

**BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO**

IN THE MATTER OF THE PROTEST OF
MARK A. SMITH
PROTEST TO DENIAL OF CLAIM FOR REFUND

NO. 98-04

DECISION AND ORDER

This matter came on for formal hearing on January 12, 1998, before Gerald B. Richardson, Hearing Officer. Mr. Mark A. Smith, hereinafter, "Mr. Smith", represented himself at the hearing. The Taxation and Revenue Department, hereinafter, "Department", was represented by Frank D. Katz, Chief Counsel. Based upon the evidence and the arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. In 1995 and 1996 Mr. Smith was employed by Intel Corporation at its Rio Rancho facility as an equipment technician. His job duties as an equipment technician involved making repairs to testing equipment that tests the speed of computer chips manufactured at the Intel facility.
2. During 1995 and 1996 Mr. Smith received compensation in the form of wages or salary for the work he performed for Intel Corporation.
3. In 1995 and 1996 Mr. Smith resided in Albuquerque, New Mexico.

4. On January 14, 1997 Mr. Smith filed an amended 1995 New Mexico Personal Income Tax (PIT) return, reporting zero federal adjusted gross income, and zero New Mexico base income. The amended return requested a refund in the amount of \$1,435, representing income taxes withheld or previously paid by Mr. Smith.

5. Mr. Smith's W-2 form from Intel Corporation reflects that in 1995 he received \$37,020 in wages, tips or other compensation from Intel Corporation.

6. On January 31, 1997 Mr. Smith filed an original 1996 New Mexico PIT return, reporting zero federal adjusted gross income, and zero New Mexico base income. The return requested a refund in the amount of \$1,593.29, representing income taxes withheld from Mr. Smith.

7. On February 6, 1997 the Department denied Mr. Smith's claim for refund for the 1995 tax year.

8. On April 11, 1997 the Department denied Mr. Smith's claim for refund for the 1996 tax year.

9. On February 23, 1997 Mr. Smith filed a written protest to the Department's denial of its claim for refund for the 1995 tax year.

10. April 21, 1997 Mr. Smith filed a written protest to the Department's denial of its claim for refund for the 1996 tax year.

DISCUSSION

The issue to be determined herein is whether the Department properly denied Mr. Smith's claims for refund. The underlying legal issue upon which the foregoing

determination depends is whether the compensation Mr. Smith received from his employment by Intel Corporation in New Mexico is subject to income taxation by the State of New Mexico. Mr. Smith has raised a number of legal arguments as to why his wages are not subject to income taxation which will be addressed individually. Prior to such discussion, however, New Mexico's personal income tax system will be explained.

New Mexico imposes its income tax upon the net income of "every resident individual". New Mexico is among the majority of states which "piggy-back" or use the federal income tax system as the basis for calculating state income taxes. The calculation of personal income taxes in New Mexico begins with a determination of "base income" which is defined to be the taxpayer's "adjusted gross income" as defined in Section 62 of the Internal Revenue Code, plus certain net operating loss deductions which can be deducted for federal purposes in arriving at federal adjusted gross income but which New Mexico does not allow to be deducted in the same manner. *See, NMSA 1978, § 7-2-2(B)*. New Mexico then allows certain deductions, such as the federal standard or itemized deductions and deductions for income from federal obligations, to arrive at "net income" upon which income tax is imposed. *See, NMSA 1978, § 7-2-2(N) and § 7-2-3*. Because Mr. Smith's arguments are, in essence, directed at the legality of the federal income tax, and provisions of the Internal Revenue Code, which provide the basis for calculating New Mexico's income tax, the Internal Revenue Code, and the federal authority interpreting it and the United States Constitution will be consulted to determine Mr. Smith's protest.

First, Mr. Smith argues that he has never earned "wages" as that term is defined in the Internal Revenue Code (the "Code"). Specifically, Mr. Smith relies upon the definition of "wages" found at Section 3401(a) of the Code which defines wages to mean,

“all remuneration...for services performed by and employee for his employer....” Mr. Smith then relies upon a definition of an “employee” purportedly found in a 1943 edition of the Federal Register which defines “employee” as follows:

The term “employee” *specifically includes* officers and employees, *whether elected or appointed of the United States, a State, territory, or political subdivision thereof* or the District of Columbia or any agency or instrumentality of any more(sic) or more of the foregoing. (emphasis supplied by Mr. Smith.)

