

IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Income Tax

JILL L. BLAYLOCK,)	
)	TC-MD 050875E
Plaintiff,)	
)	DECISION DENYING
v.)	PLAINTIFF'S MOTION FOR
)	SUMMARY JUDGMENT and
DEPARTMENT OF REVENUE,)	DECISION GRANTING
State of Oregon,)	DEFENDANT'S CROSS
)	MOTION FOR SUMMARY
Defendant.)	JUDGMENT

Plaintiff appeals Defendant's Notice of Tax Assessment dated August 30, 2005, for tax year 2002. Plaintiff filed a Motion for Summary Judgment May 26, 2006. Defendant filed its Cross Motion for Summary Judgment and Response June 14, 2006. Plaintiff filed Plaintiff's Response to Cross Motion for Summary Judgment June 26, 2006. The record is now closed, and the matter is ready for decision.

I. STATEMENT OF FACTS

The parties agree to the following facts:

Plaintiff was the owner of a life insurance policy issued by Pacific Life Insurance Company. (Ptf's Mot for Summ J at 3.) Prior to September 1996, while Plaintiff was a resident of California, loans were taken out against the policy. (Ptf's Mot for Summ J at 2-4.) Plaintiff became an Oregon resident in 1996. (Ptf's Mot for Summ J at 2; Def's Ltr at 2, May 9, 2006.)

The life insurance policy lapsed July 13, 2002, because the loans taken against it had reduced the cash value to a balance insufficient to pay the premiums. (Ptf's Mot for Summ J at 7; Def's Cross Mot for Summ J at 1.) Plaintiff alleges that her ex-husband, Thomas F. Blaylock, obtained the loans against the policy without her permission or knowledge by way of

forgery.¹ (Ptf’s Mot for Summ J at 3, 4.) Pacific Life Insurance Company issued a 1099-R under Plaintiff’s social security number for tax year 2002 for a gross distribution of \$87,330, \$37,487 of which the Internal Revenue Service (IRS) determined to be taxable income. (Ptf’s Mot for Summ J at 5; Def’s Ltr at 2, May 9, 2006.) During tax year 2002, Plaintiff was a full-year resident of Oregon. (Ptf’s Mot for Summ J at 9; Def’s Ltr at 2, May 9, 2006.)

The IRS issued a CP2000 Notice dated August 16, 2004, that increased Plaintiff’s taxable income by \$37,487. (Ptf’s Mot for Summ J at 5, 7; Def’s Cross Mot for Summ J at 1; Def’s Ltr at 2, May 9, 2006.) Plaintiff concedes that the IRS properly imposed federal income tax on the \$37,487 for the 2002 tax year. (Ptf’s Mot for Summ J at 6, 7.) In February 2005, Plaintiff settled with the IRS and paid \$2,087 of the \$8,390 in federal taxes being claimed. (*Id.* at 7.)

On August 30, 2005, Defendant issued a Notice of Tax Assessment to Plaintiff. Plaintiff appealed, arguing Oregon lacks the authority “to impose a tax on California income received in California years before Plaintiff had any contact with the State of Oregon.” (Ptf’s Mot for Summ J at 2.) Plaintiff also argues that the legislature lacks the constitutional power to legislate a tax on non-Oregon source income received by a resident of California because that would “amount to taxation without representation.” (Ptf’s Mot for Summ J at 11.) Finally, Plaintiff argues that it is inequitable for Oregon to impose tax on the income from her life insurance policy because the loans were received by Plaintiff’s ex-husband through fraud and forgery. (Ptf’s Mot for Summ J at 3, 4.)

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¹ The court notes that Defendant does not concede that this event occurred. Defendant merely concedes that Plaintiff has made this allegation.

II. ANALYSIS

A. Oregon's Authority to Impose Tax on Plaintiff's Life Insurance Proceeds

“A tax is imposed for each taxable year on the entire taxable income of every resident of this state.” ORS 316.037(1)(a).² Oregon generally follows federal law to determine the taxable income of individuals. *See* ORS 316.007. ORS 316.048 states that “[t]he entire taxable income of a resident of this state is the *federal* taxable income of the resident as defined in the laws of the United States * * *.” (Emphasis added.) Federal taxable income is defined as “gross income minus the deductions allowed by this chapter (other than the standard deduction).” IRC § 63(a).³ Gross income is “all income from whatever source derived.” IRC § 61(a). Income from life insurance contracts is included in the definition of gross income. *See* IRC § 61(a)(10).

Defendant is required to “apply and follow the administrative and judicial interpretations of the federal income tax law.” ORS 316.032(2). Turning to judicial interpretations of federal income tax law, “it is settled that receipt of a loan is not income to the borrower.” *Comm’r v. Indianapolis Power & Light Co.*, 493 US 203, 207, 110 S Ct 589, 107 L Ed 2d 591 (1990). Because of the repayment obligation, “the loan proceeds do not qualify as income to the taxpayer.” *Comm’r v. Tufts*, 461 US 300, 307, 103 S Ct 1826, 75 L Ed 2d 863 (1983). Life insurance “policy loans constitute[] true loans, rather than cash advances,” and therefore are “not taxable distributions *when received*.” *Atwood v. Comm’r*, 77 TCM (CCH) 1476 (1999)

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² All references to the Oregon Revised Statutes (ORS) are to 2001.

³ All references to the Internal Revenue Code (IRC) are to Supp II 2000.

