

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
[Redacted])	DOCKET NO. 0-655-280-128
)	
Petitioners.)	DECISION
_____)	

[Redacted] (Petitioners) protested the Notice of Deficiency Determination dated March 13, 2017. Petitioners disagree with the additional income added to their 2010 through 2014 Idaho individual income tax returns. The Tax Commission reviewed the matter and found that the evidence showed Petitioners failed to report all the income they received in tax years 2010 through 2014. Therefore, the Tax Commission upholds the Notice of Deficiency Determination.

BACKGROUND

Public information the Tax Discovery Bureau (Bureau) found stated [Redacted] plead guilty to grand theft for embezzling over \$200,000 from his employer. The Bureau reviewed Petitioners' Idaho individual income tax returns for the years identified as the years of embezzlement and found Petitioners did not include the embezzled money as income. The Bureau obtained information from the court, the prosecutor, Petitioners' bank, and a vendor that [Redacted] employer used. From that information the Bureau was able to determine the year and the amount each year that [Redacted] misappropriated. The Bureau adjusted Petitioners' Idaho individual income tax returns for the tax years: 2010 in the amount of \$2,284; 2011 in the amount of \$20,740; 2012 in the amount of \$111,160; 2013 in the amount of \$62,015; and 2014 in the amount of \$79,822. The Bureau sent Petitioners a Notice of Deficiency Determination which Petitioners protested.

Petitioners protested the Bureau's computations. Petitioners stated that the information the Bureau based its determination on has never been seen by them. Petitioners stated [Redacted] made an "Alford plea" on an original total amount of \$110,000. Petitioners stated they knew nothing of the amounts the Bureau was alleging. Petitioners stated the allegations made by the Bureau were simply that, allegations and "you cannot pay taxes on allegations."

The Bureau acknowledged Petitioners' protest and referred the matter to the Tax Commission's Appeals Unit (Appeals). Appeals sent Petitioners a letter asking how they wanted to proceed with their protest. Petitioners requested a telephone hearing in mid-October. Appeals scheduled a hearing as Petitioners requested; however, when it came time for the hearing, Petitioners had not provided a telephone number, so Appeals could not call them and Petitioners did not call in. Appeals e-mailed Petitioners about the missed hearing and asked if they wanted to reschedule. Petitioners responded that they would like to reschedule and asked that Appeals give them "some specific documentation" that they can verify. Petitioners also asked that Appeals provide them with the "Documentation of Law" that states they are required to pay tax on misappropriated funds.

Appeals provided Petitioners with the law and court cases stating that illegal gains are included in the taxable income of the individual in the year of the gain. Appeals also asked Petitioners for their list of the specific documentation needed from the Tax Commission. Petitioners did not respond. Appeals e-mailed Petitioners again asking for their list of the specific documentation or to get a hearing scheduled. Still, Petitioners did not respond.

Seeing that Petitioners had ample opportunity to provide whatever additional information they wanted the Tax Commission to consider, the Tax Commission decided the matter based on the information available.

LAW AND ANALYSIS

Idaho Code § 63-3002 states that Idaho residents are taxed on their income from all sources. Internal Revenue Code (I.R.C.) § 61 states that gross income means income from whatever source derived. Treasury Regulation § 1.61-14 states, in part, that illegal gains constitute gross income.

On March 21, 2016, [Redacted] enter into a plea agreement with the State of Idaho wherein he plead guilty to one count of grand theft for the misappropriation of funds. [Redacted] agreed to restitution in the amount of \$110,000; an amount substantially less than the amount taken. Both parties agreed that the amount taken was not less than \$204,625. Petitioners did not report any of this income on their individual income tax returns.

During its examination of Petitioners' Idaho income tax returns, the Bureau obtained additional information from the prosecutor's office and other third-party sources. From this information the Bureau was able to determine that [Redacted] misappropriated and failed to report \$276,021 over the taxable years 2010 through 2014. The Bureau adjusted Petitioners' Idaho income tax returns to include this income.

