

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 14860
[Redacted],	)	
	)	DECISION
Petitioners.	)	
_____	)	

On May 26, 2000, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayers), proposing additional income tax and interest for the taxable year 1997 in the total amount of \$32,063.

On June 7, 2000, the taxpayers sent a letter to the auditor, which was treated as a protest of the Notice of Deficiency Determination. In a subsequent letter dated June 15, 2000, the taxpayers stated their June 7 letter was not a protest nor did their case belong in appeals. The taxpayers stated the purpose of their letter was to point out that the Idaho law had no statute that makes an individual liable for income tax and to file an amended return asking for a refund of all the tax they paid because they had no statutory income.

Regardless, the taxpayers' letters were considered a protest and their case was referred for the administrative review process. The taxpayers requested a hearing to be held in the Coeur d'Alene office of the Tax Commission; however, those arrangements could not be met in a timely manner. Therefore, the taxpayer and the Tax Commission agreed to present and exchange positions through the mail. The Tax Commission, having reviewed the file, hereby issues its decision.

The Income Tax Audit Bureau (Bureau) examined the taxpayers' 1997 Idaho income tax return regarding the taxpayers' change in resident status and the flow-through items of the taxpayers' subchapter S corporations. The Bureau agreed with the taxpayers' resident status as

the evidence showed the taxpayers moved from Idaho to Washington in September 1997. However, the Bureau did adjust the taxpayers' 1997 return to reflect audit changes made to the taxpayers' subchapter S corporations.

In both of the letters the taxpayers sent after the Bureau's Notice of Deficiency Determination, the taxpayers never referred to the proposed change to their 1997 Idaho income tax return. Neither did the taxpayers present any argument against the Bureau's proposed change during the information and fact gathering process. Since the taxpayers did not present anything to show error in the Bureau's adjustment, they have not met their burden of proof. Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814, 683 P.2d 846, 850 (1984). Therefore, the Tax Commission hereby upholds the audit determination.

However, the taxpayers did submit an amended return for 1997, which the Tax Commission needs to address. The taxpayers claimed on their amended return that they had no sources of income, that income for tax purposes means corporate profit and that as individuals they had no profit; therefore, they had zero income. The taxpayers' amended return asked for a refund of \$18,502 plus any accrued interest.

In the taxpayers' argument of no sources of income they referred to Internal Revenue Code (IRC) section 61 which defines gross income in general as "all income from whatever source derived." The taxpayers believe the "source derived" is legally limited by definition in IRC section 861 and the regulations thereunder. The taxpayers believe that only the income described in the "operative sections," as listed in the regulations, are sources within the United States and therefore taxable. Since the taxpayers have no income from the identified sources, they have no taxable sources of income.

The Tax Commission views the source of income argument as a misinterpretation of the IRC. Section 861 of the IRC is for guidance in determining whether income is from sources within the United States or without the United States in the determination of the taxable income of non-U.S. citizens, nonresident aliens, and foreign corporations. Regulation 1.861-1(a) states in part, "[T]hese sections explicitly allocate certain important sources of income to the United States or to areas outside the United States, . . ." The regulation goes on to say, "[T]he rules contained in this section apply in determining taxable income of the taxpayer from specific sources and activities under other sections of the Code, referred to in this section as operative sections." The operative sections referred to are for the determination of whether income is sourced within or without the United States in order to compute other provisions of the IRC, i.e. foreign tax credit, DISC and FSC income, etc.

The courts have stated the following when faced with individuals arguing they have no sources of income within the United States.

Apparently, petitioner believes that the only sources of income for purposes of section 61 are listed in section 861, that income from sources within the United States is taxed only to nonresident aliens and foreign corporations pursuant to sections 871, 881, and 882, and that section 1461 is the only section of the Internal Revenue Code that makes anyone liable for the taxes imposed by sections 1 and 11.

Section 61(a) defines gross income generally as "all income from whatever source derived," including, but not limited to, compensation for services and interest. Sec. 61(a)(1), (4). Section 63 defines and explains the computation of "taxable income." Section 1 imposes an income tax on the taxable income of every individual who is a citizen or resident of the United States. Sec. 1.1-1(a)(1), Income Tax Regs.; see *Habersham-Bey v. Commissioner*, 78 T.C. 304, 309 (1982).

