

The Law & Your Taxes

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There are a lot of misconceptions about the legality of taxes. Some of this is based on materials supplied by groups, which illegally promote dropping out of the tax system or “untaxing”. Some of the misconceptions are based on hearsay or misunderstanding of the tax laws. In order to help Arizona taxpayers avoid problems with non-compliance, which can arise from this misinformation, the Department of Revenue has developed this publication to address the more common claims against the legality of state taxes.

False Claims and Department of Revenue Response

The following misconceptions regarding the tax system in the State of Arizona and the federal tax system are some of the most frequently encountered, either because they are promoted by various “untaxing” groups or because certain rulings in court cases or parts of state and federal law have been taken out of context.

Claim: *Filing returns and paying taxes are voluntary. Even the Department of Revenue and the Internal Revenue Service speak of voluntary compliance in their tax literature.*

Response: The term “voluntary compliance” is often taken out of context and used to falsely insinuate that taxes are optional. In the context of Arizona and federal tax law, the term “voluntary compliance” refers to the fact that taxpayers in Arizona keep records, complete their tax returns, self assess, and send in taxes due without the need for enforcement action on behalf of the Department of Revenue or the Internal Revenue Service.

The courts have consistently held that filing tax returns and paying tax is not voluntary. *Wilcox v. Commissioner*, 848 F.2d 1007, 1008 (9th Cir 1988); *United States v. Gerads*, 999 F.2d 1255, 1256 (8th Cir. 1993); *United States v. Tedder*, 787 F.2d 540, 542 (10th Cir. 1986).

Failure to file the required tax returns and pay applicable taxes can result in criminal or civil penalties. A.R.S. § 42-1125 and 42-1127.

Claim: *There is no law that says you have to file returns and pay taxes.*

Responses: Article 9, Section 12, of the Constitution of Arizona provides.

The law-making power shall have authority to provide for the levy and collection of license, franchise, gross revenue, excise, income, collateral and direct inheritance, legacy, and succession taxes, also graduated income taxes, graduated collateral and direct inheritance taxes, graduated legacy and succession taxes, stamp, registration production, or other specific taxes.

The Arizona Legislature has exercised the power granted to it in the Arizona Constitution by enacting Titles 42 and 43 of the Arizona Revised Statutes.

These titles provide for income taxes, transaction privilege taxes, property taxes, estate taxes, license taxes, and luxury privilege taxes. A.R.S. § 43-301 requires an individual whose income is taxable under Arizona law to file a tax return. A.R.S. § 42- 5014 does likewise for transaction privilege taxes.

Claim: *Since the Arizona income tax statutes base Arizona gross income on federal adjusted gross income as measured by the Internal Revenue Code, they are unconstitutional because Article 9, Section 1 of the Arizona Constitution prohibits the legislature from surrendering, suspending, or contracting away its power to tax.*

Response: Each year the Arizona Legislature adopts the provisions of the Internal Revenue Code in effect as of a given date for a specific year or years. The legislature can reject any provision of the Internal Revenue Code, which it does not choose to adopt, and did just that in 1993 when Arizona had only partial conformity. Since the legislature adopts already existing Code provisions on an annual basis rather than adopting the Code prospectively, it has not surrendered its power to tax. A.R.S. § 43-105.

Claim: *Arizona income tax statutes are unconstitutional because there is an Arizona Attorney General opinion which says that it is unconstitutional to base Arizona income taxes on federal income taxes.*

Response: Arizona Attorney General Opinion 71-18 states that it would be unconstitutional for Arizona to adopt a state income tax law which provides that the tax assessed and collected be based on a percentage of the federal income tax liability as shown on the federal income tax return. However, Arizona's income tax is not a percentage of the federal income tax. Arizona adopts certain provisions of the federal Internal Revenue Code to measure Arizona gross income. Arizona statutes then provide specific additions, subtractions, personal exemptions, and standard or itemized deductions to arrive at Arizona taxable income. A.R.S. § 43-102.A, 43-1021, 43-1022, 43-1041, 43-1042.

Claim: *A person must be required to file a federal tax return and pay federal income taxes.*

Response: A.R.S. § 43-301 defines Arizona gross income by reference to the Internal Revenue Code, but there is no provision in Arizona statutes that requires a person to file and pay federal tax in order to be obligated to pay Arizona income tax. A.R.S. §43-102 adopts the provisions of the Internal Revenue Code relating to the measuring of adjusted gross income or taxable income, but again the filing of a federal return and paying federal taxes is not a prerequisite.

Claim: *Wages are not income. A variation of this claim is that wages are not profit or gain because they are given in equal exchange for services rendered.*

Response: Numerous court cases have held otherwise. In *Romero*, the court held "Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable....".

United States v. Romero, 640 F.2d 1014, 1016 (9th Cir. 1981). Every court considering the issue has rejected the argument that wages are not income. *United States v. Becker*, 965 F.2d 383, 389 (7th Cir. 1992); *United States v. Connor*, 898 F.2d 942, 943-44 (3rd Cir. 1990).

