

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 0-212-272-128
)	
Petitioners.)	DECISION
_____)	

On January 6, 2022, the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination (Notice) to (Petitioners), asserting a combined total income tax deficiency of \$92,690 for tax years 2016, 2017, and 2019. On February 10, 2022, the Bureau issued a second Notice to Petitioners asserting an income tax deficiency of \$29,254 for tax year 2018.

Petitioners were married during the taxable years at issue; they divorced on July 9, 2021. Mr. [redacted] timely protested the Notice for tax years 2016, 2017, and 2019. He did not respond or protest the Notice for tax year 2018. Ms. [redacted] did not respond to either of the Notices.

The Tax Commission, having reviewed the file, hereby issues its decision modifying the Notices.

BACKGROUND

Information available to the Bureau indicated that Petitioners were Idaho residents who met the income threshold requirement to file Idaho returns during tax years 2016 through 2019. Because the Tax Commission’s records did not include Petitioners’ tax returns for 2016, 2017, or 2019, the Bureau prepared a joint Idaho income tax return on Petitioners’ behalf in each year and issued a Notice of Deficiency. During its audit, the Bureau determined that Petitioners’ return for 2018 was incorrect and issued a second Notice for 2018.

Petitioners purchased a home as husband and wife on February 1, 2016, at in Idaho (Idaho address). Mr. was issued an Idaho driver's license at the Idaho address on February 12, 2016, which he maintained during all tax years at issue. Additionally, at the same address, Mr. was issued an Idaho Fish and Game resident hunting license on August 28, 2016, and a resident disabled combination Class D license on May 5, 2017. These activities indicate Idaho residency for purposes of Petitioners' requirement to file an Idaho income tax return.

Based on tax information reported to the IRS and the Tax Commission from third parties, Petitioners received income in 2016 and 2017, and a small amount in 2018. The following chart demonstrates the reported income for Petitioners in each year, and the amounts adjusted by the Idaho audit.

	Mr. 1099s & W-2s	Ms. W-2s	<u>Business Income</u> <u>Estimated by</u> <u>Audit</u>	<u>Total Income</u> <u>Asserted by</u> <u>Idaho Audit</u> <u>(Joint)</u>
2016	\$96,794;	\$0	N/A (\$0)	\$96,794
2017	\$129,920	\$7,610	\$396,892	\$534,422
2018	\$0	\$621	\$396,892	\$396,892
2019	\$0	\$0	\$396,892	\$396,892

The income reported for Mr. in 2016 consisted of 1099-G unemployment income of \$4,806; 1099-MISC insurance proceeds of \$2,945; and \$85,043 in W-2 wages. The income reported for Mr. in 2017 consisted of \$4,920 of 1099-G unemployment income and \$125,000 of 1099-MISC insurance proceeds. No income was reported for Mr. in 2018 or 2019. According to W-2 filings, Ms. earned \$7,610 and \$621, respectively, in 2017 and 2018.

As mentioned, Petitioners did not file federal or Idaho individual income tax returns for tax years 2016, 2017, and 2019. Petitioners timely filed a joint federal and Idaho return for tax

year 2018 on income of \$621, listing their home address at the Idaho address and “disabled retired” as their occupation. Although they were not required to file a return on income of \$621, Petitioners claimed four (4) dependents and requested a small refund of federal tax.

The IRS audited Mr. [redacted] as a single filer and sent him a Notice for tax years 2016 and 2017 on his reported income of \$96,794 and \$129,920, respectively. The IRS did not audit 2018 or 2019 and did not audit Ms. [redacted] for any of the relevant years—the likely reason being that little to no income was reported.

The Bureau issued Notices to Petitioners on their joint income in tax years 2016, 2017, 2018, and 2019. The following section will detail the Bureau’s findings.

TAX COMMISSION AUDIT

The Bureau’s audit of tax year 2016 matched the federal audit on Mr. [redacted] income of \$96,794. However, for tax year 2017, the Bureau conducted independent research and estimated Petitioners’ income to be four times higher than the IRS did for Mr. [redacted]. Therefore, for 2017, the Bureau adjusted the income from the \$129,920 figure determined by the IRS for Mr. [redacted] to \$534,422 jointly. The Bureau concluded from its research that Petitioners had a tax deficiency for 2018 and 2019 based on estimated income of \$396,892 in each year.

