United States Bankruptcy Court
District of New Mexico

Document Verification

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
CARLA J. CHAVEZ,
Debtor. No. 13-01-11036 SS

CARLA J. CHAVEZ,
Plaintiff,
v. Adv. No. 01-1186 S

INTERNAL REVENUE SERVICE, et al.,
Defendants.

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This matter is before the Court on the trial of the above captioned adversary proceeding. Plaintiff seeks the disallowance of claims against her by New Mexico Taxation and Revenue Department ("TRD") and New Mexico Department of Labor ("DOL"), the avoidance of the liens securing those claims, and the award to her of her homestead exemption from the proceeds of the sale of her home. Plaintiff also sued the United States Internal Revenue Service. IRS responded by withdrawing its proof of claim (docket 36 in the bankruptcy case). The IRS issue is therefore not before the Court.

Plaintiff appeared through her attorney Robert Hilgendorf. TRD appeared through its attorney Donald Harris. DOL appeared through its attorney Rebecca Wardlaw. This is a core proceeding. 28 U.S.C. § 157(b)(2)(B) and (K).

Debtor and Richard Ortiz were married in May 1986, and divorced on October 20, 2000. The Debtor and Mr. Ortiz acquired real estate after subdividing Mr. Ortiz's parent's land. They then obtained a construction loan and built a house. Both made payments on the loan. The house was community property. Debtor received the house as her sole and separate property in the divorce, subject to Richard Ortiz's homestead exemption in the amount of $30,000.00 which he pledged for the payment of state and federal taxes. The property was sold on August 2, 2001 free and clear of liens with liens attaching to the proceeds. Approximately $106,000.00 of proceeds are in escrow.

In October 1994, during the marriage, Richard Ortiz registered a sole proprietorship with the Taxation & Revenue Department under the name "Ortiz Southwest Custom Builders" ("the business") and listed his name as "owner." (TRD Exhibit 4, page 1). Richard Ortiz testified that his wife had no involvement in the business. Mr. Ortiz constructed several houses, then acted as a subcontractor to other contractors. Mr. Ortiz had employees at various times. Mr. Ortiz and/or Debtor took money out of the business at various times. Mr. Ortiz failed to file CRS forms to report gross receipts taxes and state withholding taxes for several time periods. He also

failed to file certain unemployment tax returns. In the parties divorce, Mr. Ortiz assumed the obligation to pay taxes.

The Taxation & Revenue Department audited the business. Mr. Ortiz received an audit report and cover letter dated December 8, 1998. (TRD Exhibit 1, page 8). Tax and Revenue mailed one Notice of Assessment of Taxes and Demand for Payment to the business on December 30, 1998 for the periods October 1994 through February 1998. (TRD Exhibit 1, page 1). On that same date it mailed two Notices of Assessment of Taxes and Demand for Payment to Richard Ortiz, one for 1996 and one for 1995. (TRD Exhibit 1, pages 2 and 3). Mr. Ortiz did not respond to the audit, did not protest any of the assessments or take any action whatsoever to refute the correctness of the assessments. Assessments in New Mexico are presumed to be correct. Section 7-1-17(C) NMSA 1978. In fact, Mr. Ortiz's testimony indicated that he had failed to keep adequate records from which taxes could be computed. The record is clear, however, that he was fully aware of the various demands and notices transmitted by the taxing authorities.

DOL's Exhibit 1 appears to be a copy of DOL's file. It appears that Mr. Ortiz failed to file substantially all of his required unemployment tax returns. The first page of Exhibit

1 is DOL's most recent lien, filed of record in Santa Fe County, New Mexico on June 1, 2001. It consists of taxes, interest, and penalties due for each quarter beginning June 30, 1996 through March 31, 2000. The total amount claimed due is $23,946.39. Some of the amounts are estimated. See DOL Exhibit 1 page 15 ("Notice of action for collection warrant estimated wages" dated December 14, 2000). This document conspicuously states that the amounts listed as estimated "WILL BECOME FINAL THIRTY (30) DAYS AFTER SAID WARRANT IS FILED OF RECORD, UNLESS YOU ESTABLISH, TO THE SATISFACTION OF THE DEPARTMENT, THAT THE ESTIMATED AMOUNT IS INCORRECT WITHIN THIS THIRTY (30) DAY PERIOD." A Warrant of Levy and Lien was filed in Santa Fe County on February 2, 2001 (DOL Exhibit 1 page 5), and a revised one was filed on June 1, 2001 (DOL Exhibit 1 page 1). Exhibit 1 contains many other filings with Santa Fe County for earlier time periods.

