

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 1-064-190-976
)	
)	
Petitioners.)	DECISION
_____)	

The Tax Discovery Bureau (Bureau) issued a Notice of Deficiency (Notice) to husband and wife, (Petitioners) for tax year 2018. Petitioners protested and participated in an informal hearing with the Tax Commission's Appeals Unit (Appeals). The Tax Commission has reviewed the matter and hereby upholds the Notice issued by the Bureau.

BACKGROUND

The Bureau sent Petitioners a letter informing them the Tax Commission had received information that they had received income from illegal activities in 2018. Specifically, the wife was found guilty of five counts of Grand Theft and must pay restitution on the amount embezzled. The auditor examined Petitioners' 2018 income tax returns but could not find the embezzled funds in their gross income. Since Petitioners did not report the illegal income on their returns, the Bureau requested they amend their returns and include copies of audit reports, police reports, and court documents, regarding the embezzlement. Petitioners did not respond, so the Bureau issued a Notice adding the illegal income on their 2018 return with a 50% fraud penalty. The husband protested, stating he and his wife had since divorced, and she is currently incarcerated serving 3 to 71 years. He also hired a representative, and stated he will be submitting IRS Form 8857 (Request for Innocent Spouse Relief). The Bureau gave Petitioners time to submit the form, but they did not do so in a timely manner.

With no additional information submitted to resolve the issue, the case was transferred to Appeals. An informal hearing was scheduled with the husband's representative to discuss the case further. The representative gave an overview of the embezzlement case during the hearing and stated that his client was not involved in or aware of the embezzlement in any manner. His client is an unsophisticated taxpayer who was not involved in the family finances or tax return preparation in any way. He is a laborer with a high school diploma and his wife actively concealed the embezzlement from him. When asked about submitting IRS Form 8857, the representative stated he still planned on doing that, but there have been delays at the IRS. After some time, Petitioners did not provide any documentation to consider. The Tax Commission now makes its decision under the following law and analysis.

LAW AND ANALYSIS

Petitioner's wife embezzled income from her employer and Petitioners failed to report the income on their joint 2018 tax return. The income received through the grand theft is taxable and must be included on the tax returns. The U.S. Supreme Court has ruled that unlawful, as well as lawful, gains are comprehended within the term "gross income." *James v. United States*, 366 U. S. 213, 218 (1961).

Idaho Code section 63-3031(b)(3) defines the responsibility of a married couple making the election to file their tax returns with a filing status of married filing joint. "If a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several."

Because Petitioners elected to file their 2018 tax return as married filing joint, Petitioners are jointly and severally liable for the 2018 tax liability. Joint and several liability means the state

may collect any part of the liability up to the entire amount from either spouse. One spouse may have a cause of action against the other spouse. However, the state stays in a neutral position.

The main objection appears to be the husband being unaware of the embezzled income even though they were living together and married at the time. To be entitled to innocent spouse relief, the innocent spouse must not know or have reason to know of the understatement of income on the tax return. I.R.C. § 6015(b)(1)(C). After careful analysis of all the facts at hand, it is not reasonable to assume the husband received no benefit from the embezzled money. In fact, the embezzlement was discovered after a suspicious check was written by the wife to a construction company as a “business expense.” The employer contacted the construction company and was informed the check was for building an addition to Petitioners’ home. It is not clear what all the money was spent on, but even the husband admitted he thought they were “financially successful” at the time. Additionally, IRS Form 8857 has not been filed and the IRS has not granted husband relief from joint and several liability on the federal return. The Tax Commission does not have statutory authority to grant the husband relief from his joint and several liability on tax year 2018 where that relief has not first been obtained from the IRS. Idaho Code section 63-3050A states in relevant part:

63-3050A. RELIEF FROM JOINT AND SEVERAL LIABILITY ON JOINT RETURN. (1) An individual who has filed a joint return and who has been granted relief from joint and several liability by the internal revenue service shall have such relief recognized, granted and honored by the state tax commission for state income tax purposes.

Petitioners have not given documentation or authority to show that the funds embezzled are not taxable nor have they shown that Petitioner husband is entitled to innocent spouse relief under Idaho Code.

Petitioner husband also objected to the way the Notice was calculated. He stated in his protest letter that the “Complaint and Affidavit” indicates a lesser amount than what is stated in

the Notice. The Bureau noted in response that the amounts listed in the affidavit did not include all income the wife embezzled. The Bureau verified the amounts through the prosecuting attorney assigned to the case and the amounts listed on public court documents. The Tax Commission finds the amount listed in the Notice to be accurate.

Lastly, Petitioner husband objects to the 50% fraud penalty because the husband did not have the intent to fraudulently evade taxes. Petitioners filed a married joint return in 2018. Idaho is a community property state, and the money embezzled was intentionally withheld from the wife's employer and income tax returns. Idaho Code section 63-3075(b) identifies as a felony "willfully failing to collect or truthfully account for and pay over" Idaho income tax or a willful attempt "to evade or defeat any tax imposed" by the Idaho income tax act. In the case of *Holland v. United States*, 348 U.S. 121, 139 (1954), underreporting significant amounts of income infers willfulness. The Tax Commission finds the addition of the 50% fraud penalty to be reasonable.

CONCLUSION

Gross income is defined as "income from whatever source derived." Income from illegal activities is also included in the definition and must be reported on tax returns. Without any additional information or IRS Form 8857 to consider, the Tax Commission must make its decision based on the information currently available. Based on this information, the Tax Commission finds no reason to modify the Notice issued by the Bureau.

THEREFORE, the Notice dated October 28, 2021, and directed to
is hereby AFFIRMED and MADE FINAL.

IT IS ORDERED that Petitioners pay the following tax, penalty, and interest computed to September 22, 2023:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2018	\$48,546	\$24,273	\$7,867	\$80,686

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.

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