

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 15895
[Redacted],)	
)	DECISION
Petitioners.)	
_____)	

On October 1, 2001, the Tax Discovery Bureau (Bureau) 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 \$21,211 for the taxable years 1996 and 1997. The notice advised the petitioners that, if they disagreed with the deficiency determined by the Bureau, they could petition the Tax Commission for a redetermination.

The petitioners timely filed a letter of protest that the Commission treated as a petition for redetermination. The Commission notified the petitioners they could meet with a Commissioner or a designee in an informal conference to discuss the deficiency determined by the Bureau, or, in the alternative, submit additional information to show why the deficiency should be redetermined. The petitioners retained a representative and requested an informal conference.

The petitioners' representative requested that the informal conference be conducted by telephone. Pursuant to this request, a telephone conference was conducted on April 11, 2002, at 10:00 a.m. Mountain Standard Time.

This decision is based on the information contained in the Commission's files. Notes and information presented at the informal conference were placed in and made a part of the files. The Commission has reviewed the files, is advised of their contents, and now issues this decision. For the reasons set forth below, the Commission affirms the deficiency determined by the Bureau.

This is a nonfiler case. The petitioners did not file Idaho individual income returns for the taxable years in question, although they lived in Idaho. A federal audit conducted by the Internal Revenue Service determined the petitioners received approximately \$142,000 during the 1996 taxable year, and \$195,000 during the taxable year 1997.

Based on these facts, a Tax Enforcement Specialist (specialist) of the Bureau contacted the petitioners and advised the petitioners that it appeared they were required to file Idaho income tax returns. The specialist requested additional information to further determine the petitioners' filing requirements. The petitioners did not provide the requested information or file tax returns.

Subsequently, the specialist prepared provisional returns for the petitioners. [Redacted] The specialist provided the petitioners with personal deductions and exemptions, and grocery credits. Once completed, the provisional returns showed a tax deficiency existed for the taxable years 1996 and 1997. The specialist then issued a Notice of Deficiency Determination as indicated above. The Notice of Deficiency Determination included a description of the information relied upon, a copy of the provisional returns prepared by the specialist, a document showing the calculation of interest, and an explanation of the petitioners' right to request a redetermination of the deficiency.

The petitioners now seek a redetermination of the deficiency on several grounds. The petitioners believe they are not required to report their wages and other compensation on tax returns or pay Idaho individual income taxes because: (1) the term "income" is not defined in the tax code; (2) wages and other compensation for labor is not "income" subject to tax; (3) Idaho lacks the jurisdiction to impose the individual income tax; (4) they are natural born sovereign citizens and as such are not subject to the taxing jurisdiction of Idaho as only persons, such as corporations engaged in a commercial or licensed activity, must file returns and pay individual income tax; (5) they are not residents of the state of Idaho and, therefore, they are not subject to Idaho tax law; (6) they have not

entered into a consensual contract with the state of Idaho that allows the state to impose a tax; (7) federal and state taxes are based solely on voluntary compliance; (8) the Idaho income tax is an unconstitutional excise tax; and (9) the Tax Commission did not have the authority to determine the amount of tax due or issue a Notice of Deficiency Determination.

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 [Redacted]. They believe their tax obligation has somehow been eliminated despite the fact that they lived in Idaho. Simply stated, the petitioners' arguments are not supported by fact or law.

1. Definition of Income.

The petitioners claim they are exempt from taxation under the Idaho Income Tax Act because they do not earn "income." The petitioners argue the term "income" is not defined under state or federal law and 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.

2. Wages and Other Compensation for Labor.

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 includes 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 Christ 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).

Idaho Code § 63-3022 defined the term "taxable income" to mean "'taxable income' as defined in section 63 of the Internal Revenue Code, adjusted as provided" in the Idaho Income Tax Act. Section 63 of the Internal Revenue Code defines taxable income as "gross income minus the deductions allowed

under this chapter." Section 61 of the Internal Revenue Code provides that, except as otherwise provided in Subtitle A of the Internal Revenue Code, "gross income means all income from whatever source derived." Idaho has incorporated these provisions in its tax laws.

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 § 63-3002. (Emphasis added.) As incorporated into the Income Tax Act by Idaho Code § 63-3002, an individual is subject to Idaho income tax on his income from all sources, unless express federal or state exemptions, adjustments, or limitations apply. The petitioners have not provided any information to establish that their income is exempt under the Internal Revenue Code or under any other law.

3. Jurisdiction to Tax.

The petitioners claim the state of Idaho is without the power or authority to impose a tax on them because, according to the petitioners, they are not citizens of the United States and are not subject to its jurisdiction. The petitioners' convoluted logic notwithstanding, the state of Idaho does not derive its jurisdiction to tax from whether or not an individual is a citizen of the United States. *See 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. Domicile itself affords a basis for such taxation. 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."; Shaffer v. Carter, 252 U.S. 37, 52 (1920) "[J]ust as a State may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to nonresidents from their property or business within the state, or their occupations carried on therein."

Idaho Code § 63-3024 imposes an income tax on every resident individual measured by his taxable income. 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 Legislature has clearly set forth that the Idaho income tax applies to residents of this state, and the Legislature has defined the term resident. The petitioners, who resided in [Redacted], Idaho, have presented no evidence supporting their claim that they are not residents of, or otherwise subject to the jurisdiction of, Idaho.

4. Sovereign Power to Tax.

The petitioners claim the state of Idaho is without the power or authority to impose a tax on "sovereign natural born citizens." The gist of the petitioners' sovereignty argument is that the state has the power to tax only those entities which it creates or for which it authorizes creation. Thus, a state may tax a corporation that is created under state authority, but may not tax "sovereign natural born citizens."

Under our federalist system of government, the power to raise revenue to support the functioning of the government [i.e., the power to tax] is generally considered a concurrent state and federal power.

