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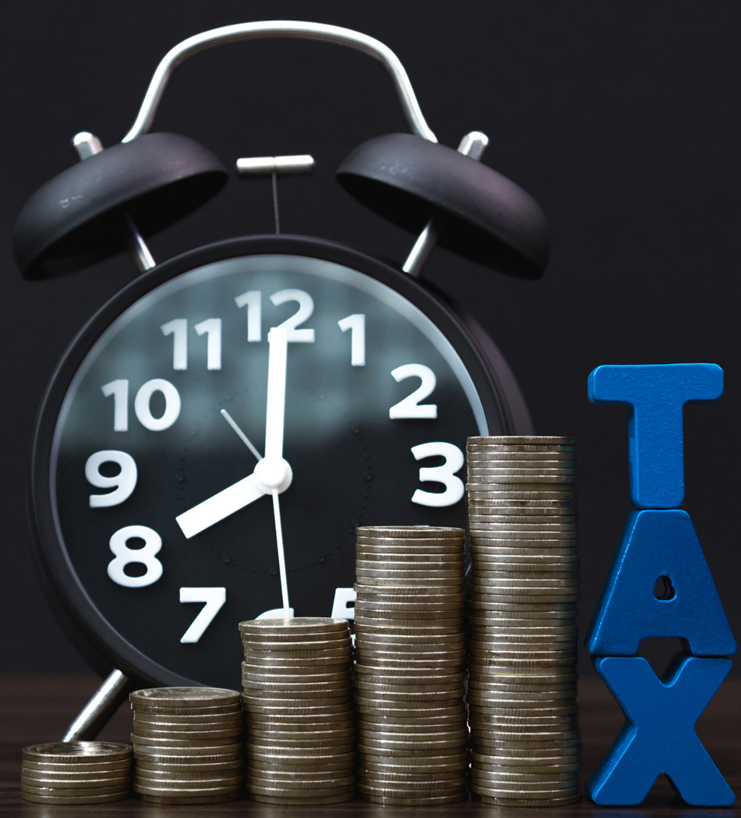
Updates *in Tax Law*



Tax Law Section

Too Big, Too Small or Just Right?

Tax Benefits for New Mexico Families Under the Tax Cuts and Jobs Act

By Grace Allison

The personal income tax provisions of the Tax Cuts and Jobs Act (the "Act"), enacted on Dec. 22, 2017, and generally effective from 2018 through 2025, reshape the tax landscape for New Mexico families, suspending some benefits while temporarily enhancing others. Some of the most important of these temporary changes are the suspension of most itemized deductions,[1] the suspension of the personal and dependency exemptions previously allowed under I.R.C. Section 151, the reduction in income tax rates, and the near-doubling of the standard deduction.

With a much larger standard deduction and only a handful of itemized deductions, fewer middle class families will itemize. More very poor families are likely to have zero taxable income—and to pay zero income tax. For this population, the absence of taxable income will make the fully refundable earned income tax credit even more valuable, because the essence of a fully refundable credit is that all of its benefits can be received even if the credit exceeds the family's tax liability. Changes to the Child Tax Credit and the creation of a new nonrefundable Dependent Tax Credit are likely to be most important to the middle class.

As always, there are unintended consequences. The U.S. Government Accountability Office estimates that 21 percent of taxpayers will be underwithheld in 2018 under the Act's provisions, versus 18 percent under prior law, and that 73 percent will be overwithheld, versus 76 percent under prior law.[2] In other words, several million taxpayers will have an unwelcome surprise, including those finding themselves with far fewer itemized deductions. Even so, the IRS will not be releasing a new withholding form until 2020. Given the applicable penalties and interest, all New Mexican households should check their withholding using the best tool currently available, the IRS withholding calculator at apps.irs.gov/app/withholdingcalculator.

Under prior law, family-based tax benefits were available for "dependents" described in I.R.C. Section 152, i.e. for a "qualifying child" or a "qualifying relative." A "qualifying child" must, *inter alia*, meet certain relationship, residence and age requirements and may not provide more than half of her own support. A "qualifying relative" must, *inter alia*, receive more than half of his support from the taxpayer and may have only a minimal amount of gross income.

These definitions remain important under the new Act. It is something of a disconnect: the dependency exemption granted in I.R.C. Section 151 and further described in I.R.C. Section 152 is suspended until 2026, but, in the interim, Section 152 remains the lodestar for determining which households can claim family-based tax benefits.

Child Tax Credit and Additional Child Tax Credit

Under prior law, a maximum $1,000 Child Tax Credit could be claimed under I.R.C. Section 24 by those with a "qualifying child" under age 17. The old CTC was fully refundable, subject to minimum earnings requirements and was available to immigrants whose children did not have a valid social security number. The benefits of the CTC under prior law were primarily limited to lower and middle-class taxpayers because the CTC began to phase out at adjusted gross income of $110,000 for marrieds filing jointly.

The Act turns prior law on its head: doubling the CTC to $2,000—but limiting the amount of CTC that can be refunded to $1,400; making the CTC fully available to those with adjusted gross income of $400,000 or less; and requiring that each child for whom CTC is claimed have a valid social security card.

The refundable portion of the CTC is known as the "Additional Child Tax Credit." As amended by the Act, CTC is now refundable in an amount equal to the lesser of $1,400 or 15 percent of the taxpayer's earned income above $2,500. This is a liberalization of prior law, which limited refunds to the lesser of $1,000 or 15 percent of earned income above $3,000.

However, doing the math, only those with earned income in excess of $11,833 will be eligible to receive the entire $1,400 refund. As a result, many of the poorest families will still find themselves ineligible for the CTC because of the minimum earnings requirement. The Urban Institute estimates that nationwide "29 million children under 17 will miss out on the full [$1,000] increase [in the CTC] because their families earn too little or owe too little tax."[3]

Dependent Tax Credit

The newly created and nonrefundable Dependent Tax Credit is potentially available to anyone with a dependent (as defined in I.R.C. Section 152) who is not eligible for the CTC, whether a "qualifying child" or a "qualifying relative." In other words, while the CTC is available only to those with "qualifying children" under 17, the Dependent Tax Credit is available to anyone with a dependent who cannot be claimed for the CTC, whether a "qualifying child" or a "qualifying relative."

For New Mexicans, for whom family ties are so important, this is a significant change. Taxpayers who support aunts, uncles, parents and/or grandparents may now be entitled to a nonrefundable $500 credit for each. In addition, the Dependent Tax Credit may be claimed for qualifying children between 17 and 24 who are students as well as for otherwise qualifying children without a social security card. The Dependent Tax Credit is also potentially available to unmarried taxpayers who support their partners and/or their partners' children. However, because it is nonrefundable, it will be unavailable to those without income tax liability.