Under section 61(a)(1) and (4), petitioner clearly is required to include his wages, tokens, and interest in gross income. It is well established that compensation for services, in whatever form received, is includable in gross income . . . . Petitioner is liable for Federal income taxes on the wages, tokens, and interest he received during 1991. *Aiello v. Commissioner*, T.C. Memo. 1995-40.

Plaintiff argues further that his remuneration is exempt from taxation under 26

U.S.C. § 861(a)(3)(C)(ii), and thus excludable under 26 U.S.C. § 61 and, by reference, excludable under Wisconsin law. Suffice it to say that if plaintiff wished to avail himself of § 861(a)(3)(C)(ii), he would have to show that his work was done for a foreign office, or an office in a United States possession, of a domestic business entity. He has not alleged this, and it is clear from the record that he performed his work in the State of Wisconsin for Wisconsin employers. Peth v. Breitzmann, 611 F. Supp 50.

In his petition, petitioner contends that respondent erred in determining the deficiencies and additions to tax because “All income received by Petitioner for the tax years in question is/was untaxable 'earned income' as defined in I.R.C. Section 911(d)(2)(A).” At the hearing on respondent's Motion For Summary Judgment, petitioner also claimed that “all of my gross income was received without the United States as defined in Subchapter N of 26 CFR 1.861-1,” and “I am not a citizen of the federal U.S. I make a living in the state of Illinois as a right, and I am not subject to the jurisdiction of the federal United States.”

We find no support for petitioner's position in the authorities he cites. Section 911(d)(2)(A) provides a definition of "earned income" for purposes of section 911. Section 911(a) allows an exclusion from gross income for foreign earned income at the election of a qualified individual, defined as an individual whose tax home is in a foreign country. Sec. 911(d)(1). Petitioner had no foreign earned income and is not a qualified individual for purposes of section 911. Similarly, petitioner's position is not bolstered by the regulations under section 861. To the contrary, section 861(a)(1) and (3) provides that interest from the United States and compensation for labor or personal services performed in the United States (with exceptions not applicable here) are items of gross income which shall be treated as income from sources within the United States.

Section 1 imposes an income tax on the income of every individual who is a citizen or resident of the United States. During the years at issue petitioner resided in Illinois and therefore was a resident of the United States and subject to tax under section 1. A Federal income tax return must be filed by all individuals receiving gross income in excess of certain minimum amounts. Sec. 6012; sec. 1.6012-1(a), Income Tax Regs. Petitioner's gross income in each year exceeds the minimum amount. In short, petitioner is a taxpayer subject to the Federal income tax laws. Solomon v. Commissioner, T.C. Memo 1993-509.

As a citizen of the United States during the years at issue, petitioner is subject to United States Federal income tax on his worldwide income. Sec. 1; Cook v. Tait, 265 U.S. 47 (1924); sec 1.1- 1(a)(1) and (c), Income Tax Regs. It is unnecessary to determine whether that income was from sources within or without the United States since petitioner is not a nonresident alien. See sec. 861. Dacey v. Commissioner, T.C. Memo 1992-187.

The underlying fact is that the taxpayers are U.S. citizens and resided in the United States in 1997. Therefore the taxpayers are taxable on their worldwide income.

The taxpayers argued that the word "income" is not defined in Federal law but that the Supreme Court said "income" means corporate profit. The taxpayers provided an excerpt from the Supreme Court case of Merchant's Loan & Trust Co. v. Smietanka, 255 U.S. 509, 1126 (1921), stating that the word "income" has the same meaning that it had in the Corporation Excise Tax Act. From this the taxpayers made the claim that "income" means corporate profit.

However, this is not exactly what the Court said. The Court stated that the Corporation Excise Tax Act of August 5, 1909, defined the word income. The Court stated it was obvious that the decisions written in developing the definition of the word "income" as used in the Corporation Excise Tax Act of 1909 has the same meaning and content in the Income Tax Acts of 1913, 1916 and 1917. This does not mean that income is only corporate profit. It means income is what the Court stated in Eisner v. Macomber, 252 U.S. 189: the gain derived from capital, from labor, or from both combined and to include profit gained through the sale or conversion of capital assets.

Therefore, income is not just corporate profit. Income includes those items listed in IRC section 61 of which a shareholder's distributive share of S corporation income is a part.