The power of the states to tax the income of individuals was first established by the United States Supreme Court in Shaffer v. Carter, 252 U.S. 37 (1920). In that case, Shaffer brought suit to enjoin the state of Oklahoma from collecting any tax assessed against him under the state's income tax law. Although Shaffer was a nonresident of Oklahoma, the Court found that the Oklahoma tax on his Oklahoma source income was constitutional. Justice Pitney, writing for the Court, stated:

In our system of government the states have general dominion, and, saving as restricted by particular provisions of the federal Constitution, complete dominion over all persons, property, and business transactions within their border; they assume and perform the duty of preserving and protecting all such persons, property, and business, and, in consequence, have the power normally pertaining to governments to resort to all reasonable forms of taxation in order to defray the governmental expenses.

Id. at 51. Justice Pitney went on to write that:

Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay. Taxes of this character were imposed by several of the states at or shortly after the adoption of the Federal Constitution.

The rights of the several states to exercise the widest liberty with respect to the imposition of internal taxes always has been recognized in the decisions of this court. In *McCulloch v. Maryland*, 4 Wheat. 316, while denying their power to impose a tax upon any of the operations of the federal government, Mr. Chief Justice Marshall, speaking for the court, conceded (pp. 428-429) that the states have full power to tax their own people and their own property, and also that the power is not confined to the people and property of a state, but may be exercised upon every object brought within its jurisdiction saying: "It is obvious, that it is an incident of sovereignty, and is coextensive with that to which it is an incident. All subjects over which the sovereign power of a state extends, are objects of taxation," etc.

In *Michigan Central R.R. Co. v. Powers*, 201 U.S. 245, the court, by Mr. Justice Brewer, said (pp. 292, 293): "We have had frequent occasion to consider questions of state taxation in the light of the federal Constitution, and the scope and limits of national interference are well settled. There is no general supervision on the part of the nation over state taxation, and in respect to the latter the State has, speaking generally, the freedom of a sovereign both as to objects and methods."

That a state may tax callings and occupations as well as persons and property has long been recognized.

"The power of taxation, however vast in its character and searching in its extent, is necessarily limited to subjects within the jurisdiction of the state. These subjects are persons, property, and business. . . . It [taxation] may touch business in the almost infinite forms in which it is conducted, in professions, in commerce, in manufactures, and in transportation. Unless restrained by provisions of the federal Constitution, the power of the state as to the mode, form, and extent of taxation is unlimited, where the subjects to which it applies are within her jurisdiction."

And we deem [sic] it clear, upon principle as well as authority, that just as a State may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to nonresidents from their property or business within the state, or their occupations carried on therein enforcing payment, so far as it can, by the exercise of a just control over persons and property within its borders.

Id. at 51-52. (Citations omitted.) *See also, People of State of New York, ex rel. Cohn v. Graves*, 300 U.S. 308, 312-13 (1937), discussed above.

5. Residency.

The petitioners claim they are not subject to tax because they do not reside in the state of Idaho.

The petitioners rely on the Buck Act in support of their claim.

The Buck Act, 54 Stat. 1059 (76th Congress 1940) (currently found at 4 U.S.C. § 105-110), establishes, inter alia, that no person shall be relieved from state income taxation on the grounds that the person receiving the income resides within a "federal area" or that the income was derived from property or transaction located or occurring in such area. 4 U.S.C.A. § 106 (West 1985). The Act defines the term "state" to include "any Territory or possession of the United States." 4 U.S.C.A. § 110(d) (West 1985).

As discussed above, Idaho Code § 63-3024 imposes an income tax on every resident individual measured by his taxable income. The term "resident" is defined in Idaho Code § 63-3013 as any individual who has resided in this state for the entire taxable year or who is domiciled in the state of

Idaho. The petitioners, who resided in [Redacted], Idaho, during the years in question, have presented no evidence supporting the claim that they are not residents of Idaho.

6. Consensual Contract.

The petitioners claim that they have not knowingly consented to the exercise of jurisdiction because they have not contracted with the state of Idaho or the United States. The petitioners refer to a contract between them and the state of Idaho that obligated them to the Tax Commission. Obviously, there is not one single written contract between the petitioners and the state of Idaho regarding their tax obligations. However, by virtue of the petitioner's living within the boundaries of Idaho, they are obligated to follow the laws, including the tax laws, established by the state legislature.

7. Voluntary Filing and Payment.

The courts have 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).

8. Unapportioned Direct Tax.

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 that 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.

9. Duty to Determine Correct Amount of Tax and Issue Notice of Deficiency Determination.

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 years in question. Their [Redacted], Idaho domicile also means that the petitioners are residents of Idaho for Idaho income tax purposes.

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. The filing threshold amount for a married couple, both under the age of 65, was \$11,800 for the taxable year 1996 and \$12,200 for the taxable year 1997. The petitioners' annual gross income of approximately \$142,000 and \$195,000, respectively, was well in excess of the statutory threshold amounts of income that trigger a married couple's obligation to file Idaho returns.

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 Idaho individual income tax returns and pay the Idaho income tax that was correctly 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 thereof, 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 in the federal audit indicated the petitioners were required to file 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 are 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 taxable years in question and that the amounts shown due on the Notice of Deficiency Determination are true and correct.

WHEREFORE, the Notice of Deficiency Determination dated October 1, 2001, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following taxes, penalty, and interest.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1996	\$6,706	\$1,677	\$2,739	\$11,122
1997	6,744	1,686	2,169	<u>10,599</u>
			TOTAL DUE	<u>\$21,721</u>

Interest is calculated through June 28, 2002, and will continue to accrue at the rate of \$2.60 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]
[Redacted]
[Redacted]

Receipt No. [Redacted]