In audit situations, practitioners have in the past looked to birth certificates, leases, utility bills and/or school and medical records to document eligibility for family-based tax credits. The same will be true in the future for audits of the Dependent Tax Credit, which, like the CTC, is fully available to taxpayers with adjusted gross incomes up to $400,000.

Earned Income Tax Credit

In 2017, the fully refundable Earned Income Tax Credit brought New Mexico's low and middle-income working families roughly $512 million in refunds and tax offsets, delivering a significant boost to the local economy.[4] It is virtually unchanged under the Act – only the measure used to inflation-adjust the credit has been permanently modified, from the Consumer Price Index for Urban Consumers ("CPI-U") to the less generous Chained Consumer Price Index for Urban Consumers ("C-CPI-U"). In 2018, EIC maximum benefits are $519 for workers with no children; $3,461 for workers with one "qualifying child"; $5,716 for workers with two "qualifying children"; and $6,431 for workers with three or more "qualifying children."

Dependent Care Credit; American Opportunity Tax Credit; Adoption Credit

The Dependent Care Credit and the American Opportunity Tax Credit are not inflation-adjusted and are unaffected by the Act. The Adoption Credit is now C-CPI-U inflation-adjusted.

IRS Form 8332

Under the Act, IRS Form 8332 (which in its latest draft is still titled "Release/Revocation of Release of Claim to *Exemption* for Child by Custodial Parent") remains the only way to allocate child-based tax benefits from the custodial to the non-custodial parent where parents do not live together. *See* I.R.C. § 152(e). As under prior law, the custodial parent must first sign the Form, which allows each named child to be treated as the "qualifying child" of the non-custodial parent. The non-custodial parent must then file Form 8332 with their Form 1040 for each year that s/he claims tax benefits that require having a "qualifying child." Under current law, as under prior law, Form 8332 is necessary to allocate CTC, Additional Child Tax Credit and American Opportunity Tax Credit. The big changes are that there is no longer a dependency exemption to allocate—and that Form 8332 is also required to allocate the Dependent Tax Credit. As under prior law, you can't use Form 8332 to allocate EIC.

Too big, too small or just right?

A Tax Policy Center study estimates that in 2018, all changes made by the Act (i.e. not just the changes to family-based tax benefits) will increase after-tax household income nationwide on average by 2.2 percent, about $1,610 per family. For New Mexico, with median household income in 2016 of $45,674, increases are estimated to be smaller because the tax cuts are estimated to favor those who generally pay the most tax. For families with income up to $25,000, the TPC forecasts an increase of $60; for those with income between $25,000 and $48,600, a $380 increase; between $48,600 and $86,000, $900; and at $149,400, $1810.

Endnotes

[1] *See*, e.g. I.R.C. § 67(g), which suspends the deduction for miscellaneous itemized deductions, such as unreimbursed employee business expenses.

[2] U.S. Government Accountability Office, *Federal Tax Withholding* (July 2018).

[3] Elaine Maag, *Who Benefits from the Child Tax Credit Now?*, Urban Institute (February 2018).

[4] U.S. Conference of Mayors, *Dollar Wise: The Best Practices on the Earned Income Tax Credit* (2008).

Grace Allison has served as director of the Low Income Taxpayer Clinic at New Mexico Legal Aid since June 2017. She is the immediate past chair of the Charitable Planning and Organizations Group, Real Property Trust and Estate Section, American Bar Association and is a member of the State Bar of New Mexico and Illinois State Bar Association.

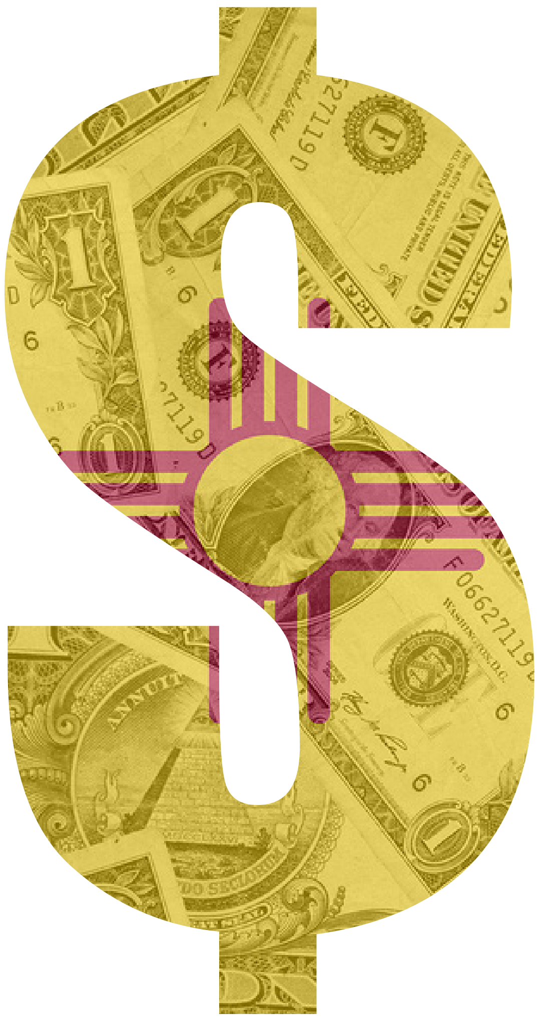
Gross Receipts TAX REFORM in New Mexico—

Some Potential Considerations

By Mark Chaiken

New Mexico's system of state and local gross receipts taxation, requires reform. The current Gross Receipts and Compensating Tax Act, NMSA 1978, §§ 7-9-1 to 115 (the "GRT Act"), and Municipal Local Option Gross Receipts Taxes Act, NMSA 1978, §§ 7-19D-1 to 18 and County Local Option Gross Receipts Taxes Act, NMSA 1978, §§ 7-20E-1 to 28 (collectively, the "Local Option GRT Acts"), as well as other local GRT tax acts, have too many deductions and exemptions, creating a tax base that is too narrow, with correspondingly higher rates on the remaining taxable receipts.[1] New Mexico's GRT system, while it is more like a traditional sales tax and less like a true gross receipts tax, in that it seeks to avoid the taxation of all receipts or business inputs at all levels of production, still does result in some "pyramiding" of taxes, so that by the time a product comes to market, it may have been subject to more than one imposition of gross receipts tax, resulting in higher costs to businesses and consumers.