As with other taxes, the New Mexico unemployment tax system provides for estimations when an employer fails to report. The estimations become final if no appeal is filed within the time period allowed. Section 51-1-36 NMSA 1978. Administrative and judicial appellate procedures are set forth in Section 51-1-8 NMSA 1978. Liens are issued and recorded

for delinquent taxes, and they attach to all real and personal property of the named person. Section 51-1-36 NMSA 1978.

The burden of proving the inaccuracy of a tax determination is on the taxpayer. 51-1-36 NMSA 1978. This burden is not changed by the bankruptcy. Raleigh v. Illinois Department of Revenue, 120 S.Ct. 1951, 1958 (2000).

On June 2, 1997 Taxation & Revenue filed a Notice of Claim of Tax Lien in Santa Fe County upon the property of Richard Ortiz for the tax period June 1995 through October 1996. (TRD Exhibit 4, page 2). On March 29, 1999 Taxation & Revenue filed another tax lien. (TRD Exhibit 4, page 3). TRD Exhibit 2 is its Amended Proof of Claim filed in Debtor's bankruptcy case, consisting of $133,462.45 secured, $331.61 priority, and $23.90 general unsecured claims.

Debtor testified that she was unaware that Mr. Ortiz was delinquent in paying taxes. She did not know about the audit. She became aware of the tax liens when she attempted to sell the house.

For centuries, community property law has made both spouses liable for the community’s debts. New Mexico has codified that law in Sections 40-3-6 through 17 NMSA 1978. Although there may be disputes about the outer edges of that liability, such as whether some debts are incurred for the

benefit of the community or not, and thus whether the community should be liable for the debt rather than the individual who incurred the debt, the principal of joint and several liability of each spouse for the debt, in relation to third parties, remains firm. Under state law, either spouse can incur a community debt for which the community is liable, "without the participation of the other spouse". Huntington National Bank v. Sproul, 116 N.M. 254, 258, 861 P.2d 935, 939 (1993)(citing Beneficial Finance Co. v. Alarcon, 112 N.M. 420, 422, 816 P.2d 489, 491 (1982)); Execu-Systems, Inc. v. Corlis, 95 N.M. 145, 147, 619 P.2d 821, 823 (1980); Fernandez v. Fernandez, 111 N.M. 442, 444, 806 P.2d 582, 584 (Ct. App. 1991).)

There are ways, of course, to make sure that third parties are put on notice of the non-liability of a spouse for certain or all obligations incurred by the other spouse; those are set out in Sections 40-3-9(4) and (5) and 40-3-10.1. There is no evidence that Ms. Chavez ever used any of those procedures. The mere non-listing of Ms. Chavez (then Ms. Ortiz) on the form submitted to the state, indeed the listing of Mr. Ortiz as the person with 100% responsibility for running the business, does not constitute compliance with any of the specified procedures or circumstances for establishing

the business debts as the separate obligations of Mr. Ortiz. Thus, the presumption that the business debts are community debts has not been set aside. In fact, the evidence that has been presented leads to the opposite conclusion.

