

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 0-835-363-840
	)	
	)	
Petitioners.	)	DECISION
	)	

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(Petitioners) protested the Billing Letter for tax years 2021 and 2022, dated October 12, 2023. This protest carried to the Notice of Deficiency Determination (Notice) for the same years, dated November 17, 2023. The Tax Commission reviewed the matter and hereby issues its final decision to modify the Notice.

**Background**

On April 11, 2023, Petitioners sent the Tax Commission an amended Idaho income tax return for tax year 2021 and an original (i.e., not amended) Idaho return for tax year 2022. The amended return for 2021 removed all reported income. Petitioners reduced “federal adjusted gross income from federal Form 1040” on the original 2021 return from \$271,989 to \$0 and “Idaho taxable income” from \$246,886 to \$0. The return for tax year 2022 reported no income. Petitioners included forms stating that the wages reported on W-2s are incorrect and do not qualify as wages as defined in Internal Revenue Code (IRC) sections 3401 and 3121.

Audit reviewed these returns and, on October 12, 2023, issued a Billing Letter denying the changes on the 2021 amended Idaho return and increasing Idaho taxable income for 2022 based on information provided to the Tax Commission by third parties. Petitioners protested the Billing Letter on the grounds that only employees receive wages, that they are not employees, and that the companies from which they earn a living have nothing to do with any source or privilege that would make their earnings taxable in nature. They went on in their protest letter to discuss the

definitions of “employee” and “trade or business” in IRC and include a quotation from a court case regarding the interpretation of definitions used in statutes<sup>1</sup>. They continued by saying they are not among the limited classes of persons subject to income tax, that they have never received “taxable income,” and that they are not “taxpayers.” They then demanded the name and position title of the individual who made the “determination, by law, of ‘frivolity’ over [their] return.” After that, they discussed bad payer information, frivolous returns, invalid returns, and refund of overpayments, and closed by stating they may take legal action “[i]f the pay that was illegally withheld from [them] is not returned in full.” Petitioners attached numerous exhibits including a copy of a memorandum from the IRS Office of Chief Counsel (200114033, 4/6/2001), a printed screenshot of a portion of the IRS webpage regarding Form W-2, *Wage and Tax Statement*, a printed copy of IRC sections 3401 and 7434, and a printed copy of select pages from IRC Section 7701.

In accordance with standard procedures, Audit issued the Notice on November 17, 2023, which included a statement that Petitioners’ protest of the billing letter would automatically apply to the Notice. Along with the Notice, Audit sent a letter acknowledging Petitioners’ protest and informing them that the case would be forwarded to the Tax Commission’s Appeals unit (Appeals) for further consideration.

Appeals sent a letter on December 26, 2023, informing Petitioners of the options available for redetermining a protested Notice. Petitioners responded with two identical copies of the same information, one received January 19, 2024, and the other received January 24, 2024. Much of this response to Appeals was taken verbatim from their protest letter to Audit. Petitioners included a statement that “[they] are not protesters and have done nothing but rebut the erroneous information

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<sup>1</sup> “When a statute includes explicit definitions, we must follow that definition, even if it varies from that term’s ordinary meaning.” “As judges, it is our duty to construe legislation as it is written, not as it might be read by a layman, or as it might be understood by someone who has not even read it.” *Meese v. Keene* U.S. 465, 484 (1987)

returns stating that [they] received taxable income.” To Appeals they also wrote, “It is apparently obvious that you have not reviewed the US Code within the statutory meaning” and quote the Code of Federal Regulations (CFR) 1.6001. Additionally, they state that Subtitle A of US Code 26 imposes income taxes on nonresident aliens with US sourced income, foreign corporations with US sourced income, and US citizens living abroad with foreign earned income, but does not impose income tax on most citizens. Petitioners mentioned Subtitle C of US Code 26 which imposes employment taxes on employees “as defined by [section] 3401(c).” This letter concluded with demands made of Appeals, including rescinding the Notice. Also attached as an exhibit were several quotations from court cases from 1916, 1937, and 1972, a 1943 quotation from testimony of a former Treasury Department legislative draftsman, and another quotation from 1979.