Finally, the Local Option GRT Acts create a patchwork of gross receipts tax rates across the various counties and municipalities of the state. The Local Option GRT Acts currently permit the imposition of various increments of local option tax, such as a municipal environmental services gross receipts tax, NMSA 1978, § 7-19D-10 (an additional one-sixteenth of one percent), or the municipal infrastructure gross receipts tax, NMSA 1978, § 7-19D-11 (which may be imposed in increments of one-sixteenth of one percent, up to a total of one-fourth of one percent). Cognate local option taxes exist for counties. *See, e.g.,* NMSA 1978, § 7-20E-17 (the county environmental services gross receipts tax), and § 7-20E-19 (the county infrastructure gross receipts tax). Collectively these gross receipts taxes, plus additional optional taxes not included in the Local Option GRT Acts, can add substantially to the overall gross receipts tax rate in a particular political subdivision. According to the most recent data from the Taxation and Revenue Department, gross receipts tax rates across the state vary from as low as 5.500 percent (which is inclusive of the 5.125 percent

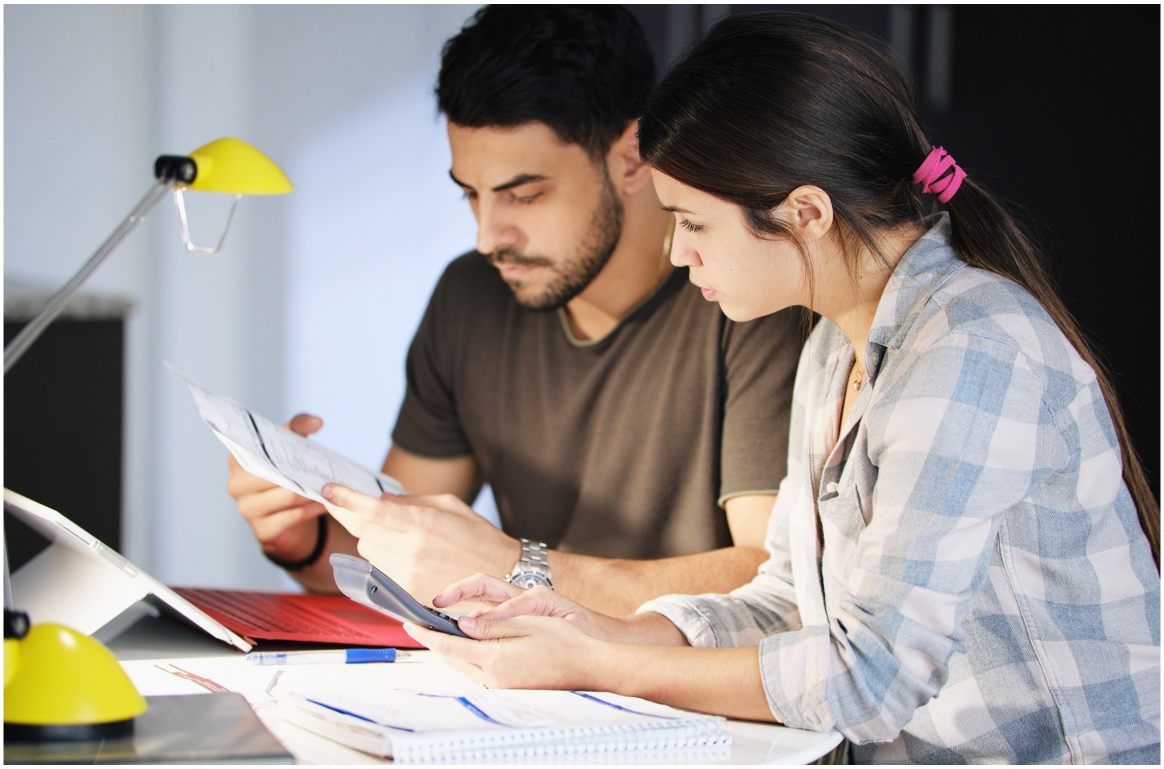


state GRT rate) in Catron and Lea Counties, to as high as 9.0625 percent in the City of Espanola. These differing rates not only have a potentially distortive effect on business and investment decisions as well as consumer purchasing, but also result in GRT rates that begin to have punitive economic consequences.

Because of these acknowledged problems in the GRT and the negative impact they have on New Mexico's economic growth, several proposals have been made in recent legislative sessions to reform the Local Option GRT Acts.[2] Both proposed bills sought to broaden the GRT tax base by eliminating some deductions and exemptions, allowing a lowering of the rate. And both bills sought to regularize the GRT tax rate across the state by eliminating the ability of counties and municipalities to impose most of the current local option gross receipts taxes.

However, it may not be so easy to eliminate existing local option GRTs that have already been imposed, as many of the political subdivisions that have imposed these taxes have bonded against them, pledging the revenues derived from those taxes to pay on long-term debt issued to finance public improvements. Eliminating already-imposed taxes whose revenues have been pledged is possibly unconstitutional, and may violate various covenants contained in relevant bond documents. Recent tax reform experience in Michigan and Pennsylvania indicates that any tax whose revenues have been pledged to payment of public debt likely will need to remain valid until the relevant debt has been paid off.

Counties and municipalities have the authority to pledge certain of their local option GRT revenues to repayment of debt incurred to finance specific projects. *See, e.g.*, NMSA 1978, §§ 3-31-1, *et seq.* (permitting the issuance of gross receipts tax revenue bonds for specific public purposes, and to which certain local option GRT revenues may be pledged); NMSA 1978, §§ 4-62-1, *et seq.* (similar authorities for counties). Many municipalities and counties throughout the State have issued such debt in order to finance public improvements, and have pledged some of their local option GRT revenues to repayment. As a result, it may not be easy to repeal such taxes. In the first place, some were imposed pursuant to an election, and voters may have a say in whether they are to be repealed. The bond or loan documents evidencing the debt will also usually contain covenants assuring investors and lenders that the taxes supporting the debt will not be repealed; no change in the repayment pledge can be made, at least without the consent of the holders of the bonds or debt instrument. Finally, and most significantly, the bond or loan documents are considered contracts, and any attempt to repeal the taxes would likely run afoul of the prohibition against the impairment of contracts contained both in Article I, Section 10 of the United States Constitution, and Article II, Section 9 of the New Mexico Constitution. It is well-settled law that a municipality violates the Contracts Clause when it attempts to repeal revenues pledged to repayment of public debt. *See, e.g., State of Louisiana ex rel. Elliott v. Jumel*, 107 U.S. 711 (1883).