Concerning the additional income for tax years 2017, 2018, and 2019, the Bureau found that Mr. [redacted] registered a domestic corporate business titled [redacted] with the Wyoming Secretary of State on December 2, 2016, and had received additional unreported income related to [redacted]. On April 26, 2018, Mr. [redacted] completed an online business registration with the Tax Commission and requested a sales tax permit for “ [redacted] ”¹

¹ The [redacted] for [redacted] was not registered in Idaho or Wyoming.

Mr. [REDACTED] confirmed that he would make retail sales in Idaho to the final consumer and estimated monthly sales tax of \$200. The business was approved for quarterly sales tax filings.

On November 5, 2019, the Tax Commission notified the business that the sales tax permit would expire of September 30, 2019 in compliance with Idaho Code § 63-3620A(3), because no taxable sales were reported during a 12-month period ending June 30, 2019. During the entire time the sale tax permit was open, the business only reported \$200 in sales for the quarterly period ending June 30, 2018.

No income information was reported to the IRS or the Tax Commission for

The Bureau consulted two online public business reporting sources, Buzzfile and Dun & Bradstreet, to support its finding that [REDACTED] had unreported, taxable income. Buzzfile estimates that the business generates \$473,478 in annual revenues, while Dun & Bradstreet estimates the business generates \$320,306 in annual sales. The Bureau reconstructed the business income for 2017, 2018, and 2019, using the average of the two sources at \$396,892 and noted “[i]f our estimates are incorrect, please file actual returns.” The Bureau did not allow any dependent exemptions.

Both reporting sources note that [REDACTED] is operating in Cheyenne, Wyoming, under the name “[REDACTED]”. Dun & Bradstreet states that the company is part of the “Nondepository Credit Intermediation Industry.” Buzzfile states that it operates “in the Working Capital Financing business/industry within the Nondepository Credit Institutions sector.” According to Buzzfile, 384 companies are located at the same address used by [REDACTED] in Cheyenne. No information is available on either website regarding the sources or basis for the income estimates.

PETITIONERS' POSITION

On March 10, 2022, Mr. [redacted] timely appealed the Notice for tax years 2016, 2017, and 2019. Mr. [redacted] protest consisted of the following statement:

amounts for filling are wrong. income for 2016 2017 and 2019 are incorrectly calculated. the amounts are not correct. Deductions are not correct and expenses are not calculated. no income for [redacted] was made in 2017 and 2019. amounts are not correct in Buzzfile and Dun and Bradstreet. the insurance payment is also wrong. Amounts for 2016 are also wrong No money was paid by [redacted] Proper state filings will be made in a timely manner. to correct this matter. [sic]

Ms. [redacted] position is unknown. The U.S. Post Office returned several pieces of correspondence sent to Ms. [redacted] Although she may not have received them, the Notices were validly mailed to her last known address in compliance with Idaho Code section 63-3045(1)(a).

As part of the appeal process, the Tax Commission sent Petitioners a letter at their respective addresses on August 26, 2022, discussing the alternatives for redetermining a protested Notice. Neither Petitioner responded. Appeals got in touch with Mr. [redacted] by phone on September 6, 2022, to discuss the appeal. Mr. [redacted] was not interested in scheduling an informal hearing, as he is disabled, but expressed that the income determined by the Bureau is incorrect. He agreed to file the missing returns within the month. He did not have his ex-wife's contact information and has not been in contact with her.

If no hearing is requested or scheduled, the Tax Commission may issue a decision forty-two (42) days from the date of the notification to Petitioners of their right to request a hearing, IDAPA 35.02.01.325.06. Since a hearing was not scheduled and no tax returns have been filed to resolve the Notices, this Decision follows.

DISCUSSION

I. Introduction and legal background.

Given the close timing and similarities between the Bureau's audits, the Tax Commission deems Mr. [redacted] protest of the Notice for 2016, 2017, and 2019 tax years to also include a protest of the Notice for 2018. Thus, the Tax Commission decides both the January 6, 2022 and February 10, 2022 Notices together in this Decision.

