BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 15686
[Redacted],	)	
	)	DECISION
Petitioners.	)	
	)	

On May 2, 2001, the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (petitioners). The Notice of Deficiency Determination was in the amount of $6,549 (tax, penalty and interest) concerning taxable year 2000. The notice advised the petitioners they could file a Petition for Redetermination with the Commission if they disagreed with the Bureau's determination.

On June 29, 2001, the petitioners filed a letter of protest that the Commission treated as a petition for redetermination. The petitioners and the undersigned Commissioner met in an informal conference on December 3, 2001, to discuss the deficiency determination.

During the informal conference, the petitioners submitted their written analysis of the Internal Revenue Service's Notice 2001-40. IRS Notice 2001-40 is the Service's interpretation of section 861 of the Internal Revenue Code (IRC § 861). The Service stated that IRC § 861 does not apply to resident citizens such as the petitioners. The petitioners disagreed with the Service's analysis. Upon further discussion, the petitioners requested an opportunity to submit additional documentation that would include citations to court cases interpreting IRC § 861. The Commission extended the time for submitting information and the parties agreed that the statutory 180-day period for issuing a decision would not begin until the petitioners submitted the information.

The Commission received the additional information from the petitioners on February 4, 2002. The Commission reviewed all of the documents and information submitted by the petitioners, as well as the file of the Tax Discovery Bureau, is advised of their contents, and now issues its decision. For the reasons set forth below, the Commission affirms the deficiency determined by the Bureau.

The petitioners filed federal and Idaho individual income tax returns for the taxable year 2000. The returns showed $ -0- federal adjusted gross income and $ -0- taxable income. Based on the "zero" returns they filed, the petitioners sought refunds of the entire amount of taxes withheld by their employers.

A Tax Enforcement Specialist (specialist) of the Bureau reviewed the returns and accompanying documents filed by the petitioners. The petitioners lived in [Redacted], Idaho during taxable year 2000. As reported on Forms W-2 the petitioners each received wages from the [Redacted] and from [Redacted] in [Redacted] Idaho. However, a majority of their income (about $67,000) was made up of distributions from Standard Insurance Company as reported on Form 1099-R. Additionally, the petitioners have a sales tax permit. They reported sales and forwarded returns and sales tax to the Commission. The amount of sales reported for taxable year 2000 was about $2,300.

Based on these facts the specialist determined the petitioners were Idaho residents with gross income of about $87,000. In a letter dated April 10, 2001, the specialist notified the petitioners that absent additional information from them, the Commission would be required to adjust their Idaho return to match the income reported on the W-2 forms.

The petitioners responded in a letter dated April 17, 2001. The petitioners stated the wages reported on their W-2 forms was not income subject to tax and asserted other arguments.

The specialist recognized the petitioners' arguments as tax protestor arguments the Commission has addressed and rejected. Therefore, after receiving the petitioners' response, the specialist prepared a provisional return for taxable year 2000, providing the petitioners with personal exemptions and deductions, a grocery credit and a credit for withholding tax. The total deficiency determined by staff amounted to $6,549 (tax, penalty and interest). The specialist issued a Notice of Deficiency Determination in that amount on May 2, 2001, as indicated above. The Notice of Deficiency Determination included an explanation of the adjustments made to their return, a copy of the provisional return prepared by the specialist, a document showing the calculation of interest, and an explanation of the petitioners' right to request a redetermination.