Both of the bills proposed in New Mexico sought to repeal the Local Option GRT Acts, substituting instead a new gross receipts or sales tax. The proposed Senate Bill would have allowed an affected county or municipality to impose additional increments of a new local option GRT to continue to repay the debt. S.B. 49, 54th Leg., 1st Sess. § 69 (N.M. 2017). But such a substitution would still require the consent of all holders of the revenue bonds. This consent may not be forthcoming, as bondholders would, under the new arrangement, share in revenues now applicable to more than one debt.[3] Bondholders might not consider the substituted revenues to be as secure as the original pledge.

House Bill 412 also proposed to repeal the Local Option GRT Acts. However, it only impressed the new, general sales tax revenues with the obligation to repay the debt, and did not allow the imposition of additional local GRT to make up for the lost revenue. H.B. 412, 53rd Leg. Sess. §§ 151-52, 328. This would not only impair the existing bond and debt contracts, but would also potentially leave some counties and municipalities without sufficient revenue to both repay their debt and conduct regular government operations.

The same problem was faced in Michigan and Pennsylvania when those states reformed their property tax systems. In both states, local school districts had been allowed to impose varying rates of property tax to fund school improvements, and to pledge the revenue from those taxes to repayment of public debt. *See* S.B. 76, Reg. Sess. (Pa. 2017-18). Ultimately, both states found that the only way to reform their property taxes on a state-wide basis was to allow the local property taxes pledged to debt to continue until the relevant bonds had been paid off. In Michigan, the property tax was repealed for the purpose of funding operations, which are now funded primarily from state sales taxes; the state was unable to figure out a way to decrease inequities in capital funding, and so the property tax is still used for that purpose, leaving highly variable property tax rates across Michigan's school districts.

New Mexico local public bodies that have pledged a particular GRT to debt will also likely need to keep it in place until the debt is paid off. In other words, some existing local GRTs will have to overlap with the new GRT system, perhaps for some time. While it is unfortunate that the local option GRTs would remain, allowing a continuing uneven pattern of GRT rates across the state, the problems and expense of substituting a new revenue stream, which would require consent of bondholders, and which might result in legal action against local public bodies, would likely be costlier and more time-consuming to address.

Endnotes

[1] The current gross receipts tax rate across the state is 5.125%. NMSA 1978, § 7-9-4(A). Also, unlike almost all other states which have either a gross receipts tax or sales tax, New Mexico imposes its gross receipts tax on receipts for most services. NMSA 1978, § 7-9-3.5(A)(1).

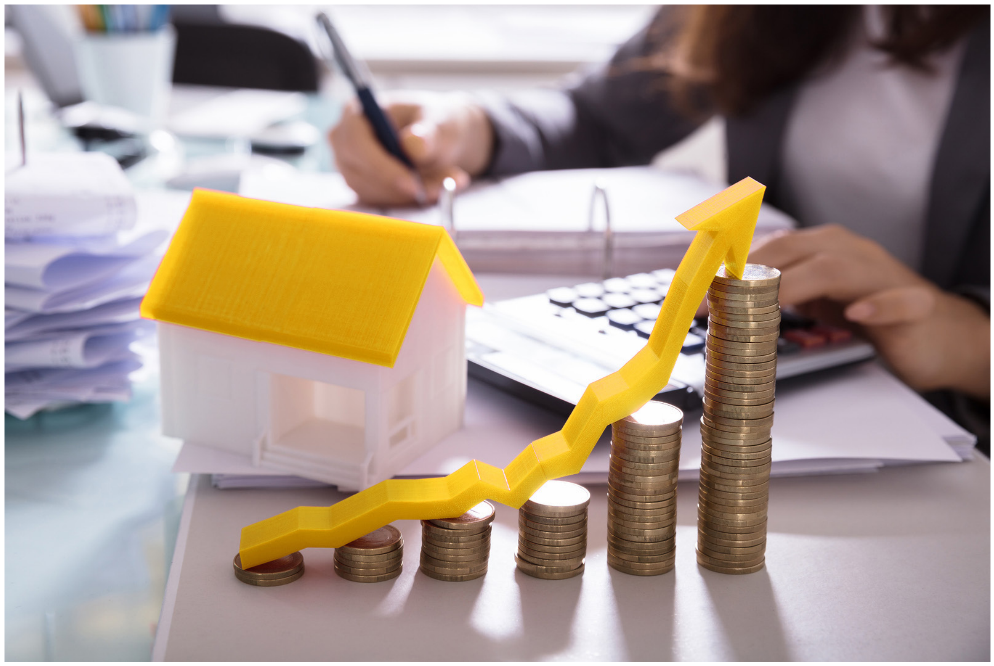
[2] The bills were sponsored by Rep. Jason Harper, H.B. 412, 53rd Leg., 1st Sess., (N.M. 2017), and by Sen. William Sharer, S.B. 49, 54th Leg., 1st Sess. (N.M. 2018).

[3] It would also be possible to substitute a different source of revenues, e.g. revenues supplied by the state, or coming from a different tax entirely, or a sinking fund established for this purpose. However, the same problems noted in this article would still arise, along with other issues of fairness to those public bodies without a significant debt burden.

Mark Chaiken received his J.D. with honors from Rutgers School of Law, Newark, and his LL.M. in Taxation from New York University School of Law. He practices primarily in the areas of public finance and taxation.

Tax Lightning
and Change of Ownership

By Frank C. Salazar



NMSA 1978, Section 7-36-21.2 (2000, amended 2010) limits the amount residential property may be valued to no higher than three percent of the property's value from the previous tax year, unless certain exceptions apply.[1] *See* Section 7-36-21.2(A). This limitation is a "cap" on property valuation; and when a taxpayer loses the limitation, the result—tax lightning. In some cases, the unanticipated loss of the cap leads residential property owners across the country to be blindsided by hefty property tax bills. Recent Bernalillo County Valuation Protest Board (Board) decisions regarding when a taxpayer loses the limitation due to change of ownership have been appealed to New Mexico State Second Judicial District Court, which in turn has certified the appeals to the New Mexico Court of Appeals. Will the Court limit the lightning strikes? The Court of Appeals decision remains pending.