Mr. Smith also relies upon the definition of “employee” found at Section 3401(c) of the Code which is substantially identical to the above quoted definition, with the addition of a reference to “employee” also including an officer of a corporation. Mr. Smith then argues that since he is not an officer or employee of the United States, a state, territory or political subdivision thereof, nor is he a corporate officer, that he is not an employee. Not being an employee, he argues that he could not have wages from employment.

The problems with this argument are numerous. In the first place, the definition of employee is written inclusively, to specifically include government employees and corporate officers. It contains no language excluding persons understood under the common law to be employees. Thus, the provisions cited fail to establish that Mr. Smith did not receive wages from employment. Additionally, Mr. Smith acknowledged at the hearing that he received a salary for his work at Intel Corporation. Further, Intel Corporation issues him a W-2 form and classified his remuneration as “wages, tips [or] other compensation” and lists him as an employee and itself as “employer” on that form. These strongly suggest that Mr. Smith does receive wages from employment.

It is also noteworthy that the statutory definitions quoted are from the provisions of the Code requiring the withholding of taxes by employers from wages, which is what Intel Corporation apparently did. While the obligation to withhold taxes from wages is imposed under these provisions of the code, the imposition of income tax is separate and apart from these provisions. The distinction between taxable income and wages subject to withholding was discussed by the U.S. Supreme Court in *Central Illinois Public Service Company v. United States*, 435 U.S. 21 at 25 (1978), where the Court noted:

The two concepts--income and wages--obviously are not necessarily the same. Wages usually are income, but many items qualify as income and yet clearly are not wages.

Thus, while the income tax is imposed upon taxable income, which may include wages, the obligation to withhold taxes is specifically confined to wages. This distinction leads us to the most significant error in Mr. Smith's argument, which is his assumption that in order for the imposition of tax upon his income to be legal, that it must be established that he had wages from employment. The imposition of the federal personal income tax is not so narrowly confined. As noted in the Findings of Fact, above, Mr. Smith has filed returns which declare that he has zero federal adjusted gross income for purposes of calculating his New Mexico taxable income. The Internal Revenue Code defines adjusted gross income for purposes of the imposition of income tax to be gross income, less certain deductions which are listed in Section 62 of the Code. Gross income is defined in Section 61 of the Code as follows:

Except as otherwise provided in this subtitle, gross income means *all income from whatever source derived, including (but not limited to) the following items:*

- (1) Compensation for services, including fees, commissions, fringe benefits and similar items;
- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowments contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

26 U.S.C. § 61 (1997). This definition is quite broad and inclusive, and is certainly broad enough to include under the first listed category, “compensation for services”, the remuneration Mr. Smith receives from Intel Corporation for the services he performs for them as an equipment technician, whether that remuneration is characterized as wages, salary or simply compensation. In this regard, Mr. Smith also cites to the Public Salary Tax Act of 1939 for the proposition that only the compensation for personal services as an officer or employee of a governmental entity is included in the definition of gross income. A reading of the plain language of the definition of “gross income”, above, belies any such narrow construction because it contains no such limiting language. Furthermore, the Public Salary Tax Act, 4 U.S.C. Section 111 also belies such a construction. That Act was enacted to waive the immunity of the federal government from the state taxation with respect to the imposition of state or local taxes upon the pay or compensation of federal officers and employees, so long as the state or local tax does not discriminate because of the federal source of such pay or compensation. Nothing in the language of the act limits the

imposition of either a federal income tax under the provisions of the Internal Revenue Code or a state income tax to only federal officers or employees.

Mr. Smith also cited to the U.S. Supreme Court decision, *Brushaber v. Union Pacific Railroad Company*, 240 U.S. 1 (1916) as supporting his argument that the sixteenth amendment to the Constitution did not alter the Constitution so as to correct the infirmities in the federal income tax. In order to better understand this issue, a review of the provisions of the Constitution relating to the power to impose taxes and of the federal caselaw with respect to income taxes is necessary.

