

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 20800
[REDACTED],	)	
	)	DECISION
Petitioner.	)	
_____	)	

On October 3, 2007, the staff of the Tax Discovery Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer) proposing income tax, penalty, and interest for the taxable years 1997 through 2005 in the total amount of \$75,181.

On December 5, 2007, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer requested a telephone hearing which was held July 24, 2008. The Tax Commission, having reviewed the file, hereby issues its decision.

The Tax Discovery Bureau (Bureau) received information [Redacted] that showed the taxpayer received wages from employment in Idaho. The Bureau searched the Tax Commission's records and found the taxpayer had not filed any Idaho individual income tax returns. The Bureau sent the taxpayer a letter asking him about his requirement to file Idaho income tax returns. The taxpayer replied requesting all the information the Bureau had that showed he had income. The Bureau sent the taxpayer the information [Redacted] as well as information from the [Redacted] County Assessor. After receiving the information from the Bureau, the taxpayer stated he needed more time to put a response together.

A few weeks later, the Bureau received a letter from the taxpayer that stated his position regarding his requirement to file Idaho income tax returns. The taxpayer stated that he agreed the income tax is constitutional and otherwise valid; however, he stated the income tax is an

excise tax on the exercise of a federal privilege. He stated the federal and state governments only have jurisdiction over those who take part in this privilege. The taxpayer stated the monies he received were private sector, unprivileged payment for labor and, therefore, not taxable; only those receipts that are federally connected are taxable. The taxpayer stated that his employer characterized his earnings as wages defined in Internal Revenue Code (IRC) sections 3401(a) and 3121(a). However, since his earnings were not federally connected, they do not qualify as wages defined in those sections. The taxpayer stated his employer incorrectly provided the Tax Commission and the Internal Revenue Service with W-2s and 1099s. By his understanding, the taxpayer's employer was not required to provide his earnings information because by definition neither he nor his employer engaged in the clearly specified privilege activities which required the reporting and filing of W-2s and 1099s.

The Bureau recognized the taxpayer's statements as those analogous to various tax protestor movements. The Bureau determined the taxpayer was required to file Idaho income tax returns, so it prepared returns for the taxpayer and sent him a Notice of Deficiency Determination.

The taxpayer protested the Bureau's determination. He cited the Idaho Constitution and stated that nowhere in the constitution is there a provision for the taxation of income. He stated the Idaho Code relies on the Federal tax code to determine taxable income. He stated there is no federal assessment because there are no assessment officers; therefore, a lawful assessment cannot be made. The taxpayer stated the state of Idaho has no regulatory authority over his time or conduct. His time is his personal property, and if he elects to exchange it into another form of property of equal value, he has not created a taxable exchange. The taxpayer also restated some of the arguments previously sent to the Bureau regarding his receipt of taxable income; his

conduct as an employee for an employer that did not operate as a trade or business; and that since there was no federal tax liability for the years in question, there can be no state tax liability for those same years. In addition, the taxpayer stated the Bureau did not account for amounts that were withheld and sent to the Tax Commission that should be returned to him.

With the formal protest of the Notice of Deficiency Determination, the Bureau referred the matter for administrative review. The Tax Commission reviewed the matter and sent the taxpayer a letter discussing the methods available for redetermining a protested Notice of Deficiency Determination. The taxpayer chose to have a telephonic hearing in which he posed numerous questions to the Tax Commission's representative. The questions posed were designed to establish a foundation for the taxpayer's argument in regards to the applicable law, when an assessment is made, who has the authority to make an assessment, what constitutes income, witnesses to the taxpayer's gain, how a gain is determined, what constitutes property, and the standard of proof. The taxpayer summed up his position by stating that he applied the law exactly as it is written and since he has no federal tax liability he can have no Idaho tax liability. The taxpayer stated he is the only person that has first-hand knowledge of the facts in this matter and unless his testimony is countered by other parties that claim to have first-hand knowledge, his testimony is the final word in the matter.

The taxpayer stated he would provide the Tax Commission with a packet of additional information to further show his position. After a couple of correspondences between the taxpayer and the Tax Commission, the taxpayer submitted his packet of information. The Tax Commission reviewed the additional information and decided the matter based upon all the information provided.

The taxpayer did not deny that he was a resident of Idaho or that he worked in Idaho. Therefore, if the taxpayer had income in excess of the amount specified in Idaho Code section 63-3030, he was required to file an Idaho income tax return.

The taxpayer's argument centers on the premise that one can exchange his labor for an equal amount of money and not have any income. This argument has been addressed by the courts and has been dismissed as being frivolous and without merit. In Olson v. United States, 760 F.2d 1003, 1005 (9th Cir. 1985), the court stated:

Olson's attempt to escape tax by deducting his wages as 'cost of labor' and by claiming that he had obtained no privilege from a governmental agency illustrate the frivolous nature of his position. This court has repeatedly rejected the argument that wages are not income as frivolous, see, e.g., *Gattuso v. Pecorella*, 733 F.2d 709, 710 (9th Cir.1984); *United States v. Romero*, 640 F.2d 1014, 1016 (9th Cir.1981), and has also rejected the idea that a person is liable for tax only if he benefits from a governmental privilege.

