

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

In the Matter of the Protest of )  
 )  
[Redacted], ) DOCKET NO. 16144  
 )  
 ) DECISION  
 )  
Petitioners. )  
\_\_\_\_\_ )

On September 12, 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 asserted tax, penalty, and interest in the amount of \$4,406 for the taxable years 1997 and 1998. The Notice advised the petitioners they could file a petition for redetermination with the Commission if they disagreed with the Bureau’s determination.

On October 22, 2001, the petitioners filed a letter of protest that the Commission treated as a petition for redetermination. The petitioners elected not to participate in an informal conference and instead submitted additional protests, which were placed in their files.

Therefore this decision is based on the information contained in the Commission’s file. The Commission has reviewed the file, is advised of its contents, and now issues this decision. For the reasons set forth below, the Commission affirms the deficiency determined by the Tax Discovery Bureau.

This is a nonfiler case. The petitioners did not file Idaho individual income returns for the taxable years in question. The Commission’s Tax Enforcement Specialist (specialist) contacted the petitioners and advised the petitioners it appeared they were required to file Idaho income tax returns. The specialist sent the petitioners information explaining Idaho’s income tax filing requirements and asked the petitioners to direct any returns to his attention.

The petitioners reviewed the information the specialist provided, but declined to file any tax returns. The specialist subsequently prepared provisional returns for the petitioners. To determine the petitioners' gross income, the specialist relied upon the wage information the petitioners' employers reported on Form W-2, as well as other information reported on Form 1099. The specialist provided the petitioners with personal deductions and exemptions and a grocery credit. Once completed, the provisional returns showed the petitioners owed \$4,406 of tax, penalty, and interest for the taxable years 1997 and 1998. As indicated above, the specialist issued a Notice of Deficiency Determination in that amount.

In the protest filed with the Commission, the petitioners assert they are not required to file income tax returns or pay Idaho income tax because: (1) they are sovereigns rather than Idaho residents, and, therefore, they are not subject to the tax laws of Idaho; (2) federal and state taxes are based solely on "voluntary compliance"; (3) filing a return would violate their Fifth Amendment rights; (4) the Idaho income tax is not constitutional because the Sixteenth Amendment to the United States Constitution was not properly ratified; (5) wages are compensation for their labor rather than "income," and, since wages are not income, they are not subject to tax; (6) only government employees and persons engaged in a commercial activity must pay individual income tax; and (7) the Tax Commission lacked the authority to determine the correct amount of tax and issued a Notice of Deficiency Determination.

The courts have addressed and rejected these common tax protestor arguments. Idaho law clearly sets forth the petitioners' obligation to file tax returns and pay the amount of tax correctly shown as due on those returns. Idaho law also specifically authorizes the Commission to issue a Notice of Deficiency Determination when a person fails to satisfy his or her state tax obligations.

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 record before the Tax Commission demonstrates the petitioners were Idaho residents 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 lived (were domiciled) in Athol, Idaho, during the taxable years in question.

Instead, the petitioners maintain they are individual “sovereigns.” The petitioners assert that as sovereigns they are separate entities, apart from the state of Idaho and beyond the state’s taxing jurisdiction.

The courts have consistently rejected claims of “sovereignty” that attempt to circumvent a person’s residency status and avoid federal or state income tax. United States v. Hanson, 2 F.3d 942, 945 (9th Cir. 1993); Lonsdale v. United States, 919 F.2d 1440, 1448 (10th Cir. 1990); United States v. Dawes, 874 F.2d 746, 750-751 (10th Cir. 1989); United States v. Studley, 783 F.2d 934, 937 & n.3 (9th Cir. 1986); Minovich v. Commissioner of Internal Revenue, 1994 T.C. Memo. 89. 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."

The obligation to file returns and pay income tax is not 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).