Article 1, §8 provides the general authority for Congress to enact laws to impose taxes. It provides as follows:

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and excises, to pay the debts and provide for the common Defense and General Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;...(capitalization in the original.)

Article 1, §2, Cl. 3 of the United States Constitution provides that:

Representatives *and direct taxes* shall be apportioned among the several States which may be included in this Union,.... (emphasis added)

Additionally, Article 1, §9, Cl.4 provides that:

No Capitation or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken. (emphasis added, capitalization in original)

These two latter clauses became the basis of the Supreme Court determination that the Income Tax Act of 1894 was unconstitutional. The Court held that the income tax was unconstitutional because it imposed a tax on income from real estate. The Court ruled that

this was the equivalent of a direct tax on the real estate itself, and since the tax was not apportioned, it violated these clauses of the Constitution. *Pollock v. Farmers Loan and Trust Co.*, 157 U.S. 429 (1895). The ruling in this case effectively thwarted the imposition of an income tax in this country for some years thereafter. In 1909, Congress passed a law imposing an excise tax on corporations of 1% of net income. This tax was challenged on the same grounds as the 1894 income tax. In *Flint, v. Stone Tracy Company*, 220 U.S. 107 (1911), however, the Supreme Court upheld that tax, ruling that the tax was an "excise tax" and therefore not a direct tax which would be unconstitutional because it was not apportioned. Thus, the determination of whether a tax was an "excise tax" or a "direct tax" became crucial to the constitutionality of a tax. This concern was eliminated, however, by the passage of the sixteenth amendment to the Constitution. It provides as follows:

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

The first case to be decided by the Supreme Court following the passage of the sixteenth amendment which challenged the constitutionality of the income tax was the *Brushaber* case. In that case a stockholder of the Union Pacific brought an action to restrain the company from paying income tax on the grounds of the unconstitutionality of the income tax provisions of the Tariff Act of 1913. The Court ruled the income tax to be constitutional. In doing so, the Court reiterated the inherent power of Congress to impose an income tax under Article 1, §8, and found that the sixteenth amendment had merely removed the requirement that such taxes be apportioned among the states. Of particular

interest in the Court's decision is its discussion of the power of Congress to tax under Article 1, §8:

That the authority conferred upon Congress by §8 of article 1 "to lay and collect taxes, duties, imposts and excises" is exhaustive and embraces every conceivable power of taxation has never been questioned, or, if it has, has been so often authoritatively declared as to render it necessary only to state the doctrine. And it has also never been questioned from the foundation, without stopping presently to determine under which of the separate headings the power was properly to be classed, that there was authority given, as the part was included in the whole, to lay and collect income taxes.

240 U.S. at 12-13. Thus, rather than supporting Mr. Smith's arguments that the federal income tax is somehow unconstitutional or illegal, *Brushaber* upholds the constitutionality of the federal income tax, based upon Congress' inherent and "exhaustive" authority to impose taxes, including income taxes.

Finally, Mr. Smith advances an argument, which I will refer to as the "natural rights" argument, that posits that as a citizen, he has the natural right to exist and support himself by his labors. This argument posits that the government may not tax his ability to exist and support himself by his labors. In support of this argument, Mr. Smith offered the following purported quotation from the U.S. Supreme Court decision in *Hale v.*

Henkel, 240 U.S. 43 at 74 (1906):

An individual may stand upon his constitutional rights as a citizen. He owes no duty to the state since he receives nothing therefrom beyond the protection of his life and his property. His rights are such as existed by the laws of the land long antecedent to the origination of the state. They can only be taken from him by due process of the law and in accordance with the Constitution. He owes nothing to the public so long as he does not trespass upon their rights.

I have researched the case and found it to be a case about the powers of the government to compel testimony before a grand jury given the right against self-incrimination under the 5th Amendment of the Constitution rather than a case about the right of an individual to exist without taxation by the government. Furthermore, the context of the quotation is to draw a distinction between the right of an individual to assert a 5th Amendment privilege, as opposed to a fictitious “person” in the form of a corporation. Finally, the quote offered by Mr. Smith is not an accurate rendition of the actual language of the Court, as will be shown below. To provide an accurate context for the language relied upon by Mr. Smith, and to demonstrate the inaccuracy of the language provided, the entire and accurate quotation is provided below, with the omitted language emphasized.

