

IN THE MAGISTRATE DIVISION
OF THE OREGON TAX COURT
Income Tax

JIMMY L. SESMA AND LAURA D. SESMA,)	
)	
Plaintiffs,)	No. 001078F (Control)
)	010321F
v.)	
)	
DEPARTMENT OF REVENUE,)	
STATE OF OREGON,)	
)	
Defendant.)	DECISION

This matter is before the court on Cross-Motions for Summary Judgment. At issue are Notices of Refund Denial for tax years 1995 and 1996 and a Notice of Deficiency for tax year 1997.

STATEMENT OF FACTS

Plaintiffs timely filed their Oregon personal income tax returns for tax years 1995, 1996 and 1997. For tax years 1995 and 1996 they later filed amended returns, claiming that they changed their election. According to plaintiffs, this change in election "resulted in overpayment of tax [liability] actually imposed upon taxable income liability." (Ptfs' Complaint Case No. 001078F at 1.) Defendant disagreed and denied the refund. Plaintiffs then filed "Overpayment Affidavits¹" with defendant. The "Overpayment Affidavits" are forms designed by plaintiffs which list the amounts that plaintiffs excluded from income. Plaintiffs included the "Overpayment Affidavit" for 1995 in their Motion for Summary Judgment. (See Ptfs' Mot for Summ J, Ex A.) In addition to Mr. Sesma's

¹Plaintiffs designed and used the "Overpayment Affidavits" because they assert "no appropriate pre-established form has been provided." (Ptfs' Resp to Def's Resp and Cross Mot for Summ J at 4.)

employment, plaintiffs sold a significant amount of stock during 1995. The stock sale was related to Mr. Sesma's employment. Those two events resulted in plaintiffs receiving \$1,239,112 in 1995. Plaintiffs referred to the amount received as "Qualified Employment Wage Income" on their 1995 "Overpayment Affidavit."² (*Id.*) Plaintiffs asked for a refund of amounts previously paid or \$113,120.³ (*Id.*)

For tax year 1997, plaintiffs' timely filed Oregon personal income tax return included this change in election. Plaintiffs also claimed this change in election on their federal return. The Internal Revenue Service (IRS) changed plaintiffs' federal return, assessing a deficiency. The IRS notified defendant of the changes on plaintiffs' federal return. As a result, defendant made corresponding changes to plaintiffs' Oregon return. Defendant added \$104,781 to plaintiffs' taxable income for 1997. After defendant's adjustments, plaintiffs' Oregon taxable income was \$103,752 for 1997. This resulted in a net tax to pay of \$8,764. (Ptf's Complaint Case No. 010321F at 3.)

Plaintiffs made this change in election because "[o]ngoing research yielded innocent error in gross income ascertainment." (Ptf's Mot for Summ J at 1.) It appears that plaintiffs originally filed their 1995 and 1996 income tax returns using itemized deductions pursuant to IRC § 63(e). At some point, plaintiffs apparently came to the conclusion that itemizing deductions pursuant to IRC § 63(e) was "in lieu of lawful 'allowable deductions.'" (*Id.* at 2.) Consequently, they filed their 1995 and 1996 amended returns and 1997 original returns pursuant to IRC § 63(a). They also assert that Mr. Sesma's compensation from his

²Plaintiffs did not submit their 1996 "Overpayment Affidavit" to the court.

³Plaintiffs also asked for interest of \$13,574.

employer is of such a type that it is not taxable income within the meaning of the Internal Revenue Code (IRC). They claim that Mr. Sesma's labor is their personal property, specifically a capital asset as that term is defined at IRC § 1221. As such they argue that it is excluded from ordinary income. Plaintiffs also state that they "use Chapter 2 of the Internal Revenue Code [relating to tax on self-employment income] since they are self-employed." (Ptf's Mot for Summ J at 5.) Plaintiffs cite a number of sections of the IRC in support of their positions.

Defendant argues that plaintiffs misinterpret the IRC. Further, defendant argues that plaintiffs' arguments are "totally meritless" and asks that the court award defendant damages pursuant to ORS 305.437. (Def's Resp and Cross Mot for Summ J at 11-12. See *also* Def's Ans in Case No. 010321F at 1.)

COURT'S ANALYSIS

Merits of Claim

Plaintiffs make a number of arguments as to why their income is not taxable under the IRC or Oregon law. Many of plaintiffs' arguments start with a false premise. Such arguments necessarily lead to incorrect conclusions. Some arguments have conclusions without supporting reasoning. **All** of plaintiffs' arguments are flawed. In the interest of judicial efficiency, the court will discuss only a sampling of plaintiffs' arguments rather than analyze each argument in detail.