(emphasis added); *see also* IRC § 72(e)(1)(A)(i), (ii), (e)(5)(A), (e)(5)(C).⁴ Rather, when life insurance policies terminate, and the policy loans are satisfied, that satisfaction of the loans has the effect of a payment of the policy proceeds to the policy owner and constitutes “income to them *at that time.*” *Atwood*, 77 TCM (CCH) at 1476 (emphasis added).

Plaintiff alleges that her ex-husband took out five loans against her life insurance policy from June 7, 1989, through June 24, 1996. Under *Atwood*, those loans against the policy were not taxable distributions when received. *See id.* Instead, the loans became income subject to tax when the policy lapsed in 2002 for non-payment of premiums.⁵ Plaintiff was a resident of Oregon at the time of the policy lapse in 2002. Accordingly, Defendant properly imposed tax on the proceeds of the policy in 2002.

B. Plaintiff’s Constitutionality Argument

Plaintiff argues that the legislature cannot constitutionally tax proceeds that were received when she was a resident of another state unless that income itself was derived from an Oregon

⁴ IRC § 72(e), provides, in pertinent part:

“(1) * * *

“(A) In general. This subsection shall apply to any amount which --
“(i) is received under [a] * * * life insurance contract, and
“(ii) is not received as an annuity, * * *.

“* * * * *

“(5) * * *

“(A) In general. In any case to which this paragraph applies -- * * *
“(ii) * * * the amount shall be included in gross income, but only to the extent it exceeds the investment in the contract.

“* * * * *

“(C) Certain life insurance * * * contracts. * * * [T]his paragraph shall apply to any amount not received as an annuity which is received under a life insurance * * * contract.”

⁵ Plaintiff concedes that federal tax was appropriately imposed at the time of the lapse: “The Internal Revenue Service * * * has properly imposed federal income taxes on the appropriate portion of the money taken [as loans], * * * and has properly deemed those cash withdrawals as federally taxable income in the year of the policy lapse which was 2002.” (Ptf’s Mot for Summ J at 7.)

source. Plaintiff claims that to tax such income would “amount to taxation without representation.” (Ptf’s Mot for Summ J at 11.) Plaintiff’s argument fails for two reasons: 1) Plaintiff was an Oregon resident in 2002 at the time the loans became taxable, and 2) Plaintiff was not taxed without representation.

Plaintiff is correct that Oregon cannot tax income received by a resident of another state unless the income is derived from an Oregon source. Her argument is flawed, however, because her argument relies on the misconception that her residency at the time the loans were *received* is determinative. Instead, as discussed above, Plaintiff was a resident of Oregon *when the policy terminated*, which was when the loans became taxable income.

The decision of whether or not to measure a resident’s taxes on a base that includes out-of-state sources “is a matter for the Legislative Assembly. No specific authority has been presented [that] clearly shows it to be unconstitutional.” *Patty v. Dept. of Rev.*, 5 OTR 332, 341 (1973). “The American colonists used the phrase [‘taxation without representation’] to assert that it is against the fundamentals of good government to raise a tax without the consent of a representative assembly.” *Schweitzer’s Casual Wear v. Dept. of Rev.*, 16 OTR 46, 48 (2002). Oregon’s ability to tax the non-source income of its residents was raised with the consent of a representative assembly. Plaintiff, therefore, was not taxed without representation.

C. *Equity*

Plaintiff finally argues that it is inequitable for Oregon to impose tax on the income from her life insurance policy because the loans were received by Plaintiff’s ex-husband through fraud and forgery.

Fraud and forgery are “in the nature of tort claims.” *Masse II v. Dept. of Rev.*, 18 OTR 240, 245 (2005). The Oregon Supreme Court has held that “tort claims cannot be combined with

tax claims because the tort claims are affirmatively located outside the Tax Court’s jurisdiction.” *TVKO v. Howland*, 15 OTR 335, 343 (2001) (citing *Sanok v. Grimes*, 294 Or 684, 662 P2d 693 (1983)). *See also Rivera v. Dept. of Rev.*, 16 OTR 60, 62, (2002) (noting “[t]axpayer’s second claim appears to sound in tort and this court has no jurisdiction over such claims”). “Where no statute places jurisdiction in a court of limited subject-matter jurisdiction such as the tax court, then the court of residual jurisdiction is the circuit court.” *Sanok*, 294 Or at 692-93 n6. Under *Sanok*, therefore, even if Plaintiff’s allegations are true, her argument in equity is outside the Tax Court’s jurisdiction.

III. CONCLUSION

Defendant properly assessed tax on money received from Plaintiff’s life insurance policy in 2002 because, at the time the money became taxable income, Plaintiff was a full-year resident of Oregon. Oregon has the jurisdiction and constitutional ability to tax the non-source income of its residents. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiff’s Motion for Summary Judgment is denied; and

IT IS FURTHER DECIDED that Defendant’s Cross Motion for Summary Judgment is granted.

Dated this _____ day of February 2007.

COYREEN R. WEIDNER
MAGISTRATE

If you want to appeal this Decision, file a Complaint in the Regular Division of the Oregon Tax Court, by mailing to: 1163 State Street, Salem, OR 97301-2563; or by hand delivery to: Fourth Floor, 1241 State Street, Salem, OR.

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 Coyreen R. Weidner on February 13, 2007. The Court filed and entered this document on February 13, 2007.