Many states have imposed similar property valuation caps. *See, e.g.*, Cal. Const. art. XIIIA, 2(b) ("The full cash value base [of real property] may reflect from year to year the inflationary rate not to exceed 2 percent for any given year[.]"); Ariz. Rev. Stat 42-13301(A) (1997, amended 1999) ("The limited property value of property for property taxation purposes is the limited property value of the property in the preceding valuation period plus five percent of that value."); Ark. Const. amend. 79, 1(b)(1)-(c)(1) (stating that for property used for homesteading purposes, increases in the assessed value of such property are limited to five percent of the assessed value of the property for the previous year); Okla. Const. art. X, 8B (stating that the assessed value of property cannot increase by more than five percent in any taxable year); Tex. Const. art. VIII, 1(i) (stating that the legislature may limit increases in the appraised value of a residence homestead for "ad valorem tax purposes" in a given year to 10 percent of that used for the preceding tax year); Mich. Comp. Laws 211.27a(2)(a) (2016) (stating that the taxable value of a parcel of property shall not exceed the taxable value of the parcel "1.05 of the inflation rate" of the immediately preceding year); Fla. Stat. 193.155(3) (2018) (stating that the assessed value of homestead property cannot increase by more than "[t]hree percent of the assessed value of the property for the prior year"). Property valuation caps aim to avoid the unfairness that results when longtime homeowners are forced to sell their homes because they can no longer afford their skyrocketing property taxes and the lightning strikes. *See* Mary LaFrance, *Constitutional Implications of Acquisition Value Real Property Taxation: The Elusive Rational Basis,* 1994 Utah L. Rev. 817, 837 (1994).

The facts underlying the decision of the Board certified to the Court of Appeals are summarized as follows: Taxpayer is trustee and beneficiary of a revocable trust (Trust). The Trust owned an apartment complex. As residential property, the apartments are subject to the valuation cap. To refinance, Taxpayer transferred the apartments from the Trust to a limited liability company. The Trust was the sole owner of LLC. After Taxpayer transferred the property from Trust to LLC, the Bernalillo County Assessor (Assessor) revoked the valuation cap and claimed to have assessed the property at its current value. Taxpayer protested.

The Assessor claimed that because ownership of the apartments changed when Taxpayer transferred them from Trust to LLC, the cap was eliminated. Taxpayer argued no ownership change occurred because the Taxpayer remained the beneficial owner of the property and only the manner in which ownership was held had changed—not the equitable ownership. Being an issue of first impression in New Mexico, Taxpayer relied upon Cal. Code Regs. tit. 18, § 462.180(b) (2014) and *In re Assessments for Year 2005 of Certain Real Property Owned by Askins Properties, L.L.C.*, 2007 OK 25, 151 P.3d 303 (2007), which Taxpayer argued stand for the proposition that a mere change to legal title is not a change of ownership for purposes of a valuation cap when the proportional or equitable ownership does not change.

The Board ruled in favor of Taxpayer, determining that it would be unreasonable for the New Mexico Legislature to have intended to revoke a property

owner's valuation cap any time an owner mortgages, grants an easement over, or has a judgment or lien filed against a property. The Assessor appealed, seeking a writ of certiorari pursuant to 1-075 NMRA,[2] arguing that the Board's decision was inconsistent with two of its prior decisions.[3] The Assessor did not dispute that it does not have a statutory right to appeal decisions of the Board.

Taxpayer responded that (1) the district court had no appellate jurisdiction to review the Board's decision; (2) the Assessor had no standing to appeal the Board's decision; and (3) the Board's decision was in accordance with the law because there was no change of ownership.[4] Specifically, Taxpayer argued that there is no authority that supports the Assessor's contention that the Board was bound to follow its prior decisions and that there is no such thing as administrative state decisions in New Mexico. Taxpayer further argued the Board's decision was in accordance with law because there is no change of ownership when property is transferred between the same beneficial owner. Taxpayer asserted that if single-member limited liability companies are not disregarded for property tax purposes, as they are for income tax purposes, injustice would occur.

In 1996, the Internal Revenue Service sought to simplify the classification of business entities by allowing singly owned entities, such as limited liability companies, to be disregarded as separate entities for purposes of income tax. *See* Katherine A. Cook, Comment, *Limited Liability Companies in New Mexico,* 27 N.M. L. REV. 615, 624 (1997). As a result, "check-the-box" regulations were codified under Title 26 of the Code of Federal Regulations. *See* 26 C.F.R. §§ 301.7701-1-301.7701-3 (1997). Under these regulations, "a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner" for income tax purposes. 26 C.F.R. § 301.7701-3(a).

Importantly, under NMSA 1978, Section 7-2A-2(E) (2014, amended 2017), New Mexico defines a "corporation" to include limited liability companies that are taxed as corporations under the Internal Revenue Code. As mentioned above, the IRS allows single-member corporations, including singly owned limited liability companies, to be disregarded as separate entities from their owners for income tax purposes. However, many Americans that form single-member limited liability companies operate under the impression that their companies will also be disregarded for property tax purposes. *See* Ethan D. Millar, *State Taxation of LLCs Not Always Black and White: A Georgia Case Study*, 2006 Tax Notes 823 (Sept. 18, 2006).

The Court of Appeals has under the certification all issues raised in the District Court appeal, including the meaning of change of ownership, the jurisdictional issues, and the issue of when the Assessor may be entitled to a Writ of Certiorari. Hopefully, the Court will decide the procedural and substantive issues and provide the much-needed guidance.
About the Author

Endnotes

[1] Section 7-36-21.2 grants certain exceptions to the limitation. New Mexico's valuation cap does not apply, among other exceptions, to residential property that changes ownership the year immediately preceding the tax year in which the property is being valued. A "change of ownership" is broadly defined as "a transfer to a transferee by a transferor of all or any part of the transferor's legal or equitable ownership interest in residential property." Section 7-36-21.2(B).

[2] "Article VI, section 13 of the New Mexico Constitution authorizes district courts to issue writs of certiorari to inferior judges or courts." *Masterman v. State Taxation and Revenue Dep't, Motor Vehicle Div.*, 1998-NMCA-126, ¶ 10, 125 N.M 705, 964 P.2d 869. But writs of certiorari may be issued only when petitioners demonstrate that they are "entitled to relief." Rule 1-075(C)(4). A petitioner is entitled to relief only when "an inferior court or tribunal has proceeded illegally and there is no statutorily specified mode of review." *Id.* ¶ 10. An inferior court or tribunal proceeds illegally when it lacks jurisdiction or when its proceedings were irregular. *See* 14 Am. Jur. 2d *Certiorari* 13 (2018).

[3] See the Board's decisions in: *Decision and Order in the Matter of the Protest of Menaulwood Apartment, LLC* (Aug. 6, 2014) and *Decision and Order in the Matter of the Protest of Desert Vista, LLC* (Aug. 6, 2014). *Menaulwood* involved a transfer of property from a revocable trust to a limited liability company where the ultimate owner remained the same. In *Desert Vista,* property was transferred from a limited liability company to the sole owner of the limited liability company. In each case, the Board determined that the transfer was a change of ownership because a limited liability company is a separate entity from its owners.