Appeals sent a follow-up letter on March 7, 2024, acknowledging receipt of Petitioners’ first response. Appeals informed Petitioners that the authority to rescind the Notice as requested lies with Audit or the Commissioners and asked some clarifying questions:

- Do you dispute the fact that \_\_\_\_\_ and \_\_\_\_\_ paid you during 2021 and 2022? Do you dispute the amount they paid you?
- Please tell me why [these businesses] paid you.
- When you say you didn’t receive taxable income, what do you mean? What is your definition of taxable income?

Appeals received Petitioners’ response to this letter on April 4, 2024. Once again, the bulk of the response was taken verbatim from the previous response, although slightly rearranged.

Petitioners provided answers to the questions Appeals asked in the March 7 letter:

- They do not dispute that they were paid, but say it is not of a taxable source. They did not mention whether or not they dispute the amount they were paid.
- They were paid because they worked for the payers, but they were not “employees.”
- “Taxable income’ is not Defined in the US Code, however through *Context Clues* throughout the Internal Revenue Code Title 26, Taxable Income can only mean remuneration paid to Nonresident Aliens and Foreign Corporations per 26 USC §1401 and §1402 which is where the “Every person is made liable” in the Code.

And is found on the instructions for W-2's which States 'every employer engaged in Trade or Business who pays remuneration (definition below). This does not include US Citizens working in the United States. However, the Code does include US Citizens working abroad earning US source income. 'Taxable income' is not to be confused with 'Wages' which are very different and are defined under 26 US Code §3401(a). 'Certain government workers' earn wages. This is also iterated in 26 USC §6331 (below)''

Petitioners also quoted a portion of 26 CFR section 301.4203-3, describing special rules for claiming a refund of overpayment on an income tax return. Petitioners ended this letter by discussing violation of 18 U.S. Code section 1512 (Tampering with a witness, victim, or informant) and section 872 (Extortion by officers or employees of the United States) and providing information regarding the penalties for being an officer or employee of the United States guilty of extortion along with civil damages for certain unauthorized collection actions.

At no time during the redetermination process did Petitioners request an informal hearing. Petitioners have simply stated their position three times and provided minimal additional information. The Tax Commission now makes its final decision based on the information currently available.

### **Law & Analysis**

Idaho Code section 63-3002 states that residents of Idaho are subject to a tax measured by Idaho taxable income. Idaho taxable income (defined in Idaho Code section 63-3011C) must be equal to federal taxable income (see Idaho Code section 63-3011B), except as required or allowed by provisions in Idaho Code. Idaho Code section 63-3030 mandates that any Idaho resident required to file a federal income tax return is also required to file an Idaho income tax return.

Contrary to Petitioners' statement, "taxable income" is defined in IRC section 63. In Petitioners' case, IRC section 63(b) would apply because they did not itemize deductions, so their

“taxable income” would be their adjusted gross income (AGI) minus the standard deduction<sup>2</sup>. AGI is defined in IRC section 62 as gross income minus the deductions listed in IRC section 62(a)(1) – (22). Gross income is defined in IRC section 61 as all income from whatever source derived, including (but not limited to) the specific items listed in IRC section 61(a)(1) – (14), except as provided in IRC Subtitle A. The first item listed is “Compensation for services, including fees, commissions, fringe benefits, and similar items.” The specific term “wages” is never used in the definition of gross income or as an example.

Petitioners argue that they are not among the classes of people subject to income tax. They state that only nonresident aliens with US source income, foreign corporations with US source income and US citizens residing abroad with foreign earned income are subject to income tax. They have failed to provide any legal or logical reasoning to support such a position. Therefore, the Tax Commission finds that Petitioners are subject to both federal and Idaho income tax and as such meet the definition of “taxpayer” for both federal and Idaho purposes.

Petitioners stated multiple times in their correspondence with the Tax Commission that they did not receive “wages,” because they were not “employees” and the companies that paid them were not “employers.” In IRC section 3401(a) (the section referenced in Petitioners’ correspondence), wages are defined as follows: “For purposes of this chapter, the term ‘wages’ means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash.” This general definition is followed by a list of exceptions, none of which apply to either Petitioner.

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<sup>2</sup> Personal exemptions provided in IRC section 151 are set to \$0 for tax years 2018 through 2025. Petitioners did not claim, and do not appear to be eligible to claim, any deduction provided in IRC section 199A or section 170(p).