The petitioners seek a redetermination of the deficiency determined by the Bureau on several grounds. The petitioners believe they are not required to report their wages and other compensation on their Idaho tax return or pay Idaho individual income taxes because: (1) they do not have Idaho taxable income as their income does not derive from a "source" listed in IRC § 861; (2) their wages are not "income" subject to tax, (3) federal and state taxes are based solely on voluntary compliance; and (4) the Idaho income tax is an unconstitutional excise tax

Although the petitioners assert they are not "tax protestors" these are the very type of arguments that tax protestors make when attempting to evade state and federal income taxes. State and federal courts have rejected these common tax protestor themes time and time again. In Coleman v. Commissioner of Internal Revenue, 791 F.2d 68, Judge Easterbrook penned,

> Some people believe with great fervor preposterous things that just happen to coincide with their self-interest. "Tax protesters" have convinced themselves that wages are not income, that only gold is money, that the Sixteenth Amendment is unconstitutional, and so on. These beliefs all lead--so tax protesters think--to the elimination of their obligation to pay taxes. The government may not prohibit the holding of these beliefs, but it may penalize people who act on them.

The petitioners assert some of the same arguments discussed by Judge Easterbrook. They believe their tax obligation has somehow been eliminated despite the fact that they live and earn a living in Idaho.

Simply stated, the petitioners' arguments are not supported by fact or law. Although the petitioners indicated they would conduct research and provide court cases interpreting IRC § 861 in the manner they suggest, the materials submitted by the petitioners did not contain any such cases. Indeed, the reported authority is to the contrary.

The courts have rejected the argument that IRC § 861 exempts all income from taxation other than income earned from a foreign source. The Idaho and federal income taxes are based on a person's gross income. Internal Revenue Code § 61 defines the term "gross income" to mean all income from whatever source derived and then it gives a non-exclusive list of various types of income. The federal regulations state that U.S. citizens (and residents) are taxed on all of their income regardless of where the source is located.

> In general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States.

Treas. Reg. § 1.1-1(b). Therefore, the general rule is that for United States citizens and residents all income is included in gross income and the taxpayer must demonstrate that the income is not taxable.

In contrast, nonresident aliens and foreign corporations are taxed only on income from sources within the United States. Consequently, it is necessary to identify the sources of income (and deductions) for nonresident aliens and foreign corporations. This is what IRC § 861 and the accompanying regulations address.

The courts rejected the petitioners' argument that a citizen and resident of the United States is not taxed on income earned 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.

Habersham-Bey v. Commissioner, 78 T.C. 304, 309 (1982). *See also* 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 (E.D. Wis. 1985). *See also* Solomon v. Commissioner, T.C. Memo 1993-509 and Dacey v. Commissioner, T.C. Memo 1992-187. Internal Revenue Code § 861 applies to nonresident aliens and foreign corporations, it does not apply to resident citizens.

Since the petitioners are United States citizens and residents, they must report all of their income, regardless of the source of the income pursuant to Internal Revenue Code § 61, unless specifically excluded by the tax code itself. The policy of taxing residents in this manner is set forth in Idaho Code § 63-3002.

> **63-3002 Declaration of intent.** It is the intent of the legislature by the adoption of this act, **insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code** relating to the measurement of taxable income, to the end that the taxable income reported each taxable year by a taxpayer to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law; to achieve this result by the application of the various provisions of the Federal Internal Revenue Code relating to the definition of income, exceptions therefrom, deductions (personal and otherwise), accounting methods, taxation of trusts, estates, partnerships and corporations, basis and other pertinent provisions to gross income as defined therein, resulting in an amount called "taxable income" in the Internal Revenue Code, and then to impose the provisions of this act thereon to derive a sum called "Idaho taxable income"; **to impose a tax on residents of this state measured by Idaho taxable income wherever derived** and on the Idaho taxable income of nonresidents which is the result of activity within or derived from sources within this state. **All of the foregoing is subject to modifications in Idaho law** including, without limitation, modifications applicable to unitary groups of corporations, which include corporations incorporated outside the United States.

Idaho Code § 3002 (emphasis added). Despite the petitioners' interpretation of IRC § 861, neither the federal tax code, nor Idaho's tax statutes, excludes the petitioners' wages and other compensation from taxation by the state of Idaho.

The petitioners next argue that the term "income" is not defined under state or federal law, but that the U.S. Supreme Court said that "income" is limited to a corporate profit. This is not exactly what the Court said.

