-half interest in the community property that existed at the time of James Raines' death.

DATED June 29, 2000.