If a taxpayer fails to file a return when required, the Tax Commission may prepare a return and issue a Notice based on its own information and on information it obtains by examining the taxpayer's records, from testimony or otherwise. *See* Idaho Code § 63-3042; IDAPA 35.02.01.200. When a taxpayer's accounting records are inadequate, or when a taxpayer fails to produce records, the IRS and the Tax Commission may reconstruct income by several different methods. However, the Tax Commission's methods of reconstructing income must be reasonable and defensible.

Typically, the Tax Commission requires the taxpayer to establish that the amount asserted in its Notice is incorrect—this is because for most cases a deficiency determination issued by the Tax Commission “is presumed to be correct, and the burden is on the taxpayer to show that the Commission's decision is erroneous.” *Parker v. Idaho State Tax Comm'n*, 148 Idaho 842, 845, 230 P.3d 734, 737 (2010) (citing *Albertson's Inc. v. State Dep't of Revenue*, 106 Idaho 810, 814, 683 P.2d 846, 850 (1984)). However, the presumption of correction does not apply to a “naked” assessment—that is, an assessment without any foundation whatsoever. *United States v. Janis*, 428 U.S. 433, 441 (1976); *Erickson v. Comm'r*, 937 F.2d 1548, 1551 (10th Cir. 1991) (“Some reasonable foundation for the assessment is necessary to preserve the presumption of correctness.”). In other words, a court will not uphold a tax deficiency based merely on the presumption of correctness where it has been shown that the amount of the deficiency is entirely

arbitrary or based on no rational foundation.

In cases involving unreported income, as is at issue here in 2017 through 2019 tax years, the taxing authority is given wide latitude in reconstructing or estimating the amount of the unreported income, and the presumption of correctness will apply unless the technique employed is manifestly irrational or arbitrary. *De Cavalcante v. Commissioner*, 620 F.2d 23, 28 (3d Cir.1980) (the presumption of correctness requires only “a minimal factual basis”); *U.S. v. Fior d’Italia, Inc.*, 536 U.S. 238, 243 (2002) (courts have consistently upheld estimates of an individual’s tax liability as long as the method used is a “reasonable one”); *Erickson v. Comm’r*, 937 F.2d at 1555 (in testing the minimum requirements of a notice of deficiency, there is only one rule, “that there be some rational underpinning”).

A tax deficiency is not “naked” if it is based on a reasonable estimate of the taxpayer’s income, or if the unreported income asserted in the deficiency can be linked back to the taxpayer. *Fior d’Italia, Inc.*, 536 U.S. at 241; *Day v. C.I.R.*, 975 F.2d 534, 537 (8th Cir. 1992). The Commission is required only to produce “some evidentiary foundation linking the taxpayer to the alleged income-producing activity” before the deficiency determination will be accorded its usual presumption of correctness. *Weimerskirch v. Comm’r*, 596 F.2d 358, 362 (9th Cir. 1979). Although a determination that is unsupported by evidentiary foundation is clearly arbitrary and erroneous, the required showing is “minimal.” *Blohm v. Comm’r*, 994 F.2d 1542, 1549 (11th Cir. 1993).

II. The Tax Commission finds that the business income estimates derived from online sources did not meet the required minimal showing for a presumption of correctness; therefore, it modifies the Bureau’s adjustment to 2017 and cancels the adjustments to 2018 and 2019.

In this case, the Bureau reconstructed Petitioners’ income based on information reported by third parties on tax forms and based on public information from online sources. The wage and income information reported on Forms W-2, 1099-G and 1099-MISC provided a reasonable

foundation for the deficiency determined by the Bureau for 2016 and 2017. Idaho Code section 63-3002 states that it is the intent of the Idaho Legislature to make the Idaho Income Tax Code identical to the Internal Revenue Code as to the measurement of taxable income. Upon a final determination of any deficiency of federal taxes, the taxpayer is required to send written notice to the Tax Commission within 120 days. Idaho Code § 63-3069. Mr. [redacted] did not file his Idaho tax returns or send notice of his final federal determination as to 2016 and 2017. Therefore, it was proper for the Bureau to prepare returns using the federal adjustments to Mr. [redacted] Idaho taxable income and using the income information reported by third parties for Ms. [redacted].