Allowance of IRC § 62 Deductions

Plaintiffs assert that "[t]he use of Form 1040, by § 63(a) definition ('itemized deductions'), precludes the use of the definition of taxable income found at § 63(b) **since § 62 deductions are disallowed.**" (Ptf's Resp to Def's Resp and Cross Mot for Summ J at

3 (emphasis added).) However, a careful look at IRC §§ 63(a) and (b) reveals the differences between the sections.

IRC § 63(a) defines taxable income as "gross income minus the deductions allowed by this chapter (other than the standard deduction)." Those deductions include the deductions used to arrive at adjusted gross income. See IRC § 62 ("adjusted gross income" means, in the case of an individual, gross income minus the following deductions"). For example, among those deductions are trade and business deductions "if such trade or business does not consist of the performance of services by the taxpayer as an employee." IRC § 62(a)(1). The other deductions allowed by IRC § 63(a) are those commonly known as Schedule A deductions, such as home mortgage interest, and medical expenses. See IRC §§ 163(h)(3) and 213.

IRC § 63(b), on the other hand, defines taxable income as "adjusted gross income minus (1) the standard deduction, and (2) the deduction for personal exemptions provided in section 151." As noted above, adjusted gross income is defined as IRC § 62. The deductions allowed in arriving at adjusted gross income are set forth at IRC § 62(a)(1) - (17). Plaintiffs' assertion that IRC § 62 deductions are disallowed when calculating taxable income pursuant IRC § 63(b) is without merit.

Allowed Deductions Compared to Allowable Deductions

Plaintiffs quote IRC § 63(e)(1) in their materials. That section states that,

"Unless an individual makes an election under this subsection for the taxable year, no itemized deduction shall be allowed for the taxable year. For purposes of this subtitle, the determination of whether a deduction is allowable under this chapter shall be made without regard to the preceding sentence."

After quoting the above section, plaintiffs state that "[t]he second sentence explicitly says that deductions are still **allowed** even without taking a § 63(e) election." (Ptf's Resp to Def's Resp and Cross Mot for Summ J at 4 (emphasis added)). Plaintiffs appear to believe that allowed and allowable are identical in meaning. They are not. Deductions may be allowable under the IRC but are not allowed as to a particular taxpayer unless the taxpayer elects to itemize. For example, a taxpayer would not be allowed to deduct home mortgage interest unless that taxpayer itemizes his or her deductions. In other words, allowable deductions are only potential deductions. Allowable deductions do not become actual deductions, or allowed, until a taxpayer elects to itemize.

Labor as Personal Property

Plaintiffs believe that by filing their returns pursuant to IRC § 63(a) Mr. Sesma's compensation becomes self-employment income, presumably because it is a capital asset. Their assertion that Mr. Sesma's labor is a capital asset rests on the assumption that Mr. Sesma's labor is personal property. Plaintiffs provide two quotes from *Slaughter House Cases*, 83 US 36, 16 Wall 36, 21 L Ed 394 (1872), in support of their premise. However, the *Slaughter House Cases* dealt with zoning and the state's use of its police power. They had nothing to do with taxation. Further, the quotation "[l]abor is property" is from the dissent. See *id.* at 127.

Labor is not a capital asset; nor is it property. See *Gorman v. Com.*, TC Memo 1986-344, 52 TCM 26 (1986) ("an income item (i.e., unpaid wages) cannot be transformed into a capital asset, having a cost basis, until it is first included in income"); *Bostick v. Com.*, TC Memo 1957-220, 16 TCM (CCH) 1008 (1957) ("Petitioner's ability

and desire to work are not, for the purposes of the income tax, property or a capital asset.").

Summary of Analysis

The above are just a small sampling of plaintiffs' flawed arguments. Plaintiffs stated that their "appeal should not be considered frivolous." (Ptf's Resp to Def's Resp and Cross Mot for Summ J at 9.) Ultimately, their arguments are no different than those arguments heard in many other cases. Plaintiffs' core argument is that wages are not income, they are property. This court will state what many courts before it have stated "WAGES ARE INCOME." See e.g. *U.S. v. Connor*, 898 F2d 942, 943 (3rd Cir 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income.") (citations omitted); *Wilcox v. Com.*, 848 F2d 1007, 1008 (9th Cir 1988) ("Wages are income."); *U.S. v. Koliboski*, 732 F2d 1328, 1329 n1 (7th Cir 1984) ("WAGES ARE INCOME."). Plaintiffs' attempts to recharacterize Mr. Sesma's wages as property do not make them something other than what they are. One's labor is not a capital asset or any other type of property. Calling Mr. Sesma's compensation, reported on a W-2, self-employment income is nothing more than an attempt to avoid paying income taxes required by the IRC and Oregon statutes.

