

BEFORE THE STATE BOARD OF TAX APPEALS
STATE OF ARIZONA
100 North 15th Avenue - Suite 140
Phoenix, Arizona 85007
602.364.1102

JAMES and KATHY MORSE,

Appellants,

vs.

ARIZONA DEPARTMENT OF REVENUE,

Appellee.

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) Docket No. 1953-06-1
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) NOTICE OF DECISION
) FINDINGS OF FACT AND
) CONCLUSIONS OF LAW
)

The State Board of Tax Appeals, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follow:

FINDINGS OF FACT

James and Kathy Morse ("Appellants") timely filed their 1999 resident Arizona individual income tax return and reported a federal adjusted gross income ("FAGI") of negative \$2,150. Based on this return, Appellants received a state refund of \$209 for withholding taxes paid to Arizona.

The Forms W-2 that Appellants attached to their 1999 Arizona return reported that Kathy Morse received wages in the amount of \$15,707.49 from Komic Enterprises, Inc., and James Morse received \$22,911.17 in wages from Cerbat Lanes. Additionally, a Form 1099-C that Appellants attached reported \$886 Appellants received from Capital One in debt forgiveness. None of these items were reported as income on Appellants' 1999 Arizona income tax return.

Through an exchange of information agreement with the Internal Revenue Service ("IRS"), authorized by 26 U.S.C. § 6103(d), the Arizona Department of Revenue ("Department") determined that Appellants underreported their FAGI to Arizona and assessed them additional income tax, interest and

1 a penalty for late payment.¹ Appellants protested the assessment and filed an amended 1999 Arizona
2 income tax return, claiming they had no gross income for the tax year but increasing the income reported
3 on their return to \$2,150 so that the FGI amount was changed to zero. The Department did not accept
4 the amended return or adjust the assessment. Appellants protested the assessment to the Department's
5 hearing officer, who upheld the assessment. Appellants then protested to the Director of the Department,
6 who summarily affirmed the hearing officer's decision because Appellants raised no facts or arguments
7 that would warrant a review. See A.A.C. R15-10-131(H)(2). Appellants now timely appeal to this Board.

8 DISCUSSION

9 The issue before the Board is whether the Department properly assessed Appellants income tax,
10 interest and a late payment penalty.

11 Under the Arizona Constitution, the legislature has authority to levy and collect taxes. Ariz.
12 Const. art. IX, § 12. Pursuant to this authority, the legislature enacted the following:

13 (A) It is the intent of the legislature . . . to accomplish the following objectives:

14 (1) To adopt the provisions of the federal internal revenue code relating to the
15 measurement of adjusted gross income for individuals, to the end that adjusted gross
16 income reported each taxable year by an individual to the internal revenue service shall
17 be the identical sum reported to this state, subject only to modifications contained in this
18 title.

(4) To impose on each resident of this state a tax measured by taxable income wherever
derived.

19 A.R.S. § 43-102(A)(1) and (4).

20 In measuring adjusted gross income, the Arizona Legislature chose to adopt the provisions of the
21 Internal Revenue Code ("I.R.C."). Accordingly, an individual taxpayer computes Arizona taxable income
22 by starting with federal adjusted gross income. See A.R.S. § 43-1001. The I.R.C. provides that "gross
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24 ¹ The IRS increased Appellants' FGI from negative \$2,150 to \$37,354.
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1 income" means "all income from whatever source derived, including . . . (1) Compensation for services . . .
2 . . ." and "(12) Income from discharge of indebtedness" 26 U.S.C. § 61(a).

3 Appellants do not dispute the amounts reported on either their Forms W-2 or the Form 1099-C.
4 Instead, Appellants argue that the reported amounts do not constitute "wages," and they are not
5 "employees" of an "employer" as any of these terms are defined under the I.R.C. Appellants' argument is
6 the same tax protester argument held to be frivolous by all state and federal tribunals to address it.

7 The I.R.C. states that "the term 'wages' means all remuneration . . . for services performed by an
8 employee for his employer" 26 U.S.C. § 3401(a).

9 . . . wages for personal services are income under the Internal Revenue Code
10 Notwithstanding (a taxpayer's) belief that his wages are not gains or profits but merely
11 what he has received in an equal exchange for his services, the Internal Revenue Code
12 clearly, includes compensation of this nature within reportable gross income.

11 *United States v. Lawson*, 670 F.2d 923 (10th Cir. 1982).

12 The term "employer" is defined as "the person for whom an individual performs or performed any
13 service, of whatever nature, as the employee of such person" *Id* (d). The term "employee"
14 "includes an officer, employee, or elected official of the United States, a State, or any political subdivision
15 thereof . . ." *Id*(c). Section 7701 clarifies that the use of the word "includes" shall not be deemed to
16 exclude other items otherwise within the meaning of the term defined. 26 U.S.C. § 7701. Thus, the word
17 "includes" as used in the definition of "employee" is a term of enlargement, not of limitation. It makes
18 government employees and officials a part of the definition of "employee," which generally includes
19 private citizens. See, e.g., *United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985) (stating that
20 interpreting I.R.C. § 3401 in a way that "does not include privately employed wage earners" as an
21 "employee" is a "preposterous reading of the statute"); *Sullivan v. United States*, 788 F.2d 813 (1st Cir.
22 1986) (stating that taxpayer's argument that the I.R.C. limits the definition of "employee" only to
23 government officers and employees is "meritless").

1 For the foregoing reasons, Appellants are liable for the tax assessed.

2 The late payment penalty may be abated only upon a showing that the failure to timely pay is due
3 to reasonable cause and not due to willful neglect. A.R.S. § 42-1125(D). Appellants have not
4 demonstrated that their failure to timely pay was due to reasonable cause. Therefore, the late payment
5 penalty may not be abated.

6 For Arizona purposes, interest is a part of the tax and generally may not be abated unless the tax
7 to which it relates is found not to be due for whatever reason. A.R.S. § 42-1123(C). The tax in this case
8 is due and the associated interest cannot be abated.

9 CONCLUSIONS OF LAW

10 1. Appellant's wages and debt discharge are taxable Arizona income and the Department
11 properly assessed the tax at issue. See A.R.S. § 43-102(A)(1) and (4); A.R.S. § 43-1001; I.R.C. 61(a).

12 2. Appellants have not demonstrated that their failure to timely pay was due to reasonable cause.
13 Therefore, the late payment penalty may not be abated. See A.R.S. § 42-1125.D.

14 3. Appellant is liable for the interest assessed. A.R.S. § 42-1123(C).

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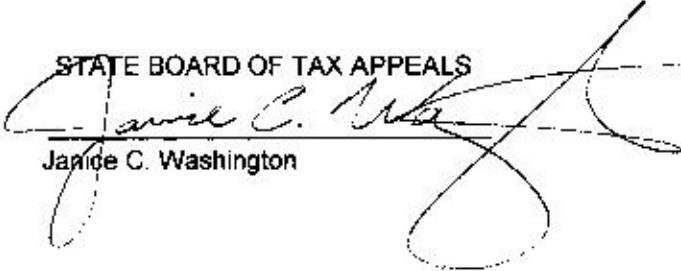
ORDER

THEREFORE, IT IS HEREBY ORDERED that the appeal is denied and the final order of the Department is affirmed.

This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer, unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this 18th day of July, 2007.

STATE BOARD OF TAX APPEALS


Janice C. Washington

JCW:ALW

CERTIFIED

Copies of the foregoing
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