It is also the case that this was a community debt. Both spouses had the right to manage the business, even if only one of them actually did the managing, and both obtained the advantages, such as they were, of the business. Taxes due on community earnings are a community debt. Protest of Raines, No.00-18 (Taxation and Revenue Department, State of New Mexico 2000), at 4. Courts in community property states routinely hold that taxes are community debts. See e.g. Hyde v. United States, 72 A.F.T.R.2d 93-6150, 93-2 USTC P50,605, 1993 WL 512059 at 2 (D. Az. 1993) aff'd 26 F.3d 130 (1994). (Holding that 100% of wife's pension fund, a community asset, was subject to IRS levy based on her husband's failure to remit withheld income and FICA tax for a company in which he was an officer because the debt was a community debt); Baca v. Village of Belen, 30 N.M. 541, 240 P. 803, 805 (1925)(Real estate tax on community property is a community debt, subject to satisfaction out of community property.); Wine v. Wine, 14 Ariz.App. 103, 105, 480 P.2d 1020, 1022 (1971)(Noting that income taxes, penalties and interest are probably "per se"

community debts); Vail v. Vail, 117 Idaho 520, 521, 789 P.2d 208, 209 (Ct. App. 1990)(Taxes are community debt); Hanson v. Hanson, 55 Wash.2d 884, 888, 350 P.2d 859, 861 (1960)(Income tax is community obligation which becomes a joint obligation after a divorce.)

The overriding rule in this case is that under New Mexico law, the entire community is liable for all community debts. Section 40-3-11(A) NMSA. By authorizing community claims to be enforced against the entire community, while at the same time having long established that either spouse can incur a community debt, New Mexico has given each spouse an interest in the entire community which is subject to creditors' claims and liens. See also 11 U.S.C. § 541(a)(2) and 726(c) (All community property becomes property of the estate of a debtor with a nonfiling spouse (not just the filing debtor's one-half interest), and all community claims are paid from this property.); Swink v. Fingado (In re Fingado), 995 F.2d 175, 178 (10th Cir. 1993).

In consequence, Ms. Chavez, as part of the community, is liable for the taxes that went unpaid during the existence of the community. The fact that the divorce allocated that obligation to Mr. Ortiz is irrelevant of course for third parties such as these taxing authorities. Ms. Chavez may have

a cause of action against Mr. Ortiz based on the divorce stipulation, but that does not affect Ms. Chavez's liability to third parties. Hanson v. Hanson, 55 Wn.2d 884, 887-88, 350 P.2d 859 (1960)(After divorce, community creditors can collect community debts from either party and payment of a joint debt sustains action for contribution.) Furthermore, it is commonplace in New Mexico to wait until enforcement to determine whether a debt is separate or community. Both spouses do not need to be parties to the action liquidating the debt. Huntington National Bank v. Sproul, 116 N.M. 254, 259, 861 P.2d 935, 940 (1993); Dell v. Heard, 532 F.2d 1330, 1334 (10th Cir. 1976). Compare Oyakawa v. Gillett, 175 Ariz. 226, 228, 854 P.2d 1212, 1214 (Ct. App. 1993)(In California, community property is liable for a debt incurred by either spouse and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt; however, in Arizona, by statute, a plaintiff desiring to obtain a judgment against the marital community for a community debt must join both spouses.)

The consequences of this conclusion are that Ms. Chavez' share of the proceeds of the sale of the community homestead are liable for the community taxes, and that liability overrides her homestead exemption. § 42-10-11 NMSA 1978.

Ms. Chavez raises the argument that due process should require the state to have provided more specific or targeted notice to her as a condition to collecting from her. In other words, Ms. Chavez argues that the laws of the state of New Mexico, developed by courts over a period of more than a hundred years, and the legislature's judgments in codifying the case law and in setting up a structure whereby the state generates the revenue it needs to run the state, are unconstitutional. It is a commonplace to say that Ms. Chavez bears a very heavy burden to prove that. Nothing presented to the Court suggests she has met that burden. In particular, courts have always been careful to protect the power of the government (both the federal government and state governments) to generate and protect the public fisc. See, e.g., DePaolo v. United States (In re DePaolo), 45 F.3d 373, 376 (10th Cir. 1995) (post-confirmation IRS audit and demand for additional tax payments). Nothing about the procedures used by the government in this case appear to be so unfair as to justify a finding that either the federal or the state constitution demand a different behavior. Similarly, the community property law approach to resolving conflicting disputes and allocating responsibilities is so deeply embedded in this state's historical, social and legal fabric, that only the

most compelling evidence of a violation of a basic right guaranteed by either constitution should justify overturning that law. Ms. Chavez' generalized claim of a lack of due process does not come close to meeting that standard.