[4] Under Rule 1-075, district courts may grant writs of certiorari to "aggrieved" parties. Taxpayer argued the Assessor lacks standing to appeal the Board's decision because a party is not aggrieved merely because it feels aggrieved by a tribunal's ruling. *See State v. Aguilar*, 1981-NMSC-027, ¶ 7, 95 N.M. 578, 624 P.2d 520. Instead, an aggrieved party "is one whose personal interests are adversely affected by an order of the court." *State v. Castillo*, 1980-NMCA-020, ¶ 4, 94 N.M. 352, 610 P.2d 756.

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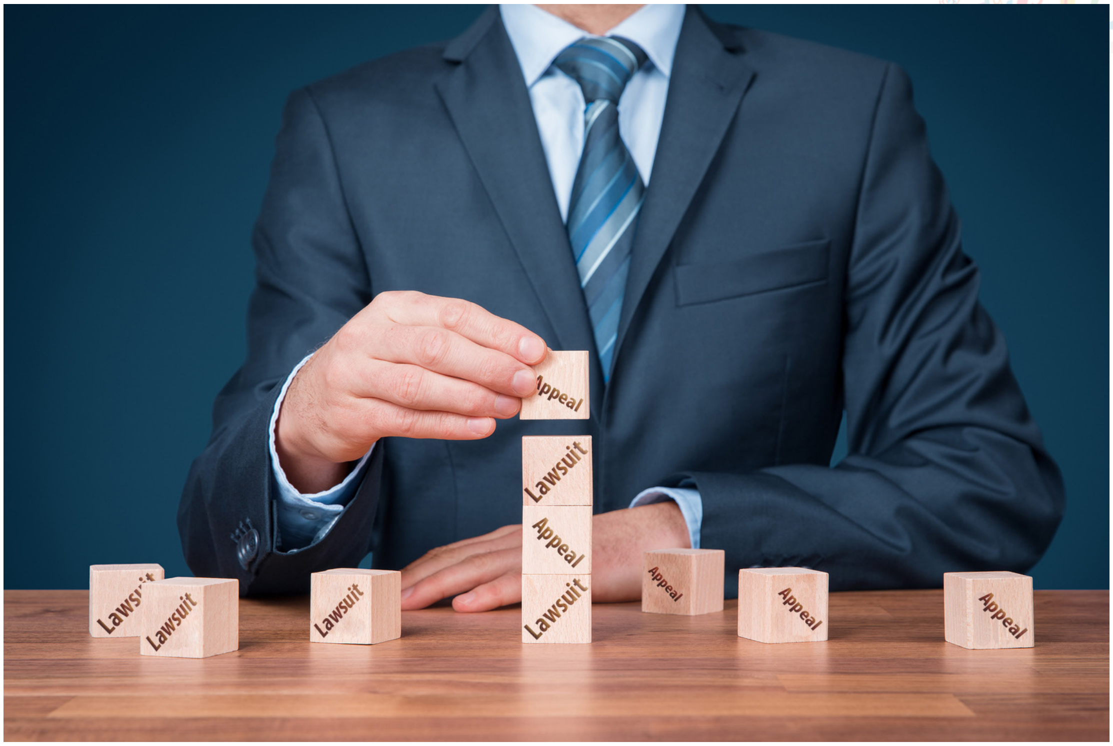
The Tax Lien Sale That Generated **Two** Lawsuits and **Two** *Pro Se* Appeals … **And Counting**

By Michael J. Thomas



If you, even rarely, counsel people involved in the purchase of real estate at tax lien sales, or the former owners of such land, you should know about the tax lien sale and ensuing litigation discussed here, which clarified an important legal issue arising from facts that could serve as the basis of a civil procedure exam.

In the interest of disclosure, I represented the purchasers in one appellate stage in 2014 as detailed below.

Tax Lien Sale, Portales, Fall 2011

In October 2011, Allan and Sherry Snyder, formerly of Illinois, were visiting Portales as they scouted retirement areas when they learned of a public auction scheduled at the Roosevelt County Courthouse. They were the only bidders on roughly 4 acres composed of two adjacent parcels outside Portales, owned by the Valenzuelas subject to property tax liens. The Snyders purchased the property for $215, obtained deeds from the New Mexico Taxation and Revenue Department, and recorded the deeds.

In March 2012, the parties signed a short-term rental agreement under which the Valenzuelas continued to use the land (on which they had a mobile home) for $5 per month while the parties discussed a potential sale back to the Valenzuelas. The agreement would terminate if the Valenzuelas removed their home and personal effects. By the end of March, the Valenzuelas, through their counsel, filed a lawsuit against TRD asserting they did not receive proper notice of the auction.

In July 2012, the Valenzuelas filed an amended complaint joining the Snyders as defendants. After some early motions, including the Snyders' unsuccessful attempt to obtain a stay pending resolution of the claim against TRD, the plaintiffs obtained summary judgment against the Snyders on the basis that the $215 purchase price was grossly disproportionate to the fair market value, such that allowing the sale to stand would be unconscionable.

First Appeal

The Snyders appealed in 2013 and prevailed. *Valenzuela v. Snyder*, 2014-NMCA-061. The opinion noted that the Snyders had failed to properly respond to the Valenzuelas' motion for summary judgment in the district court, so the district court had properly deemed as admitted the Valenzuelas' assertion that the property's fair market value was at least $25,000.

However, the Court of Appeals clarified that an inadequate purchase price, i.e. one grossly disproportionate to the property's value, is not a ground for setting aside a tax lien sale under New Mexico law, including the Property Tax Code, NMSA 1978, §§7-35-1 to 7-38-93. The opinion noted that purchasers at such sales may need to file a quiet title action, with the implication being that one should view the purchase price with that reality in mind. *See Valenzuela*, 2014-NMCA-061, ¶ 23. The Court of Appeals reversed and remanded with instructions to enter judgment for the Snyders. A concurrence suggested it may be time for the legislature to reexamine the tax sale provisions of the Property Tax Code to better balance the competing interests of the parties.

The Valenzuelas, through counsel, sought and obtained a writ of certiorari. An *Albuquerque Journal* columnist covered the case in a four-part series, noting that a small tax lien sale case was soon to be heard by the state Supreme Court.[1] I read the first article in August 2014. The case intrigued me, and I believed the process would benefit if formerly *pro se* parties had representation at such a crucial point. I contacted the Snyders and expressed my willingness to assist them in that stage for a nominal, virtually *pro bono*, flat fee, plus postage and copying expenses. They hired me and I spent more than 40 hours reviewing the record, writing and editing the brief and conducting research.