Petitioners questioned the accuracy of the Bureau's adjustments to their income tax returns. Petitioners stated they asked the prosecutor's office to give back their personal property so they can deal with their income tax issues, but so far, they have not been given any of their records. Petitioners stated they know nothing about the amount the Bureau is asserting. They only know about the amount ordered as restitution.

Petitioners said they would need copies of specific documentation the Bureau used to determine their taxable income; however, Petitioners never provided a list of the specific documentation. Petitioners have provided nothing for the Tax Commission to consider.

In Idaho, a State Tax Commission deficiency determination is presumed to be correct. The

burden is on the taxpayer to show that the deficiency is erroneous. *See Parsons v. Idaho State Tax Commission*, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986). Petitioners did not meet their burden. Petitioners did ask about the legality of taxing someone on embezzled funds that they are required to pay back. The U.S. Supreme Court addressed this in its decision *James v. U.S.*, AFTR 2d 1361 (366 U.S. 213), (S. Ct), 1961. In *James* the court ruled that Congress intended to tax income from whatever source derived, lawful or unlawful. The court said embezzled funds are included in the income of the perpetrator in the year of embezzlement.

However, the Tax Court and the Court of Appeals decided, in two separate cases after the *James* decision, that if or when an individual makes restitution for the embezzled funds, the restitution may be deductible in the year of payment. *See Norman v. CIR*, 407 F2d 1337 (1969) and *Morrison v. CIR*, T. C. Memo. 1981-617, 1981. Therefore, embezzlement is a taxable event on both ends; upon the taking and when paying back.

The Bureau added the fraud penalty to Petitioners Idaho tax. The fraud penalty is added when there is an intent to evade tax. *See Idaho Code § 63-3046(b)*. The Tax Commission bears the burden of proving that a taxpayer acted falsely or fraudulently. When applying the fraud penalty, the Tax Commission must review all the facts and circumstances surrounding the preparation of the income tax return. IDAPA 35.02.01 Tax Commission Administration and Enforcement Rules, Rule 420 gives guidance in what to consider when asserting fraud. According to Rule 420, the Tax Commission must consider the business and financial practices of the taxpayer; the public and private statements regarding income or sales of the taxpayer; the taxpayer's knowledge of principles of finance, accounting, law, or taxation; and the objective and subjective evidence showing or tending to show intent to evade payment of tax.

The Bureau reviewed Petitioners 2010 through 2014 Idaho individual income tax returns.

Based on court documents and other third-party information, the Bureau found Petitioners did not report all the income they received/took during those years. Petitioners provided no explanation why the income was not reported.

The amount of unreported income exceeded \$100,000 in tax year 2012. Although the amount of unreported income is not solely determinative in the determination of fraud or the intent to evade, it does provide a measure of the substantiality of the action. Nevertheless, considering the amounts involved and particularly the amounts for 2012, 2013, and 2014, it is evident Petitioners knowingly did not report the income.

Since Petitioners did not avail themselves of the opportunity to show their innocence and lack of intent to defraud the state, the Tax Commission upholds the addition of the fraud penalty.

CONCLUSION

Petitioners filed their 2010 through 2014 Idaho individual income tax returns but failed to report all their income. The Bureau corrected Petitioners' returns. Petitioners provided nothing to show the additional income should not be included on their income tax returns. Therefore, the Tax Commission upholds the Notice of Deficiency Determination.

THEREFORE, the Notice of Deficiency Determination dated March 13, 2017, and directed to [Redacted] is AFFIRMED.

IT IS ORDERED that Petitioners pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2010	\$171	\$86	\$52	\$309
2011	1,620	810	426	2,856
2012	8,225	4,113	1,857	14,195
2013	4,590	2,295	885	7,770
2014	5,906	2,953	903	<u>9,762</u>
			TOTAL DUE	<u>\$34,892</u>

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

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2019.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2019,
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.