Claim: *The Sixteenth Amendment to the Constitution of the United States cannot constitutionally include wages and salaries as a taxable source of income. Therefore Arizona, which has adopted the federal Internal Revenue Code for the determination of Arizona gross income pursuant to A.R.S. § 43-102.A, cannot require Arizona taxpayers to include wages and salary in gross income.*

Response: The Sixteenth Amendment gave Congress broad power to tax income "from whatever source derived." This language is enough to authorize Congress and the State of Arizona to tax wages and salaries as income. The United States Supreme Court has also defined **income** as "the gain derived from capital, from labor, or from both combined." *Eisner v. Macomber*, 252 U.S. 189, 207 (1920). Some people have mistakenly taken the above holding out of context and argued that Eisner means that only gain is income. This argument was rejected by the United States Supreme Court. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955); *Commissioner v. Kowalski*, 434 U.S. 77 (1977).

Claim: *Being forced to file a tax return violates the Fifth Amendment right against self-incrimination.*

Response: The United States Supreme Court has consistently held that the mere filing of a tax return does not violate the individual's Fifth Amendment rights. In *Sullivan*, the Court held that a taxpayer cannot use the Fifth Amendment privilege to refuse to provide any and all financial information on a federal income tax return. *United States v. Sullivan*, 272 U.S. 259, 263 (1927); *Garner v. United States*, 424 U.S. 648 (1976). In *Neff*, the Ninth Circuit held that there is no violation of a person's Fifth Amendment privilege where income tax questions are "neutral on their face and directed to the public at large." *United States v. Neff*, 615 F.2d 1235, 1240 (9th Cir. 1980).

Claim: *Being forced to file a tax violates the Fourth Amendment right to privacy.*

Response: No Fourth Amendment claim arises under the United States Constitution unless an illegal search or seizure has occurred. A.R.S. § 42-1105C provides that every person subject to taxes administered by the Department of Revenue shall keep suitable records and other books and accounts necessary to determine the tax for which the person is liable. It also provides that the books,

records, and accounts shall be open for inspection at any reasonable time by the department or its authorized agent.

Claim: *In response to a letter from the Department of Revenue, the individual submits a "U.C.C. 3-507 Statement of Dishonor" asking the Department to furnish the instrument with the individual's signature that obligates that individual to the Department's claim and the authority to make presentment, etc.*

Response: The Uniform Commercial Code is not law until a state adopts all or part of it into its own statutes. Arizona has adopted much of the Uniform Commercial Code, which can be found at A.R.S. § 47-1101 et seq. The statute found at A.R.S. § 47- 3501 pertains to when it is necessary to present a draft, check, promissory note or bank-acknowledged certificate of deposit (negotiable instrument) in order to charge the drawer or any endorser. This statute is not relevant to incurring a tax liability. The Arizona statutes which are relevant to tax liabilities are found in A.R.S. Titles 42 and 43. A.R.S. § 43-102.A.4 specifically states that, "It is the intent of the legislature...[t]o impose on each resident of this state a tax measured by taxable income wherever derived." Whether Arizona has personal jurisdiction over an individual is a matter of constitutional law, not commercial law. Courts and state agencies do have personal jurisdiction over individuals domiciled in Arizona. *Shaffer v. Heitner*, 433 U.S. 186 (1977).

Claim: *The Sixteenth Amendment of the Constitution of the United States applies to corporations, not individuals. Therefore, an individual is not taxable under the Internal Revenue Code or by the State of Arizona.*

Response: This limitation is not reflected in the amendment. In addition, court cases have held that the Sixteenth Amendment applies to individuals as well as corporations. *United States v. Stillhammer*, 706 F.2d, 1073 (10th Cir. 1983).

Claim: *The Arizona and federal tax laws and procedures violate a person's due process rights. Before a person can be assessed and property can be seized that person must be given a hearing or trial.*

Response: The courts have held that the mere postponement of a judicial inquiry is not a denial of due process if the ultimate opportunity given for judicial determination of the liability is adequate.

They have also held that all due process requires is the opportunity to litigate the government's position, even if the opportunity is delayed. *Phillips v. Commissioner*, 283 U.S. 589 (1931); *Bob Jones University*, 416 U.S. 725***

Claim: *Various Internal Revenue Code sections, such as IRC § 3121 (e), 3306(j) and 7701 (a), say that the United States includes the District of Columbia, Puerto Rico, and the Virgin Islands, or includes these entities and the Northern Mariana Islands and certain other possessions, enclaves, and trust territories. Therefore if a person is not a resident of one of these, that person is not a resident of the United States and is not taxable under the Internal Revenue Code.*

Response: According to *Black's Law Dictionary*, the term "include" may, according to context, express an enlargement and have the meaning of *and* or *in addition to*, or merely specify a thing already included within general words theretofore used. Courts have consistently rejected as "frivolous" arguments that federal tax laws apply only to United States territories and the District of Columbia. *United States v. Mundt*, 29 F.3d 233, 237 (6th Cir. 1994); *In re Becraft*, 885 F.2d 547, 549-50 (9th Cir. 1989).

For Additional Information, call:

Phoenix (602) 255-3381
Toll free from area codes 520 & 928 .. (800) 352-4090

Or Write to:

Arizona Department of Revenue
Taxpayer Information & Assistance
1600 W Monroe
Phoenix, AZ 85007

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