With respect to the taxpayer's claim of Fifth Amendment immunity, it is true that the Fifth Amendment of the United States Constitution protects an individual from compelled self-incrimination. It is well settled, however, that a blanket claim of Fifth Amendment immunity is insufficient to avoid the legal requirement to file an income tax return. Garner v. United States, 424 U.S. 648, 651 (1976); California v. Byers, 402 U.S. 424, 430 (1971); United States v. Campbell, 619 F.2d 765, 769 (8th Cir. 1980); United States v. Stout, 601 F.2d 325, 332 (7th Cir. 1979); United States v. Edelson, 604 F.2d 232, 235 (3d Cir. 1979); United States v. Johnson, 577 F.2d 1304, 1311 (5th Cir. 1978); Idaho State Tax Commission v. Peterson, 107 Idaho 260, 262 (1984). Absent some factual basis to show that the petitioners are faced with a real and substantial danger of self-incrimination, they remain legally obligated to fill out and file their Idaho returns. See, e.g., Marchetti v. United States, 390 U.S. 39, 53 (1968). ("The central standard for the privilege's application has been whether the claimant is confronted by substantial and 'real,' and not merely trifling or imaginary, hazards of incrimination.")

The courts also addressed and rejected the argument that individuals are not required to file returns or pay income tax on the ground that the Sixteenth Amendment was not properly ratified. Miller v. United States, 868 F.2d 236 (7<sup>th</sup> Cir. 1988); Prescott v. Commissioner, 561 F.2d 1287 (8<sup>th</sup> Cir. 1977); Rowlee v. Commissioner, 80 T.C. 1111 (1983); and Mendonca v. Oregon Department of Revenue, 11 Or. Tax 236 (Or. T.C. 1989).

Despite the petitioners' arguments to the contrary, they are clearly Idaho residents who have an obligation to file a proper Idaho tax return. In addition to establishing the petitioners'

residency status, the record before the Commission demonstrates the petitioners received income in excess of the statutory amount that triggers a person's filing requirement.

Idaho Code § 63-3030 provides that every resident individual having 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 petitioners' wage and income information reported on Forms W-2 and 1099 show the petitioners received gross income in excess of the threshold amount. During each of the taxable years, the petitioners received more than \$40,000 of compensation. The filing threshold for a married couple filing a joint return, both under the age of 65, was gross income in excess of \$12,200 for the taxable year 1997 and \$12,500 for the taxable year 1998. Pursuant to Idaho Code § 63-3030 the petitioners were required to file returns for the taxable years in question.

The petitioners try to circumvent this requirement by claiming their wages are compensation for labor rather than "income." The petitioners maintain that only the gains of corporations are subject to income taxes. The petitioners argue that, because their compensation results from their own labor or services rather than from an investment of capital or "commercial activity," that their compensation does not constitute "income" subject to federal or state income taxes.

The petitioners cite the United States Supreme Court's decision in Eisner v. Macomber, 252 U.S. 189 (1920), for the proposition that they have no income subject to income taxation. In Macomber, the United States Supreme Court held that although Congress had clearly intended, in the Revenue Act of 1916, to tax stock dividends as income, such taxation was unconstitutional

because stock dividends did not qualify as income as that term was used in the Sixteenth Amendment.<sup>1</sup>

However, according to the Court, income in the constitutional sense meant “the gain derived from capital, from labor, or from both combined.” Id. at 207. A stock dividend did not meet this definition of income because nothing had been “derived.” Id. While the Court found that the stock dividend resulted in a gain in the sense that the shareholders had obtained “a growth or increment of value” in their capital investment, that increment of value did not become “income” until “severed from the capital.” Id.

While the actual holding of Macomber (that stock dividends do not constitute income) has been clarified by subsequent United States Supreme Court cases,<sup>2</sup> the concept that a gain from an capital investment is not taxable as income until “severed” has evolved over time into the modern day “taxable event” principle. That is, the appreciation in the value of an asset does not constitute income subject to income taxation in the absence of a “taxable event” that separates the appreciation

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<sup>1</sup>The Sixteenth Amendment granted Congress the power to “lay and collect taxes on income, from whatever source derived, without apportionment among the several states. . . .” U.S. Const. amend. XVI. (Emphasis added.)