If, whenever an officer or employee of a corporation were summoned before a grand jury as a witness he could refuse to produce the books and documents of such corporation, upon the ground that they would incriminate the corporation itself, it would result in the failure of a large number of cases where the illegal combination was determinable only upon the examination of such papers. Conceding that the witness was an officer of the corporation under investigation, and that he was entitled to assert the rights of the corporation with respect to the production of its books and papers, we are of the opinion that there is a clear distinction in this particular between and individual and a corporation, and that the latter has no right to refuse to submit its books and papers for an examination at the suit of the state. The individual may stand upon his constitutional rights as a citizen. He is entitled to carry on his private business in his own way. His power to contract is unlimited. He owes no duty to the state or to his neighbors to divulge his business, or to open his doors to an investigation, so far as it may tend to criminate him. He owes no such duty to the state, since he receives nothing therefrom, beyond the protection of his life and property. His rights are such as existed by the law of

the land long antecedent to the organization of the state, and can only be taken from him by due process of law, and in accordance with the Constitution. *Among his rights are a refusal to incriminate himself, and the immunity of himself and his property from arrest or seizure except under a warrant of the law.* He owes nothing to the public so long as he does not trespass upon their rights. (emphasis added.)

As a review of the full and accurate quotation makes clear, this case does not support Mr. Smith's contention that the government may not tax an individual for the privilege of existing.

It is also preposterous to argue that the income tax is a tax on an individual's right to exist. It is a tax on the income one earns. Many individuals exist without earning any taxable income and those individuals are not taxed under the income tax.

Mr. Smith also cited to *Redfield v. Fisher*, 292 P. 813 (Or. 1930), in support of his "natural rights" argument. The case is a 1930 Oregon Supreme Court decision which had struck down an Oregon tax on intangible property owned by individuals. The court struck down the tax as violative of the provision of the Oregon Constitution which requires taxation to be uniform on the same class of subjects. Because the same intangible property would not have been taxed when owned by corporations, the court ruled the tax unconstitutional. Mr. Smith cited to dicta in the court's opinion which stated that an individual, unlike a corporation, cannot be taxed for the mere privileges of existing and owning property, which are natural rights. This "natural rights" theory apparently derives from a line of thought embraced by the tax protester movement by which they claim that they are not citizens of the United States, but are "freeborn, natural individuals", and as such are the master or sovereign, and are not a servant to the government. This theory has been

soundly rejected by the federal courts which have upheld the imposition of the federal income tax. As stated in *Lovell, v. U.S.*, 755 F.2d 517 (7th Cir., 1984):

All individuals, natural or unnatural, must pay federal income tax on their wages, regardless of whether they received any "privileges" from the government.

Id. at 519. *See, also, U.S. v. Sloan*, 939 F. 2d 499, 500-501 (7th Cir. 1991).

Mr. Smith's protest and other written materials he submitted in support of his claim that his earnings are not subject to taxation are rife with examples of citations which do not establish the proposition or arguments they are cited for. I have seen these authorities and quotations before, as they are propounded by a movement called the tax protester or tax resister movement. The arguments propounded are often elaborately structured and rely upon quotations either misconstrued, taken out of context, or from cases which are no longer current law, such as cases decided prior to the adoption of the sixteenth amendment. Clearly, someone has taken great pains to construct such arguments and to research archaic law. Yet, my review of the law challenging the Federal income tax reveals numerous cases which directly address the many arguments propounded by the tax resister movement and reject them soundly. I am left to conclude that Mr. Smith and the other members of the movement have not really thoroughly researched the law which they so ardently state to support their view that they are not subject to taxation. Instead, these individuals appear to be motivated solely by their own selfishness and greed in their singleminded pursuit to pay no taxes. Surely, these individuals must wonder why the vast majority of their fellow citizens agree to report and pay taxes if they really don't need to do so.