Damages

Defendant requests the court award it damages under ORS 305.437.⁴ That statute reads:

“(1) Whenever it appears to the Oregon Tax Court that proceedings before it have been instituted or maintained by a taxpayer primarily for delay

⁴All references to the Oregon Revised Statutes are to 1999.

or that the **taxpayer's position in such proceeding is frivolous or groundless, damages in an amount not to exceed \$5,000 shall be awarded * * ***

“(2) As used in this section, a taxpayer's position is ‘frivolous’ if there was no objectively reasonable basis for asserting the position.”

(Emphasis added.)

Plaintiffs' beliefs may be sincerely held, if misguided. This court has previously held that “[o]rdinary citizens without legal training are free to interpret the laws any way they choose. However, if their interpretations are contrary to those of the legislature and the Supreme Court, they do so at their peril.” *Harvey v. Dept. Of Rev.*, 11 OTR 407, 409 (1990). In a case affirming the dismissal of a taxpayer’s petition as frivolous and upholding the imposition of a penalty, the Fifth Circuit Court of Appeals stated:

“An appeal that lacks merit is not always - or often - frivolous. However, we are not obliged to suffer in silence the filing of baseless, insupportable appeals presenting no colorable claims of error and designed only to delay, obstruct, or incapacitate the operations of the courts or any other governmental authority. * * * The government should not have been put to the trouble of responding to such spurious arguments, nor this court to the trouble of ‘adjudicating’ this meritless appeal.”

Crain v. Com., 737 F2d 1417, 84-2 USTC ¶ 9721 (1984).

As this court stated in *Mansuetti v. Dept. of Rev.*, 2000 WL 321415 (Or Tax, Mag Div. 2000):

"The language of ORS 305.437 is mandatory. In order to determine the appropriate level of damages, the court will evaluate a number of factors. Some of the factors include: the specific arguments presented to the court, whether plaintiff made threats against the government or its employees, whether any amount was withheld from wages, the number of years at issue, whether returns were filed, whether plaintiff sent defendant a “demand” letter, how many levels of authority plaintiff has appealed to and whether defendant is represented by an attorney. This list is not meant to be exhaustive nor is each argument weighted equally. The first two factors address whether it is

appropriate to impose damages. The balance goes to the level of damages."

As noted above, plaintiffs' basic argument is that wages are not income, but a capital asset. They had a number of supporting arguments for making that claim. The Second Circuit Court of Appeals in *Connor v. Com.*, 770 F.2d 17, 85-2 USTC ¶ 9598 (2d Cir. 1985) held that "[w]ages are income. The argument that they are not has been rejected so frequently that the very raising of it justifies the imposition of sanctions." (Citation omitted.) This court agrees with that reasoning.

Taking all the factors into consideration and the time that both defendant and the court spent on plaintiffs' claim, the court finds that the appropriate level of damages under ORS 305.437 is \$2,000.

CONCLUSION

Plaintiffs state that their arguments are based "on the authentic interpretation of law." The only possible interpretation of law leads to the inescapable conclusion that plaintiffs' arguments are totally without merit. As this court stated in *Clark v. Dept. of Rev.*, 2000 WL 1339536 (Or. Tax Reg. Div. 2000), aff'd 332 Or. 236, --- P.3d ---- (2001), "[t]he public should not have to suffer increased tax burdens because particular individuals use state resources to espouse views that are frivolous or groundless."

IT IS THE DECISION OF THIS COURT that plaintiffs' Motion for Summary Judgment in Case No. 001078F is denied.

IT IS FURTHER DECIDED that defendant's Cross-Motion for Summary Judgment in Case No. 001078F is granted.

IT IS FURTHER DECIDED that plaintiffs' appeal in Case No. 010321F is denied.

IT IS FURTHER DECIDED that pursuant to ORS 305.437, defendant shall be awarded a money judgment for damages against plaintiff in the amount of \$2,000.

Dated this _____ day of July, 2001.

SALLY L. KIMSEY
MAGISTRATE

IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, FOURTH FLOOR, 1241 STATE ST., SALEM, OR 97301-2563. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.

THIS DOCUMENT WAS SIGNED BY MAGISTRATE SALLY L. KIMSEY ON JULY 31, 2001. THE COURT FILED THIS DOCUMENT ON JULY 31, 2001.