<sup>2</sup>See e.g., Helvering v. Gowran, 302 U.S. 238, 242-243 (1936) (Stock dividend declared on common stock payable in preferred stock was constitutionally taxable.); Helvering v. Griffiths, 318 U.S. 371, 375 (1943) (Persons receiving stock dividends were not escaping taxation; taxation was only postponed until sale or other realization has occurred.); Helvering v. Sprouse, 318 U.S. 604, 608 (1943) (In order to render the receipt of a stock dividend “taxable as income, there must be a change brought about by the issue of shares as a dividend whereby the proportional interest of the stockholder after the distribution was essentially different from his former interest.”). According to one commentator:

The cases [subsequent to Eisner v. Macomber] consistently hold that, absent a change in the shareholder’s overall relationship to the corporation, a non-elective distribution of shares to the shareholder is not income, and thus Congress may not tax the distribution. Nevertheless, the cases also emphasize that not all distributions of shares by a corporation meet Macomber’s “no income” criteria. Distribution of common on preferred shares or preferred on common shares, when preferred is currently outstanding, changes the shareholder’s rights in the corporation. Accordingly, Congress may choose to tax such distributions.

Ordower, Revisiting Realization: Accretion Taxation, the Constitution, Macomber, and Mark to Market, 13 Va. Tax Rev. 1 (Summer 1993). This Constitutional principle that certain stock dividends are not taxable as income upon distribution is also codified under section 305 of the Internal Revenue Code.

from the related capital. Helvering v. Bruun, 309 U.S. 461 (1940); C.I.R. v. Glenshaw Glass Co., 348 U.S. 426 (1955). Normally the “event” upon which the appreciation in value is “realized” is the sale or other disposition of the asset. United States v. Davis, 370 U.S. 65 (1962); See also I.R.C. § 1001.

The Sixteenth Amendment provides that Congress shall have the power to tax income from whatever source derived. Under this broad constitutional grant of authority, Congress has defined the term gross income to include compensation for services. I.R.C. § 61(a)(1). The petitioners’ wages and other compensation clearly meet the definition of gross income under the Internal Revenue Code, and none of the cases cited by the petitioners requires a contrary result. Even in Eisner v. Macomber, the United States Supreme Court states that the term “income” as used in the Sixteenth Amendment, “may be defined as the gain derived from capital, from labor, or from both combined.” Eisner v. Macomber at 207. (Emphasis added.) (Citations omitted.)

Since the Eisner decision, the courts have repeatedly held that a person’s compensation for labor or wages 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 petitioners next state that since they are not government employees or members of the armed forces they have no taxable gross income. The petitioners have provided no explanation for this theory that only government employees and members of the armed forces can have gross income, and no support for this theory can be found by any rational review of the relevant federal and Idaho income tax laws.

The term “gross income” is defined in section 61(a) of the Internal Revenue Code as:  
all income from whatever source derived, including (but not limited to) the  
following items:

- (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

Nothing in this definition of gross income limits its applicability only to certain classes of persons.

The term “income” includes compensation for labor or services and for purposes of the federal and state income tax includes all income derived from any source, unless specifically excluded. Idaho Code § 63-3002 incorporates the federal definition of income for state tax purposes.

**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). As a general rule all of the income of a resident is included in gross income regardless of the source of the income. The statutes do not limit taxable income only to government employees and members of the armed forces.

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.

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 on Form W-2 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 prepared 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 a petitioner 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 amount shown due on the Notice of Deficiency Determination is true and correct.

WHEREFORE, the Notice of Deficiency Determination dated September 7, 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>
1997	\$1,153	\$ 288	\$ 371	\$1,812
1998	\$1,818	\$ 455	\$ 444	<u>\$2,717</u>
				<u>\$4,529</u>

Interest is calculated through June 28, 2002, and will continue to accrue at the rate of \$0.58 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

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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]

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ADMINISTRATIVE ASSISTANT 1