In DeMoss v. Commissioner, 1995 U.S. App. LEXIS 2672, 75 A.F.T.R.2d 841 (9th Cir. 1995) the court stated:

DeMoss contends that the compensation he received from his employers is not taxable because his basis in his labor is equal to the amount of compensation he received. The tax court properly rejected this frivolous contention. See *Carter v. Commissioner*, 784 F.2d 1006, 1009 (9th Cir. 1986); *Olson v. United States*, 760 F.2d 1003, 1005 (9th Cir. 1985).

Other court cases addressing this issue and coming to the same conclusion include: United States v. Lawson, 670 F.2d 923, 925 (10th Cir. 1982); Rowlee v. Commissioner, 80 T.C. 1111, 1119-22 (1983); Casper v. Commissioner, 805 F.2d 902, 906 (10th Cir. 1986); United States v. Buras, 633 F.2d 1356, 1361 (9th Cir. 1980); Angstadt v. Internal Revenue Service, 84 AFTR2d 99-5455, (U.S.D.C. E.D.Pa. 1999); Peth v. Breitzmann, 611 F. Supp. 50, 53 (E.D.Wis. 1985); United States v. Studley, 783 F.2d 934, 937 (9th Cir. 1986); Wheelis v. Commissioner, T.C.

Memo 2002-102, 2002 TNT 74-14, aff'd 2003 TNT 108-7, No. 02-73119 (9th Cir. 5/16/2003); Sumter v. United States, 61 Fed. Cl. 517, 518 (2004); Ledford v. United States, 297 F.3d 1378, 1381, 2002 TNT 153-6, No. 02-5027 (Fed. Cir. 8/6/2002); Brown v. U.S., 35 Fed. Cl. 258, 269 (1996) aff'd, 105 F.3d 621 (Fed. Cir.), reh'g denied (1997); and Granzow v. Commissioner, 739 F.2d 265, 267 (7th Cir. 1984) among numerous others.

In addressing the taxpayer's argument that he has a basis in his labor and it should offset the fair market value of the property (wages) received, the court stated:

Even if wages are, in effect, an exchange of equal value for value, they are nevertheless taxable income. *Rowlee v. Commissioner*, 80 T.C. 1111, 1121-1122 (1983); *Rice v. Commissioner*, T.C. Memo. 1982-129. And even if we apply section 1001 to determine petitioner's gain, his basis is defined under sections 1011 and 1012 as his cost, not fair market value. Since he paid nothing for his labor, his cost and thus his basis are zero. *Rice v. Commissioner*, supra. Consequently, even under section 1001, his taxable income from his labor is his total gain reduced by nothing, i.e., his wages. . . . Petitioner's argument fails for the same reason that other protesters' arguments fail; the worker's cost for his services--and thus his basis--is zero, not their fair market value.

Talmage v. Commissioner, T.C. Memo. 1996-114, aff'd 101 F.3d 695 (4th Cir. 1996).

The taxpayer argued he was not an "employee" for an "employer" as the terms are defined in the relevant tax codes. He also argued that he was not engaged in a "trade or business" or employed by a "trade or business" as defined in the relevant tax codes. Therefore, he had no taxable income and no federal tax liability, and since he had no federal tax liability, he could have no Idaho tax liability.

These arguments have also been examined by the courts and have been rejected as being without merit and frivolous. The argument that the taxpayer was not an employee is based on a misinterpretation of IRC section 3401, which imposes the responsibility on employers to withhold tax from wages. That section establishes the general rule that wages include all

remuneration for services performed by an employee for his employer. Section 3401(c) defines employee and states that the term “includes an officer, employee or elected official of the United States, a State, or any political subdivision thereof . . . .” The taxpayer believes that this section specifically identifies the only employees required to pay a tax, and since he was not employed by the federal government, a state, or any other governmental body, he was not an employee subject to the income tax. However, the purpose of this subsection is not to specify every possible employee, or define the employees that are required to pay income tax. The purpose of this subsection is to include, for withholding income tax from wages, individuals employed by the government.

The notion that IRC section 3401(c) is exclusive is refuted by IRC section 7701(c). IRC section 7701(c) states that the use of the word "includes" when used in a definition in the IRC, “shall not be deemed to exclude other things otherwise within the meaning of the term defined.” Thus, the word includes, as used in the definition of employee, is a term of enlargement, not of limitation. Clearly, federal employees and officials are part of the definition of employee, but it also pertains to all other employees, public and private. See United States v. Latham, 754 F.2d 747, 750 (7th Cir. 1985); Sullivan v. United States, 788 F.2d 813, 815 (1st Cir. 1986); Peth v. Breitzmann, 611 F. Supp. 50, 53 (E.D. Wis. 1985); and Pabon v. Commissioner, T.C. Memo. 1994-476, 68 T.C.M. (CCH) 813, 816 (1994). Furthermore, IRC section 3121, as cited by the taxpayer, is a significantly broader definition of employee that does include private sector employees.