Just in case Mr. Smith really has made an effort to fully understand the law in this area and he simply has failed to find authority opposing his views, I would direct him to one case in particular, which addresses the standard tax resister arguments and cites to numerous federal cases upholding federal income taxes in the face of these arguments, and I would urge him to read it and the other cases cited therein. In *Coleman v. Commissioner of Internal Revenue*, 791 F.2d 68, the Seventh Circuit Court of Appeals addressed the consolidated cases of Mr. Norman Coleman and Mr. Gary Holder. Both of these individuals had argued that their wages were not subject to federal income taxation. The court had this to say about those arguments:

Coleman says that wages may not be taxed because they come from his person, a depreciating asset. The personal depreciation offsets the wage, leaving no net income. Coleman thinks that only net income may be taxed under the Sixteenth Amendment--net income as Coleman defines it, not as Congress does. Holder, who styles himself a "private citizen," insists that wages may not be taxed because the Sixteenth Amendment authorizes only excise taxes, and in Holder's world excises may be imposed only on "government granted privileges." Because Holder believes that he is exercising no special privileges, he thinks he may not be taxed. ***These are tired arguments. The code imposes a tax on all income. See, 26 U.S.C. § 61. Wages are income, and the tax on wages is constitutional. See, among hundreds of other cases, United States v. Thomas***, 788 F.2d 1250, 1253 (7th Cir. 1986); ***Lovell v. United States***, 755 F.2d 517 (7th Cir. 1984); ***Granzow v. CIR***, 739 F.2d 265, 267 (7th Cir. 1984); ***United States v. Koliboski***, 732 F.2d 1328, 1329 & n. 1 (7th Cir. 1984). See also ***Brushaber v. Union Pacific R.R.***, 240 U.S. 1, 12, 24-15, 36 S.Ct. 236, 239, 244-45, 60 L.Ed. 2d 493 (1916).

Id. at 70. As this case and the cases cited therein indicate, there is really no question that Mr. Smith's income from his work in New Mexico is income for federal tax purposes, and

as such, would be included in federal adjusted gross income for federal purposes, and by inference, for purposes of calculating New Mexico personal income taxes.

I would leave Mr. Smith with the following admonition:

Some people believe with great fervor preposterous things that just happen to coincide with their self-interest. "Tax protesters" have convinced themselves that wages are not income, that only gold is money, that the Sixteenth Amendment is unconstitutional, and so on. These beliefs all lead--so tax protesters think--to the elimination of their obligation to pay taxes. The government may not prohibit the holding of these beliefs, *but it may penalize people who act on them.* (emphasis added).

The federal caselaw contains hundreds of cases where tax protesters have been sent to prison for tax evasion or fined substantially for filing frivolous returns based upon the theories espoused by the tax protester movement. New Mexico also makes it a felony to file false returns or to evade taxes, *see*, NMSA 1978, §§ 7-1-72 and 7-1-73, and it imposes a 50% of tax civil penalty for the fraudulent failure to pay any tax required to be paid. NMSA 1978 § 7-1-69(B). Mr. Smith may be faced with such consequences if he should continue to file returns in the same manner as he filed his 1995 and 1996 state and federal returns. This is especially so now that he has been informed of the law. He has the opportunity to rectify his error by filing amended returns with both New Mexico and the Internal Revenue Service. I would urge his to act on this opportunity.

CONCLUSIONS OF LAW

1. Mr. Smith filed timely, written protests to the Department's denial of his claims for refund and jurisdiction lies over both the parties and the subject matter of this protest.

2. Mr. Smith's compensation from Intel Corporation is included in both "gross income" and "adjusted gross income" as those terms are defined in the Internal Revenue Code.

3. Mr. Smith's compensation from Intel Corporation is included in both "base income" and "net income" as those terms are defined in the Income Tax Act, Chapter 7, Article 2, NMSA 1978.

4. Mr. Smith is not entitled to a refund of the taxes previously paid or withheld from his earnings in New Mexico during 1995 or 1996 because those earnings were properly subject to the imposition of New Mexico's income tax.

For the foregoing reasons, Mr. Smith's protest IS HEREBY DENIED.

DONE, this 26th day of January, 1998.