The burden of proving the Tax Commission's assessments were erroneous as to the concrete information in the Tax Commission's records remains with Petitioners, and Petitioners failed to show that the tax forms filed by third parties or federal adjustments made were incorrect. The Tax Commission finds the provisional returns for 2016 and for 2017—as modified herein—to be a fair representation of Petitioners' taxable income.

On the other hand, the Tax Commission finds that the specific item of \$396,892 of business income added in tax year for 2017, 2018, and 2019 based solely upon company information databases to be arbitrary and without reasonable foundation. The Bureau did not summons business records or perform any independent investigation of the business income. Further the Bureau has not connected any dots to explain how Mr. [redacted] was in a [redacted] business in Wyoming even though he stated he was doing business as [redacted] and making sales to Idaho consumers. The Bureau did not make any showing as to who Petitioners were in business with and what exactly they may have been doing to earn such a substantial income. Because the Bureau did not provide any additional information to corroborate the figures provided by Buzzfile and Dun & Bradstreet, and because there is no information available as to how the figures were created by

said websites, the Tax Commission finds the estimated income to be arbitrary and without foundation. An estimate that is arbitrary and without foundation is a “naked” assessment that is not entitled to any presumption of correction. Therefore, the Tax Commission herein modifies the 2017 adjusted income to that reported by third parties in the amount of \$137,530 and cancels the adjustments to 2018 and 2019 which were based solely on the estimated income.

III. The Tax Commission may use a joint filing status on behalf of married taxpayers who fail to file tax returns.

Under Idaho Code section 63-3031(a), a “husband and wife *may* make a single return jointly even though one of the spouses has neither gross income nor deductions[.]” (Emphasis added). Filing a joint Idaho tax return is generally permissive. A joint Idaho return is required only when a couple files a joint return for federal purposes. Idaho Code § 63-3031(c).

Under Idaho Code, the married filing joint filing status is not an election and does not require any specific action on behalf of the taxpayer. Thus, Tax Commission overturns its prior decisions holding that the Bureau cannot prepare a married filing joint return on behalf of nonfiling taxpayers, unless the couple had filed a joint federal return that year. *See, e.g.* Docket No. 0-194-881-536 (2021); Docket No. 19750 (2007); Docket No. 16173 (2002) et al. These decisions incorrectly focus on the joint filing status being an election which is inconsistent with the plain language of the statute.

The Tax Commission has the statutory authority to make a return where none has been made. Idaho Code § 63-3042. For married taxpayers who have not filed a tax return, the Tax Commission has discretion to create a joint return or a married filing separate return with a community property split. As Mr. and Ms. were married during the audited tax years, the Bureau properly used the married filing joint status in its provisional returns.

IV. Interest and penalty are appropriately added to the income tax deficiency.

The Tax Commission reviewed the interest and 25% late file penalty added to the 2016 liability and the 2017 liability as modified herein and finds both to be appropriate per Idaho Code sections 63-3045 and 63-3046. Interest is mandatory and applies to all deficiencies of tax. Idaho Code § 63-3045(7). Although the Bureau did not explain the application of the penalty in its Notice, the Tax Commission finds that the maximum 25% late file penalty is appropriate. A penalty of 5% per month, not to exceed 25% of the deficiency amount, may be imposed against a taxpayer who does not file on or before the due date of the return. Idaho Code § 63-3046(c)(1) and Idaho Code § 63-3046(d). Petitioners did not file their 2016 or 2017 return and the maximum penalty is therefore applicable.

CONCLUSION

The Tax Commission upholds the Notice as to 2016, modifies the Notice as to 2017 and cancels the Notices as to 2018 and 2019. The Bureau is not entitled to a presumption of correctness where it reconstructs income based on estimates which are without foundation or arbitrary.

IT IS ORDERED that Petitioners pay the following tax, penalty and interest for 2016 and 2017 computed to March 14, 2023. The Notices as to 2018 and 2019 are hereby cancelled and the liabilities adjusted to \$0.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2016	\$4,939	\$1,235	\$1,044	\$7,218
2017	7,018	1,754	1,253	10,025
2018	0	0	0	0
2019	0	0	0	0
			TOTAL	\$17,243

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 _____ 2023.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2023,
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:

Receipt No.
