Rowlee v. Commissioner, 80 T. C. 1111 (1983)

Wages are taxable income under the Sixteenth Amendment, and filing false W-4 forms to avoid tax withholding constitutes fraud.

Summary

E. Kevan Rowlee challenged the IRS's determination of tax deficiencies and fraud penalties for the years 1977-1979, claiming his wages were not taxable income. The Tax Court upheld the IRS's position, ruling that wages are taxable under the Sixteenth Amendment. Rowlee's refusal to file returns and submission of false W-4 forms to avoid tax withholding were found to be fraudulent acts. The court emphasized that well-established law supports the taxability of wages and that Rowlee's actions were intended to evade taxes, justifying the fraud penalties.

Facts

E. Kevan Rowlee worked for Oswego Warehousing, Inc. in 1977 and 1978, and for W. T. Anderson Ford, Inc. in 1979. He received wages of $10,345. 92 in 1977, $7,830. 01 in 1978, and $5,854. 25 in 1979. Rowlee submitted W-4 forms claiming he was exempt from tax in 1978 and 1980, and claimed 10 exemptions in 1979, resulting in no federal income tax being withheld. He did not file federal income tax returns for these years, asserting that his wages were not taxable income because they were an equal exchange for his labor. The IRS determined deficiencies and added fraud penalties, which Rowlee contested.

Procedural History

The IRS issued a notice of deficiency to Rowlee on March 12, 1981, for the tax years 1977-1979, including deficiencies and fraud penalties. Rowlee petitioned the U. S. Tax Court for a redetermination. The Tax Court, in a decision filed on June 15, 1983, upheld the IRS's determinations, finding that Rowlee's wages were taxable and his actions constituted fraud.

Issue(s)

1. Whether wages received in exchange for labor are taxable income under the Sixteenth Amendment?
2. Whether Rowlee's failure to file tax returns and submission of false W-4 forms constituted fraud?

Holding

1. Yes, because wages are considered income under the Sixteenth Amendment and the Internal Revenue Code, which clearly includes compensation for services within the definition of gross income.
2. Yes, because Rowlee's actions demonstrated an intent to evade taxes through

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concealment and misrepresentation, as evidenced by his failure to file returns and submission of false W-4 forms.

Court's Reasoning

The Tax Court relied on established legal principles to determine that wages are taxable income. It cited the Sixteenth Amendment's broad authorization to tax income from any source and referenced cases like *Brushaber v. Union Pacific Railroad Co.* and *Eisner v. Macomber*, which upheld the constitutionality of taxing wages. The court rejected Rowlee's argument that wages were not income because they were an equal exchange for labor, emphasizing that the law does not recognize such a distinction. On the issue of fraud, the court found that Rowlee's failure to file returns and submission of false W-4 forms were deliberate acts to avoid tax liability. The court noted that Rowlee's actions were intended to conceal his noncompliance and that his refusal to provide financial information to the IRS further evidenced his fraudulent intent. The court applied the clear and convincing evidence standard to find fraud, supported by Rowlee's knowledge of his tax obligations from his 1975 return and his subsequent actions to evade them.

Practical Implications

This decision reaffirms that wages are taxable income and cannot be avoided by claiming they are an equal exchange for labor. It serves as a warning to taxpayers that filing false W-4 forms to avoid tax withholding can lead to fraud penalties. Legal practitioners should advise clients of the taxability of wages and the severe consequences of tax evasion tactics. The ruling also underscores the importance of complying with tax filing obligations and cooperating with IRS investigations. Subsequent cases, such as *United States v. May*, have cited Rowlee to support the taxability of wages and the fraudulent nature of filing false W-4 forms. This case continues to influence tax law by reinforcing the principles of income taxation and the enforcement of tax compliance.

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