Debtor argues that state law entitles her to specific notice directed to her, citing to Protest of Tafoya No.99-19 (Taxation and Revenue Department, State of New Mexico 1998), a published decision from a hearing officer of the Taxation and Revenue Department. In Tafoya, the hearing officer ruled that a corporate officer had to be individually assessed for the corporation's withholding taxes before those taxes could be collected from him personally. Id. at 8. The corporation had been assessed, but the hearing officer stated "There is nothing in the Tax Administration Act that would make this assessment effective against Anthony Tafoya, a corporate officer of American Ready-Mix, in his individual capacity." Id. at 6.

Unlike Tafoya, in this case the community property laws impose an automatic liability on the spouse. The Court finds that an assessment on the husband, as agent for the community, is sufficient. In a sense, the taxpayer was the marital community. Section 7-1-3(O) defines "person" very broadly, including "any individual who, as such, is under a duty to

perform any act in respect of which a violation occurs;..." NMSA (2001 Replacement Pamphlet). A single notice to the marital community would seem to satisfy due process. See Huntington National Bank v. Sproul, 116 N.M. 254, 265-66, 861 P.2d 935, 945-46 (1993)(No need to join non-debtor spouse prior to foreclosure of a judgment lien against the debtor spouse.) See also Price v. State of Louisiana, 664 So.2d 802, 807 (La. Ct. App. 1995), cert. denied 669 So.2d 405 (La. 3/8/96)(Wife was not entitled to prior notice of garnishment of her wages for her husband's taxes properly assessed against him.); Kerico v. Doran Chevrolet, Inc., 572 So.2d 103, 104-05 (La. Ct. App. 1990)(No violation of due process to sue only husband because there is a Louisiana statute that states that either spouse is a proper defendant during the existence of the marital community in an action to enforce an obligation against community property.); Komm v. Department of Social and Health Services, 23 Wash. App. 593, 600, 597 P.2d 1372, 1376 (1979)(Due process not implicated when the community (as opposed to the non-debtor spouse) is not deprived from asserting defenses to a claim.)

In addition, section 3.1.6.16 NMAC (repealed on January 15, 2001, see New Mexico Register, Vol 12, No. 1) provided that the Department did not need to do a separate assessment

on anyone "secondarily liable." According to the regulation, this included "spouses of sole proprietors with respect to proprietorship tax liability." In other words, the Department's position was that it need not assess spouses as secondarily liable taxpayers. (Debtor concedes that there existed no similar DOL regulation, but argues that due process required the same result of DOL.) Debtor argues that 1) the repeal of this regulation is an acknowledgment by the Department that it needed to assess spouses separately, and 2) Tafoya held that a separate assessment was needed.

To begin with, whatever the reason was for the repeal of the regulation, its repeal cannot reinstate a law or rule that did not exist to begin with. That is, the repeal of a regulation that said that TRD did not need to give separate notice to a sole proprietor's spouse does not "reinstate" (or perhaps more accurately, "instate") a rule that the spouse must receive separate notice, when no such rule existed before the regulation was put into effect. By asserting that the regulation, even though repealed, implicitly recognized that to be the law, Plaintiff in effect makes this argument.

And the overall problem with Debtor's arguments is that the taxing authorities are pursuing not the "sole proprietorship" as such but rather are pursuing, for these

community debts, the community which held the sole proprietorship as a community asset. It was the community that owned the sole proprietorship, not one of the individuals. Thus the target of the collection efforts is not merely Mr. Ortiz as an individual, with the result that Ms. Chavez is, by that fact, a secondarily liable party. Rather, it is the community that is properly the target of the collection activities, and thus TRD and DOL are entitled to pursue the community property in satisfaction of the debt. See NMSA §40-3-11(A), dealing with priorities for satisfaction of community debts (community debts satisfied first from non-homestead community property, then from the homestead [subject to exemption laws], then from the separate property of the spouse incurring the debt.) There is nothing in the record to indicate that the taxing authorities are claiming liens against any of the Debtor's property that was held as separate property during the marriage.

