

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

In the Matter of the Protest of	)	
	)	DOCKET NOS. 15025 & 15460
[REDACTED],	)	
	)	DECISION
Petitioners.	)	
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On July 28, 2000, the Income Tax Audit Section of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (petitioners), asserting income tax, penalty and interest in the amount of \$3,698 for the taxable years 1995 through 1997.

On August 18, 2000, the petitioners filed a protest and requested an informal conference. The matter was assigned Docket No. 15025. The informal conference regarding Docket No. 15025 was conducted on March 20, 2001. The petitioners attended the conference and submitted additional materials during the conference.

On January 3, 2001, the Tax Discovery Bureau of the Idaho State Tax Commission issued another Notice of Deficiency Determination to the petitioners. The second Notice of Deficiency Determination asserted income tax, penalty and interest in the amount of \$27, 878 for tax year 1998.

On March 1, 2001, the petitioners filed a protest and requested another informal conference. The second protest and hearing was assigned Docket No. 15460. At the petitioners' request Docket No. 15025 and Docket No. 15460 were combined. An informal conference was conducted on September 6, 2001, at which time the petitioners discussed issues relating to their protests in both Docket No. 15025 and Docket No. 15460.

This decision is based on the information contained in the Commission's files, including materials and notes from the informal conferences. The Commission has reviewed the files, is advised of their contents, and now issues its decision.

For the taxable years 1995 through 1997, the petitioners filed Idaho individual income tax returns and paid the amount of tax due, as shown on those returns. However, on January 20, 2000, an individual acting as the petitioners' representative filed documents purporting to be amended returns. The documents filed by the petitioners' representative reversed many of the deductions the petitioners claimed on the individual income tax returns they filed. Instead of claiming the deductions, the representative asserted the petitioners' reported income was exempt from taxation. Based on the asserted exemption, the petitioners' representative claimed a refund.

The Tax Commission's Tax Auditor reviewed the documents filed by the petitioners' representative and concluded the petitioners' income was not exempt from taxation as claimed by the representative. The auditor therefore denied the representative's request for a refund.

Because the representative purported to "amend" the original returns by means of the documents he filed with the Commission, the auditor also prepared provisional returns for the petitioners using the available wage and income information reported on Forms W-2 and 1099. The auditor provided the petitioners with standard deductions and personal exemptions in preparing the provisional returns, rather than the deductions claimed by the petitioners on their original returns. The change in reported deductions resulted in an additional tax liability for the petitioners. The provisional returns showed a total deficiency of \$ 3,698 (tax, penalty and interest) and the auditor issued a Notice of Deficiency Determination in that amount.

The petitioners' representative also filed documents entitled "Legal Notice" with the Tax Commission regarding the 1998 tax year. The petitioners did not file a standard return for that tax year as they had in previous years. In the "Legal Notice" filed by the representative, the representative again claimed the petitioners' wage and income information reported on their W-2 and 1099 forms was exempt from Idaho's individual income tax.

The Commission's Tax Enforcement Specialist (specialist) contacted the petitioners' representative and explained that the "Legal Notice" filed for tax year 1998 did not constitute an acceptable individual income tax return. The Specialist also advised that the petitioners would be treated as nonfilers unless they filed a proper tax return.

The petitioners declined to file a proper return so the specialist prepared a provisional return for the 1998 tax year based on the wage and income information reported on Forms W-2 and 1099. The Specialist provided the petitioners with standard deductions and personal exemptions in preparing the provisional return. The provisional return showed a total deficiency of \$ 27,878 (tax, penalty and interest) and the Specialist issued a Notice of Deficiency Determination in that amount.

The petitioners and their representative believe the petitioners' wages and other income is exempt from federal and state individual income tax because: (1) the petitioners' wages are not "income" subject to tax; (2) federal and state taxes are based solely on "voluntary compliance"; (3) the Idaho income tax is an unconstitutional excise tax; and (4) the Tax Commission did not have the authority to issue a Notice of Deficiency Determination.

The Tax Commission finds the petitioner's legal arguments are erroneous as a matter of law. The courts have addressed and rejected these common tax protestor arguments. Additionally, Idaho law clearly sets forth the petitioner's obligation to file tax returns and pay the amount of tax properly due on those returns. The Commission is authorized to issue a Notice of Deficiency Determination when an individual fails to satisfy his or her tax obligations.

The record before the Tax Commission demonstrates the petitioner was an Idaho resident during the years in question. The term "resident" is defined in Idaho Code § 63-3013 as any individual who has resided in the state of Idaho for the entire taxable year or who is domiciled in this state.

The petitioners do not dispute they are residents of Idaho. The petitioners' representative

originally asserted the petitioners' wages should be exempted from taxation because they were earned outside the borders of the state of Idaho. However, at the informal conference, the petitioners withdrew this ground for exemption and agreed that, consistent with court rulings, the income of a resident may be taxed regardless of where the income is earned. Domicile itself affords a basis for a state's individual income tax. People of State of New York ex rel. Cohn v. Graves, 300 U.S. 308, 312-13 (1937). "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. . . . Enjoyment of the privileges of residence in the state and the attendant right to invoke the protections of its laws are inseparable from responsibility for sharing the costs of government."