Employer is defined in IRC section 3401(d) as follows: “For purposes of this chapter, the term ‘employer’ means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person.” This is again followed by some exceptions which do not appear to apply in Petitioners’ case.

Employee is defined in IRC section 3401(c) as follows: “For purposes of this chapter, the term ‘employee’ includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term ‘employee’ also includes an officer of a corporation.”

If the concept of following an explicit definition found in statute – as Petitioners found in the *Meese v. Keene* quotation – is applied to Petitioners’ use of the definitions of “wages,” “employee,” and “employer” in IRC section 3401(a), (c), and (d), then Petitioners’ argument about not earning wages, not being employees, and their payers not being employers becomes moot. All three definitions begin with the phrase “For purposes of this chapter,” meaning they do not apply to anything outside that chapter. Section 3401 is found in IRC Chapter 24, *Collection of Income Tax at Source of Wages*, which has no bearing on the calculation of taxable income or whether income is of a taxable nature or not.

Additionally, only two of these definitions are explicit: “wages” and “employer.” Both definitions incorporate the term “means,” which is then followed by a clear description of what or who qualifies. The definition for “employee” uses the term “includes,” which is then followed by illustrative examples, but not an exhaustive list. The idea that the list is not exhaustive is supported by the fact that “employee” is defined separately in IRC section 7701(a)(20) with illustrative examples which do not correspond with the examples used in IRC section 3401(c), and that IRC section 3401(c) uses the term “employee” in its definition of “employee.” This implies that there

is already an understanding of what an employee is, and the definition is only providing examples. Also, IRC section 7701(c) states: “The terms ‘includes’ and ‘including’ when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.” “In this title” refers to Title 26, the Internal Revenue Code. Petitioners are wrong in their belief that “employee is certain government employees as defined in IRC Title 26 section 3401(c).” While it is true that officers, employees, and elected officials of the United States, a State, etc., and an officer of a corporation are considered employees for purposes of IRC Chapter 24, they are not the only workers who qualify.

In Revenue Ruling 2006-18, 2006-1 CB 743, the IRS warns of the consequences of using this argument:

This revenue ruling emphasizes to taxpayers, promoters, and return preparers that all individuals are subject to federal income tax. This revenue ruling also provides that the terms “employee” and “wages” carry the meanings given to them in the Internal Revenue Code, regulations, and publications of the Internal Revenue Service. Under the Internal Revenue Code, wages include any compensation received due to the performance of services as an employee, and the term employee includes any individual for whom the legal relationship between the individual and the person for whom the individual performs services is the legal relationship of employer and employee. All wages are included in gross income for purposes of determining federal income tax liability, and are also subject to federal employment taxes. Any argument that Forms W-2 only record and report payments made to federal employees, or that only federal employees or residents of the District of Columbia or federal territories and enclaves earn wages subject to tax, has no merit and is frivolous.”

The IRS has imposed, and courts have upheld, civil and criminal penalties for people using this argument. See, for example: *Taliaferro v. Freeman*, 595 F App’x 961, 962-63 (11th Cir. 2014); *Monterro v. Commissioner*, 354 F App’x 173 (5th Cir. 2009); *Sullivan v. United States*, 788 F.2d 813, 815 (1st Cir. 1986); *United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985); *United States v. Hendrickson*, 100 A.F.T.R.2d (RIA) 2007-5395 (E.D. Mich. 2007); *Briggs v. Commissioner*, T.C. Memo 2016-86; and *Waltner v. Commissioner*, T.C. Memo 2014-35.

Based on all of the above information, the Tax Commission finds that each Petitioner meets the definition of “employee,” each payer of remuneration in exchange for services provided to said payer for tax years 2021 and 2022 meets the definition of “employer,” and said remuneration meets the definition of “wages.” Based on information provided to the Tax Commission by said payers, Petitioners received enough gross income in 2021 and 2022 to be required to file federal and Idaho returns for both years. Even if Petitioners had not received “wages,” they still had received enough compensation for services (see IRC section 61(a)(1)) as gross income to be required to file.