Unlike the relationship between a corporation and its officers who are ordinarily only secondarily liable for the corporate debts (if even that), the community is “primarily”, not secondarily, liable for these TRD and DOL debts, by virtue of the community property laws. Therefore section 3.1.6.16 NMAC does not or would not apply because there is no attempt

in this case to pursue secondarily liable parties. Perhaps if the taxing authorities were attempting to collect from Debtor's formerly separate property the Tafoya case might be applicable, but that obviously is a ruling that the Court need not and does not make in this case.

Is what happened to Ms. Chavez unfair? Assuredly so. It is just as unfair to her as would be a credit card debt incurred by her then husband and left for her to pay. The unfairness, however, arises from the actions of her husband, not the creditors, for whom denying payment would merely transfer rather than remedy any unfairness. The State of New Mexico has made a policy decision that in these circumstances, it is the two married individuals who must suffer the consequences of debts going unpaid, not the creditors, and there is no basis for this Court to overrule that policy decision.

To be sure, in this case the consequences go far beyond the incursion of a credit card debt. Here the government is taking away from Ms. Chavez a substantial part of the fresh start which she seeks by invoking her homestead rights. However, there is again nothing about the policy decision of the state of New Mexico that is so offensive to the constitutions of the United States or the State of New Mexico

that compels this Court to overrule the state's scheme for raising and spending money in order to protect Ms. Chavez' homestead exemption, "even though such conduct may seem inequitable or may impair the debtor's fresh start." DePaolo v. United States, 45 F.3d at 376.

Debtor argues that Section 40-3-11(B) NMSA 1978 prevents the tax lien from attaching to the residence. The Court disagrees. Section 40-3-11(B) requires both spouses to join in writings that create a debt or obligation that create a lien on the marital residence. No writing is required for the creation of a tax debt. Tax debts arise by statute.

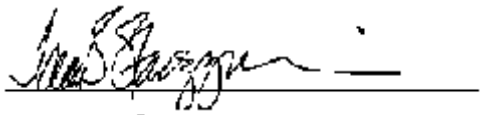
Debtor also argues that the tax debt should be treated as a separate tort or crime, i.e., a separate debt of Mr. Ortiz, so that her share of the community property would not be liable. The taxes, however, are not the result of a tort or crime. The taxes arose by operation of law. It may have been a crime to fail to file returns, but the liability itself did not arise from a crime or tort.

Debtor argues that since the divorce she holds the real estate as her separate property, and it should not be liable for her ex-husband's tax debts. But, a community debt incurred prior to a divorce is properly payable out of community funds even if they have been transmuted into

separate property by virtue of the divorce decree. Moucka v. Windham, 483 F.2d 914, 916-17 (10th Cir. 1973)(applying New Mexico law).

The Court agrees with the arguments of TRD and DOL that the Debtor has had all the process due her. First, there are statutory and administrative remedies to the original assessments of the taxes. (In opening statements, Mr. Hilgendorf admitted that Mr. Ortiz did not file returns, that the taxing authorities audited him, and that the protest periods had all expired. He also conceded that the amounts claimed are binding on Mr. Ortiz.) As part of the community Ms. Chavez could have appealed the assessments. She should not get a second chance to challenge the validity of the underlying taxes. For example, if Mr. Ortiz had a judgment entered against him for negligence, Debtor could not now relitigate that judgment. The only avenue left in theory would be to argue that the debt was not a community debt, or that the Debtor was not a spouse at the time the debt was incurred (arguments that, in this instance, are contrary to the facts). She could have raised those arguments in this context, and that would have been the amount of process she was due.

For the foregoing reasons, the Court will enter a judgment for New Mexico Taxation and Revenue Department and New Mexico Department of Labor.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on September 27, 2002, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

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