Nevertheless, a key point missed by the taxpayer in citing IRC sections 3121 and 3401 is that each subsection starts the definition of employee with, “For purposes of this chapter . . . .” This phrase limits the term defined in the section to the subject matter of the chapter. In the case

of IRC section 3121, the definition is limited to chapter 21, the Federal Insurance Contributions Act, and for IRC section 3401, it is limited to chapter 24, the Collection of Income Tax at Source, in other words withholdings. Therefore, if the taxpayer claims that he is not an employee as defined in IRC section 3401, he is claiming not to be subject to withholding on his wages.

Regardless of whether the taxpayer should or should not have withholdings made from his wages, the taxpayer admitted he received wages from a private-sector employer. Since wages are income, the taxpayer was required to report that income to the state of Idaho on his income tax returns. See United States v. Connor, 898 F.2d 942, 943-44 (3d Cir.), cert. denied, 497 U.S. 1029 (1990) and Coleman v. C.I.R., 791 F.2d 68 (1986).

The taxpayer argued he can have no Idaho tax liability if he has no federal tax liability. He stated the Idaho Code is wholly dependent on the federal tax code and since he has no federal tax liability, he cannot have an Idaho tax liability. Presumably, the taxpayer is arguing that the requirement to file an Idaho income tax return hinges on whether a federal income tax return was filed. In a way, that is true; however, just because an individual does not file or believes he is not required to file a federal return does not automatically exempt him from filing an Idaho individual income tax return.

Idaho Code section 63-3002 states the intent of the Idaho income tax act to impose a tax on the residents of this state measured by Idaho taxable income wherever derived. This section also states that the provisions of the Idaho act are to be as identical as possible to the federal internal revenue code relating to the measurement of taxable income, subject to specific modifications contained in the Idaho law. Idaho Code section 63-3030 provides the income thresholds for individuals required to file Idaho income tax returns. It states that every resident

individual required to file a federal return under section 6012(a)(1) of the internal revenue code is required to file an Idaho income tax return. By referencing the filing requirements of IRC section 6012(a)(1), the Idaho Code is saying that every individual having gross income in excess of the exemption amount is required to file an Idaho return. The information available [Redacted] shows that the taxpayer received wages far in excess of the exemption amount for all the years in question. Therefore, unless the taxpayer can show that his income is exempted, he is required to file an Idaho income tax return.

The taxpayer also claimed that he is the only one who had first-hand knowledge of his income, and as a result, if there are no witnesses to the contrary, his testimony should be the determining factor in this case. However, in the taxpayer's own statements or testimony, he stated he received money from the private sector for unprivileged payment for labor; in other words, he received wages. Those wages were reported by the taxpayer's employer [Redacted] as required by law. Therefore, the Tax Commission has documented evidence that the taxpayer received income in the form of wages. The taxpayer did not deny the wages, he just claimed they were not taxable income under the argument discussed above.

The taxpayer's arguments have not persuaded the Tax Commission that his income was not taxable income. Since the taxpayer's income exceeded the filing threshold of Idaho Code section 63-3030, the Tax Commission finds that the taxpayer was required to file Idaho individual income tax returns for all the years in question. Furthermore, the taxpayer has not shown that the returns prepared by the Bureau were erroneous. Parsons v. Idaho State Tax Commission, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986). He has not met his burden of proof. The taxpayer stated his employer withheld and remitted money to the Tax Commission on his behalf; however, the taxpayer has provided nothing to show the

amount of the withholdings, nor does the Tax Commission have any record of those withholdings. Therefore, the Tax Commission upholds the Bureau's determination of the taxpayer's Idaho income tax deficiency.

The Bureau added interest and penalty to the taxpayer's Idaho tax. The Tax Commission reviewed those additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

WHEREFORE, the Notice of Deficiency Determination dated October 3, 2007, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest (computed to March 15, 2009):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1997	\$2,809	\$ 702	\$2,071	\$ 5,582
1998	3,709	927	2,448	7,084
1999	4,053	1,013	2,380	7,446
2000	5,455	1,364	2,766	9,585
2001	4,848	1,212	2,085	8,145
2002	5,673	1,418	2,075	9,166
2003	6,238	1,560	1,952	9,750
2004	7,391	1,848	1,869	11,108
2005	7,851	1,963	1,514	11,328
			TOTAL DUE	<u>\$79,194</u>

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

An explanation of the taxpayer's right to appeal this decision is enclosed.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_, 2009, 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.

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