In Merchants' Loan & Trust Company v. Smientanka, 255 U.S. 509 (1921), the Court said 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.

As the Court stated in Eisner v. Macomber, 252 U.S. 189 (1920), the term "income" is defined for income tax purposes as gain derived from capital, from labor, or from both combined and to include profit gained through the sale or conversion of capital assets. One further note on the definition of the word "income." The Court in Merchant's stated, "In determining the definition of the word 'income' thus arrived at, this Court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution."

The Supreme Court of Idaho also stated that the terms used in statutes are given their plain, ordinary meaning. The plain ordinary meaning of a term can be found in the dictionary definition of the term. *See* Corporation of Presiding Bishop of Church of Jesus of Latter-Day Saints v. Ada County, 123 Idaho 410, 849 P.2d 83 (1993). Webster's New Collegiate Dictionary defines income as a gain or recurrent benefit usually measured in money that derives from capital or labor.

Contrary to what the petitioners assert, the courts have consistently held that wages or “compensation for labor” is 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 courts also rejected 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).

Additionally, the courts addressed and rejected the 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 record before the Tax Commission demonstrates the petitioners were domiciled in Idaho. The petitioners do not dispute that they lived in Idaho during the taxable year in question. Their Idaho domicile also means that the petitioners are residents of Idaho for Idaho income tax purposes. 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 Idaho income tax filing requirements are set out in the Idaho statute. Idaho Code § 63-3030 provides that every resident who has gross income, as defined by Section 61(a) of the Internal Revenue Code, exceeding a specified dollar amount is required to file an Idaho individual income tax return. For the taxable year 2000, the filing threshold for a married couple filing a joint return, both under the age of 65, was gross income in excess of $12,700. The petitioners' income information reported on Forms W-2 and 1099 and sales tax returns demonstrates the petitioners received gross income of approximately $87,000, an amount well in excess of the statutory threshold amount of income triggering a married couple's obligation to file an Idaho return for the taxable year 2000.

Persons who are required to file an Idaho individual income tax return must pay Idaho income tax on their taxable income at the rate set forth in Idaho Code § 63-3024. Contrary to the petitioners' arguments, they had taxable income subject to Idaho individual income tax. In sum, the petitioners were required to file an Idaho individual income tax return and pay the Idaho income tax that was correctly due on those returns.

The Tax Commission is charged with the duty of examining the returns filed with it and determining the correct amount of tax due.

> **63-3040. EXAMINATION OF RETURN AND DETERMINATION OF TAX.** As soon as practicable after the return is filed, the state tax commission shall examine it and shall determine the correct amount of the tax.

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 specialist found the information reported by the petitioners' employers and other persons on Forms W-2 and 1099, and by the petitioners themselves on their sales tax returns, indicated the petitioners were required to file a tax return and report their income. Because the petitioners were domiciled in Idaho and were Idaho residents, the specialist correctly determined the petitioners' income was subject to Idaho individual income tax, prepared provisional returns and issued a Notice of Deficiency Determination.

It is well settled in Idaho that provisional returns determined 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 petitioners to show that the tax deficiency is erroneous. Id. The petitioners have failed to show that the provisional returns prepared by the Tax Commission were incorrect. Therefore, based on the information available, the Tax Commission finds the provisional returns to be a fair representation of the petitioners' taxable income for the year in question and that the amount shown due on the Notice of Deficiency Determination is true and correct.

WHEREFORE, the Notice of Deficiency Determination dated May 2, 2001, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty and interest:

TAX	PENALTY	INTEREST	TOTAL
$4,309	$2,155	$393	$6,857

Interest is calculated through June 28, 2001, and will continue to accrue at the rate of $0.83 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 ___________________, 2002.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of ________________, 2002, 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]

____
ADMINISTRATIVE ASSISTANT 1