The taxpayers also presented alternative arguments of voluntary compliance, the income tax is imposed directly which violates the constitution, items of income are not sources, there is no statute under Idaho law (or federal law) that makes an individual liable for income tax, and that Idaho violates its constitution when it defers to Federal law when determining the meaning of income.

The taxpayers' belief that their obligation to file and pay income tax is completely voluntary is erroneous. While both the federal and Idaho tax laws are based on honest and forthright self-reporting, this does not support the argument that these laws are optional.

Lonsdale v. United States, 919 F.2d 1440, 1448 (10th Cir. 1990); Wilcox v. Commissioner, 848 F.2d 1007, 1008 (9th Cir. 1988); United States v. Witvoet, 767 F.2d 338, 339 (7th Cir. 1985).

The taxpayers stated the income tax is imposed directly which is in violation of the constitution. However, Idaho and federal courts specifically rejected similar arguments that the income tax is unconstitutional on the alleged grounds that it is an unapportioned direct tax. In Brushaber v. Union Pacific Railroad Co., 240 U.S. 1 (1916), the court stated the federal income tax of 1913 was constitutionally valid even though it imposed an unapportioned direct tax. Ratification of the Sixteenth Amendment removed the constitutional barrier against unapportioned direct taxes. As for Idaho, the court stated in Diefendorf v. Gallet, 51 Idaho 619 (1932), the Idaho income tax, which is an excise tax and not a property tax, is constitutional.

The taxpayers' argument that items of income are not sources comes from IRC section 61 where it defines gross income as all income from whatever source derived and then states "including (but not limited to) the following items." At this point the IRC provides a nonexclusive list. The list includes compensation for services, fees, commissions, gross income from business, gains from dealings in property, interest, rents, royalties, dividends, pensions, and more.

The taxpayers argued that this list is a list of items of income rather than a list of sources of income. However, looking at the list and the language of the IRC, the Tax Commission sees the list as a list of sources of income. The term "items" used in referencing a list has the meaning of members of a particular group. In IRC section 61 the group or the listing is of "income from whatever source derived." Therefore, the Tax Commission finds this argument unpersuasive.

The taxpayers claimed that there is no law or statute that makes them liable for income taxes. The Tax Commission finds this argument frivolous and without merit. IRC subchapter A,

part I, section 1 is the determination of tax liability for the tax imposed on individuals. "Section 1 imposes an income tax on the taxable income of every individual who is a citizen or resident of the United States. Sec. 1.1-1(a)(1), Income Tax Regs." Habersham-Bey v. Commissioner, 78 T.C. 304, 309 (1982). This section of the IRC seems to clearly impose a tax liability for federal income taxes. Likewise, Idaho Code section 63-3024 imposes a tax, measured by Idaho taxable income, on the income of individuals meeting the filing requirements of Idaho Code section 63-3030.

Finally, the taxpayers argued it is against Idaho's constitution to delegate its legislation to another legislative body. Here the taxpayers are saying that, since Idaho law defers to federal law in determining the meaning of "income," the Idaho Legislature delegated its authority to create law to the Congress of the United States. The Tax Commission does not agree.

The Idaho Legislature has the authority and ability to create laws for the state of Idaho. In that process, the Idaho Legislature can adopt federal laws or the laws of another state. It can also choose to "model" an Idaho law after that of another state or the federal government. By adopting a law already in existence, the Idaho Legislature is not delegating its authority to create Idaho law. The law is decided by the Idaho Legislature and voted into law if deemed appropriate for the state of Idaho.

Having considered the taxpayers' arguments, the Tax Commission is not persuaded that the amended return submitted by the taxpayers is a true and accurate representation of the taxpayer's Idaho taxable income. Therefore, the Tax Commission denies the taxpayers' refund claim. In addition, the Tax Commission upholds the Bureau's determination.

WHEREFORE, the refund request made by the taxpayers' amended return is hereby DENIED and the Notice of Deficiency Determination dated May 26, 2000, is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
1997	\$27,259	\$7,464	\$34,723

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayers' right to appeal this decision is included with this decision.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2001.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED] Receipt No. [Redacted]  
[Redacted] [REDACTED]

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ADMINISTRATIVE ASSISTANT 1