The Tax Commission finds the amount reported on line 3, *Idaho Taxable Income Revised*, of the Notice to be a reasonable calculation of Petitioners’ Idaho taxable income for tax year 2022 and hereby upholds the Notice for tax year 2022.

For tax year 2021, Petitioners filed an Idaho return in January 2022, reporting a federal AGI of \$271,989. They did not provide a corresponding federal return to support the amount reported. Despite this, Petitioners’ 2021 Idaho return was processed as filed, and they were issued a refund of \$235. On the amended federal return Petitioners sent the Tax Commission with their amended Idaho return, the AGI reported to the IRS was \$264,002. This matches information provided by the IRS. Petitioners “corrected” the AGI on both the federal and Idaho returns to \$0. In the Notice, Audit reinstated the original federal AGI of \$271,989 as reported on the Idaho return, which the Tax Commission determined is incorrect.

Petitioners did not report all their gross income on the federal return they filed with the IRS, and they claimed a deduction for educator expenses they do not appear to qualify for<sup>3</sup>. Based on all available information, the Tax Commission calculated Petitioners’ 2021 AGI as follows:

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<sup>3</sup> For purposes of IRC section 62(a)(2)(D), the term “eligible educator” means an individual who is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. The Tax Commission has no information to indicate that either Petitioner meets these criteria.



Wages-	\$197,696
Wages-	1,447
Wages-	64,198
Taxable distributions-	329
Capital gain distribution-	70
Ordinary dividends-	8
Schedule E net income- Rental property <sup>4</sup>	<u>910</u>
AGI	\$264,658

From this AGI, the Tax Commission allowed the standard deduction amount for a married couple filing a joint return, \$25,100 for 2021, resulting in Idaho taxable income of \$239,558. Based on this, Petitioners' income tax liability is \$15,085.

While the Notice restores Petitioners' income on their 2021 Idaho return, it does not restore the Idaho child tax credit and the grocery credit Petitioners claimed on their original return but not on their amended return. In the interest of fairness, the Tax Commission decided to restore them and calculated the adjustment to Idaho tax as shown below:

Tax based on income	\$15,085
Less: Idaho Child Tax Credit	(205)
Plus: Permanent Building Fund tax	10
Less: Grocery credit	(300)
Less: Idaho withholding	<u>(15,302)</u>
Total overpayment per redetermination	(712)
Less: Overpayment per amended return	<u>(15,292)</u>
Increase to tax	<u>\$14,580</u>

Audit added interest to Petitioners' tax deficiency. The Tax Commission reviewed this addition and finds it to be appropriate and in accordance with Idaho Code section 63-3045. Audit also added a 5% negligence penalty to Petitioners' deficiency because of their careless disregard of their tax obligation. However, the Tax Commission has determined that Petitioners' actions

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<sup>4</sup> The Tax Commission has no information about Petitioners' rental property other than the net income they reported to the IRS.

constitute an intent to evade their tax obligations and hereby adds to the deficiency for tax year 2022, instead of the 5% negligence penalty, a fraud penalty equal to 50% of the deficiency.

Petitioners' comments about a determination of "frivolity" over their return, and about valid and invalid returns are irrelevant to this decision. Audit made no determination that Petitioners' returns were frivolous or invalid. The returns were processed and then selected for examination. A valid return does not necessarily equate to an accurate return. The Tax Commission is authorized by Idaho Code section 63-3040 to examine the correctness of an income tax return submitted to the Tax Commission. Any changes the Tax Commission makes to Petitioners' returns are to bring them into compliance with Idaho income tax statutes.

### **Conclusion**

Petitioners filed an amended income tax return for 2021 and an original tax return for 2022 reporting \$0 of income. The Tax Commission determined that these returns were valid but incorrect. Based on available information, the Tax Commission determined Petitioners' Idaho taxable income and tax liability for each year.

THEREFORE, the Notice dated November 17, 2023, and directed to  
is hereby MODIFIED and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>REFUND HELD</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2021	\$14,580	(15,057)	\$0	(\$41)	(\$518)
2022	6,807	(5,928)	439	44	<u>1,362</u>
					\$844

The Tax Commission DEMANDS immediate payment of this amount. Interest is calculated in accordance with Idaho Code section 63-3045.

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2024.

IDAHO STATE TAX COMMISSION

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2024,  
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.

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