In November 2014, the court quashed the writ of certiorari, benefitting the Snyders by leaving the Court of Appeals' opinion undisturbed. That ended my professional involvement in the case. Other than those three months, the Snyders have been *pro se* throughout. The case was remanded for a trial to determine whether TRD provided legally sufficient notice to the Valenzuelas before the fall 2011 auction. The Snyders were dismissed from the case in accordance with the Court of Appeals mandate about a week before the bench trial in October 2015.

Trial, Fall 2015

In its Decision Letter after trial, the district court found that Mrs. Valenzuela visited the Roosevelt County Treasurer's Office in early September 2011 upon learning that a TRD employee had delivered two "Courtesy Red Tag Notices" (one for each lot) regarding unpaid taxes for 2007-2010. The court found that, after being informed that the Valenzuelas owed approximately $1,400 (including penalties), Mrs. Valenzuela returned and paid $700, thereby failing to cover the full amount.

However, crucially, the court found the required notices were not sent to the correct address, which was "reasonably ascertainable" by TRD, and concluded that the sale, and the associated deeds issued by TRD's Property Tax Division, were invalid. The court entered its final judgment in December 2015.

Second Appeal

For the second time in three years, the Snyders appealed. In its memorandum opinion issued March 6, 2017 (No. 35,313), the Court of Appeals dismissed the appeal because the Snyders were not "aggrieved parties" as to the judgment invalidating the tax lien sale. The court, describing the procedural history, noted the Snyders were dismissed from the case before the final judgment and, accordingly, the 2015 judgment could not be enforced against the Snyders. The court observed that "[u]ltimately, we are in no position to speculate whether any path remains for Plaintiffs to pursue the return of the property at issue in this case." *Valenzuela v. Snyder*, No. 35,313, mem. op. ¶ 8 (N.M. Ct. App. Mar. 6, 2017) (unpublished).

Second Lawsuit, 2017

In May 2017, five-and-a-half years after the October 2011 tax lien sale, the Valenzuelas filed a new lawsuit, specifically a quiet title action, naming the Snyders and, as expected in such an action, "unknown claimants."

The Snyders asserted the lawsuit was barred by the two-year statute of limitations in NMSA 1978, § 7-38-70(C) ("After two years from the date of sale, neither the former real property owner shown on the property tax schedule as the delinquent taxpayer nor anyone claiming through him may bring an action challenging the conveyance") but were unsuccessful in a motion for summary judgment on that basis. The Snyders submitted a proposed order that would have permitted them to apply to the Court of Appeals for permission to pursue an interlocutory appeal regarding the statute of limitations issue, but the district court declined to approve the order. The Snyders then unsuccessfully sought a writ of mandamus in the New Mexico Supreme Court.

The Valenzuelas went on to obtain a judgment in their favor, and the Snyders have appealed again, asserting that the May 2017 lawsuit was time-barred. The appeal, docketed but not briefed at the time this article was finalized, represents the third pro se appeal by the Snyders in less than six years.

The entire matter is an example of how both sides, even in a relatively low-value matter, can become entrenched (justified or not), particularly when attorneys are added to the mix.[2] A "low"-dollar case can be just as important to the parties as a high-dollar case is to its respective parties. But one may reasonably suggest that both sides would have fared better, considering the value of their time, legal fees, expenses, etc., if both sides had attempted to reach a resolution before years of litigation spread across two separate lawsuits.

As an aside, the fair market value of the land remains unclear. I am not aware of an appraisal being conducted during any time relevant to these proceedings. Days after the district court's October 2015 letter decision, the Valenzuelas' attorney

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Trust & Estates –

Income Tax of Decedents – Collection and Personal Liability

By Patricia Tucker

In mid-2017, two new developments highlighted a changing approach of the IRS to collection of outstanding income tax due from decedents. When the IRS files a formal claim and appears in a formal probate or action in court to close a trust, general lien priority rules apply. In this context, the federal tax lien by statute has priority over administrative expenses and statutory allowances, even those given priority by state statute. IRM 5.17.13.4, IRM. The doctrine of Federal Preemption moves the IRS claims ahead of the state statutory priority statutes, and also takes priority over the state provisions for setting limitations on the filing of claims by giving Notice to Creditors.[1] This brings into play three alternatives to the IRS's traditional practice of filing a formal claim in state court probate or trust closing proceedings.

Chief Counsel Advice 201723018, June 2017, considered a situation in which the IRS filed a proof of claim in a probate proceeding, but failed to object to a Request for Approval of Final Accounting which provided for payment of several debts and expenses that did not have priority over the income tax claims. The advice was that failure to object to that Request for Approval, or to file an appeal, waived not only the claim in the probate, but also waived assertions of transferee liability or fiduciary liability. The advice concluded that the "best practice" for the IRS was to either refrain from participating in the probate and use collection alternatives, or to enter the probate and fully participate.

The IRS is increasingly pursuing three alternatives: (1) imposition of **personal liability on fiduciaries** who pay certain debts of the decedent which are not superior to the IRS liens; (2) **transferee liability** imposed on beneficiaries to the extent of the value of property received; and (3) **foreclosure of liens** on property received by beneficiaries. These three collection mechanisms apply whether or not a probate is filed.

The first two types of liabilities, personal liability of a fiduciary and transferee liability, are not limited to the specific property received. Collection can be made from any property of the fiduciary or a beneficiary otherwise available. Foreclosure of tax liens, however, is limited to seizure of the specific property covered by the lien. Sometimes the Internal Revenue Service has more than one basis on which to proceed to collection. For example, if real property subject to a recorded tax lien passes on a transfer-on-death deed, the IRS may either foreclose on the specific real estate by filing in Federal District Court or proceed against the beneficiary on transferee liability grounds.

1. Personal Liability of a Fiduciary

Personal liability of a fiduciary or executor arises under 31 U.S.C. § 3713. Subsection (a) states that a claim of the U.S. Government will be paid first when the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor. Subsection (b) provides that a representative of a person or an estate who pays any part of a debt of the person or estate before paying a US government claim is personally liable to the U.S. Government to the extent of the payment for unpaid claims of the government. The statute of limitation for assertion of fiduciary liability is not later than 1 year after the liability arises or not later than the expiration of the period for collection

from the decedent, whichever expires later. Sec. 6901(c)(3), IRC.

However, for personal liability purposes under 31 U.S.C. § 3713, covered debts are often held to be limited to debts "of the decedent" incurred prior to his or her death. Expenses or debts which arise after death are not debts of the decedent. The payment of funeral expenses (*Rev. Rul. 80-112*); administrative expenses including attorney fees and court costs, *In Re Estate of Funk*, 849 NE 2d 366 (2006); and family allowances, *Schwartz v. Commissioner*, 560 F.2d 366 (2006), do not create personal liability under 31 U.S.C. § 3713.