Rather than challenging the state's jurisdiction to tax income earned outside the state of Idaho, the petitioners contend their wages are not income. However, the courts have consistently held that wages are income for income tax purposes. Coleman v. Commissioner, 791 F.2d 68, 70 (7th Cir.1986); United States v. Lawson, 670 F.2d 923 (10th Cir. 1982); United States v. Buras, 633 F.2d 1356 (9th Cir. 1980); Mitchell v. Agents of State, 105 Idaho 419, 425 (1983); State v. Staples, 112 Idaho 105, 107 (Ct. App. 1986); Parsons v. Idaho State Tax Com'n, 110 Idaho 572, 575 (Ct. App. 1986).

The petitioners also asserted they "elected" not to file a return under the provisions of 26 U.S.C. § 63(e). The petitioners' reliance on this section of the Internal Revenue Code is misplaced. Section 63(e) of the Internal Revenue Code allows taxpayers to make the election between claiming a standard deduction and itemizing their deductions when determining their taxable income for federal income tax purposes. The code section does provide taxpayers with the option of voluntarily complying with the requirements of filing tax returns and paying income tax.

The courts have addressed the argument that the obligation to file returns and pay income tax

is completely voluntary. 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 courts also have addressed and rejected the common tax protestor argument that the individual income tax is an unconstitutional excise tax. In Brushaber v. Union Pacific Railroad Co., 240 U.S. 1 (1916), the United States Supreme Court ruled the federal income tax of 1913 was constitutionally valid even though it imposed an unapportioned direct tax. The Court held the ratification of the Sixteenth Amendment removed the constitutional barrier against unapportioned direct taxes. In the case of Diefendorf v. Gallet, 51 Idaho 619 (1932), the Idaho Supreme Court found the Idaho income tax, which is an excise tax and not a property tax, is constitutional.

The Idaho income tax filing requirements are set out in Idaho Code § 63-3030. Any resident who, during the taxable year, has a gross income in excess of the stated threshold amount must file a return. The petitioners' annual income exceeded the threshold amount determined by law.

Persons who are required to file an Idaho individual income tax return also must pay Idaho income tax on their taxable income at the rate set forth in Idaho Code § 63-3024. Therefore, under Idaho laws, the petitioners were required to file Idaho individual income tax returns and pay the Idaho income tax shown as due on those returns.

In the event a person fails to file a tax return or to pay the proper amount of individual income tax, Idaho law specifically provides the Commission with the authority to issue a Notice of Deficiency Determination.

**63-3045. NOTICE OF REDETERMINATION OR DEFICIENCY -- INTEREST.** (1) (a) If, in the case of any taxpayer, the state tax commission determines that there is a deficiency in respect of the tax imposed by this title, the

state tax commission shall, immediately upon discovery hereof, send notice of such deficiency to the taxpayer by registered or certified mail or by other commercial delivery . . . .

As stated above, the Enforcement Specialist found a deficiency existed based upon the wage information reported by petitioners' employers on Form W-2, as well as other income reported on Form 1099. Because the petitioners were domiciled in Idaho and were Idaho residents, the Enforcement Specialist correctly determined the petitioners' wages and other income was subject to Idaho individual income tax and issued a Notice of Deficiency Determination.

It is well settled in Idaho that a Notice of Deficiency Determination issued by the Idaho State Tax Commission is presumed to be correct. Albertson's Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814 (1984); Parsons v. Idaho State Tax Com'n, 110 Idaho 572, 574-575 n.2 (Ct. App. 1986). The burden is on the petitioner to show that the tax deficiency is erroneous. Id. Since the petitioners failed to meet the burden regarding the deficiency for the tax year 1998, the Tax Commission finds that the amount shown due on the Notice of Deficiency Determination for tax year 1998 is true and correct.

For the reasons stated above, the Commission's auditor also correctly denied the representative's claim for a refund regarding tax years 1995 through 1997. However, the Tax Commission is mindful that the Idaho federal district court recently found the petitioners' representative guilty of tax fraud, in large part for preparing and filing with tax authorities documents similar to the documents filed with the Tax Commission in this case. Therefore, the deductions the petitioners claimed on the original returns they filed for tax years 1995 through 1997 will not be reversed or disallowed as suggested by the petitioners' representative in the "amendment" documents he filed with the Commission. The misplaced reporting by the representative aside, there is no reason to believe the deductions petitioners claimed on their original

tax returns are not proper deductions.

WHEREFORE, the portion of the Notice of Deficiency Determination dated July 28, 2000, asserting income tax, penalty and interest in the amount of \$3,698 for the taxable years 1995 through 1997, is hereby WITHDRAWN AND CANCELED regarding the asserted deficiency.

HOWEVER, to the extent the Notice of Deficiency Determination dated July 28, 2000, denied the petitioners' request for a refund for taxable years 1995 through 1997, the Notice is hereby APPROVED, AFFIRMED, AND MADE FINAL.

FURTHER, the Notice of Deficiency Determination dated January 3, 2001, asserting income tax, penalty and interest in the amount of \$27,878 for the taxable year 1998 is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners' refund claim is DENIED and that the petitioners pay the following tax, penalty and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1998	\$ 16,956	\$ 8,478	\$ 3,557	<u>\$ 28,991</u>

Interest is calculated through December 31, 2001, and will continue to accrue at the rate of \$3.71 per day until paid.

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

An explanation of the petitioners' right to appeal this decision is enclosed 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]  
[REDACTED]

Receipt No. [Redacted]

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ADMINISTRATIVE ASSISTANT 1