Under § 3713, an "executor" must have knowledge of the tax liability. The test is whether the "executor" knew *or should have known* of the tax liability. *McCourt v. Comm., 1950 TC 734.* Knowledge can be inferred from knowledge that no income tax returns had been filed by the decedent, information that returns should be amended, or knowledge that a tax audit is occurring or likely.[2]

For this section, an "executor" is defined as **any person** in possession of property of a decedent, whether through a probate or otherwise. The recipient of property from a decedent, say a stock account on a payable on death transfer, is a person in possession of property of a decedent for this purpose. If the proceeds of the account are used to pay other creditors of a decedent while there is outstanding federal income tax due, the recipient of the funds is an "executor" for the purpose of personal liability. For example, if a probate is opened and the personal representative pays a credit card debt of the decedent, then the personal representative can be personally liable for the decedent's tax to the extent of the credit card payment made.

The "should have known" basis for liability raises questions as to what steps an executor should take to avoid personal liability. A release of a fiduciary from personal liability issued by a probate court does not release an executor from personal liability under § 3713 unless the tax priorities were actually determined in the probate proceeding and all appeals have been exhausted. *See Leroy New*; *US v. Weisburn, 48 F. Supp. 393 (E.D. Pa, 1943).* A request for release of personal liability of a fiduciary for outstanding tax debt of the decedent may be filed using IRS Form 5495. There may or may not be an audit or request for information after the Form is filed. If the request is not denied, the fiduciary is released nine months after the form is filed.

2. Transferee Liability of a Beneficiary

Transferee liability arises when a transfer is made during insolvency, or created an insolvency of the decedent, the transfer was for no or inadequate consideration and the transfer was made at a time when there were outstanding debts of the transferor or debts were reasonably anticipated. Transferees for these purposes include donees, heirs, devisees, legatees and distributes. Transferee liability is imposed on persons who received property of a decedent who owed federal taxes. *Shimco v. Commissioner*, TC Memo 1972-64.

Transferee liability is assessed in the same manner as income tax assessments. Notice of an anticipated assessment is given to the transferee, and Tax Court determination of liability is available. Liability is general – collection can be made from any assets of the transferee, not just from the property received. The statute of limitations (issuance of a Statutory Notice of Deficiency, for practical purposes) on the initial transferee is one year after the expiration of the statute of limitations on collection from the decedent.

3. Lien Foreclosure

Lien enforcement is a collection method often used in connection with real property that is subject to a federal tax lien. The reason is that liens can be foreclosed without any delay for administrative procedures which would apply in the case of transferee liability or fiduciary personal liability situations.

A tax lien can be foreclosed by an action in federal district court. In most cases, the liability is reduced to judgment and the judgment foreclosed on in the same proceeding.

Practical considerations:

Dealing with an insolvent estate with outstanding federal tax liabilities is a complicated undertaking. Strict procedures need to be followed and care needs to be taken to ensure that any payment of expenses and claims will not subject the fiduciary to personal liability. Understanding of the particular priority rules regarding federal tax liens, and the breadth of possible discretionary waivers of priority for certain expenses, is essential in protecting a fiduciary.

There are a number of steps available to protect against the risk of liability:

A fiduciary is required to file a Form 56 Notice of Fiduciary Relationship with the IRS. After the Notice is filed, the fiduciary will receive a Notice of Tax Due. This will include only tax already assessed. Tax which will be due on returns not yet filed are not included in the Notice, nor are potential audit deficiencies. The Notice is not a claim in any probate or trust closing proceeding. If the IRS wants to file a formal claim, it is done by separate document.

Request a transcript of account on the last six years to ensure that returns were filed and to determine if any audits have been opened or any claims for refund are pending. File any delinquent returns.

File a Form 4810 request for prompt assessment of income tax on any returns for which deficiency assessments are possible. This will shorten the three-year assessment statute period to eighteen months from the request.

Marshall assets from outside the probate estate into the probate to pay the tax claims, or obtain informal payment or contribution from holders of non-probate assets. Property outside of probate is still subject to levy or other collection action.

Request for discharge from personal liability for income tax using a Form 5495.

Endnotes

[1] In mid-2017, the case of *Estate of Frederick Alan Simmons, Raelinn Spiekhout, PR* (May 22, 2017, SD IN) held, on the basis of strong Supreme Court precedent, that a recorded federal tax lien for income tax had precedence over all other claims filed in a probate, including claims with priority from creditors' claims under state law. Such superseded claims included claims for administrative expenses such as PR/Trustee fees, attorney and professional fees, statutory allowances, funeral expenses, etc. *See also Bd. Comm Jackson County v. US*, 308 US 343 (1939); *US v. Summerlin*, 30 US 414 (1940). This is federal preemption at work.

[2] *Leroy New, 48 TC 1967*; *Frost, TC Memo 1993-94*; *Giovanine Terranove, 2 TCM 616 (1943).*

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The Tax Lien Sale That Generated Two Lawsuits and Two *Pro Se* Appeals … And Counting

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issued a press release stating that the land was worth $50,000, double the amount claimed in the 2012 amended complaint.[3]

Conclusion

Regardless of the resolution of the issue presented in the latest appeal, a prolonged window of time in which the former owner may file a lawsuit challenging a tax lien sale will tend to discourage people from bidding at a tax lien auction, making it more difficult for the state to obtain payment of unpaid property taxes via public auction.

There are numerous ways in which the tax lien sale procedures can be improved. For example, the provision of notice of an impending tax sale could be made easier than it was decades ago when the Property Tax Code was enacted, by allowing email to be used as an additional means of notice to those who agree to it. Additionally, protection of the delinquent taxpayer could be promoted, in part, by requiring that a winning bid must exceed a minimum percentage of assessed value.

Endnotes

[1] Joline Gutierrez Krueger, "$215 Property Fight Goes to NM Supreme Court," *Albuquerque Journal*, August 9, 2014. The other three articles were published in December 2014, October 2015, and June 2017.

[2] For example, in August 2012, the Valenzuelas offered, through their counsel, to repurchase the land by reimbursing the purchasers the $215 paid at auction, an offer that was rejected in part due to the time and expenses the Snyders had already incurred on the case.

[3] October 26, 2015 press release issued by attorney Eric Dixon of Portales (PDF on file with author). Conversely, the Snyders contended the land was worth about $7,500. Joline Gutierrez Krueger, "Couple loses property bought at tax auction after 4-year battle," *Albuquerque Journal*, October 31, 2015, A1, A4.

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