TAXABLE INCOME

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1) Overview

Despite "common knowledge" to the contrary, the income of most Americans is not subject to the United States federal income tax. The strict limits on federal power imposed by the Constitution prohibited Congress from imposing a tax on the incomes of United States citizens who live and work exclusively within the 50 states, and the federal statutes and regulations demonstrate that Congress ***did not*** impose such a tax. This was not due to an oversight, or to some technical imperfection in the legislative process. Congress never even *attempted* to impose such a tax. Instead, a limited income tax was imposed, and was worded in such a way to give the impression that it was applicable to the income of most Americans. However, a more in-depth study of the federal statutes and regulations reveals that the tax is far more limited in scope than the public has been led to believe.

While following the proof of this may require concentration, it does *not* require any "leap of faith," or any questionable "interpretation" of the law. The legal system of the United States is a system of written law, and the words in the law must inform individuals of exactly what the law requires. Therefore, an accurate determination of what the law requires can be accomplished only by an examination of the relevant legal documents themselves, without regard for preconceived assumptions about what the law says. Despite the enormous, complex maze of federal statutes and regulations built up by government lawyers over the years, written in what is virtually a foreign language to most (sometimes called "legalese"), the truth is still quite provable, as will be shown below.

Though many have complained about and/or resisted the federal income tax, the truth is that most Americans have no reason to "protest" the law at all. The federal income tax is neither invalid nor unconstitutional. The tax complies fully with the strict Constitutional limitations on the power of Congress.

What *does* warrant protest and demand for correction is how the tax has been (and still is) grossly misrepresented to the American people, and misapplied by federal employees, most of whom are equally ignorant of the truth. Many citizens have been harassed, robbed, and imprisoned unjustly, and the few in government who knew the truth did nothing to stop it. Political power has long been associated with dishonesty and deception, but the misrepresentation of the federal income tax (referred to below as "the Great Deception") constitutes the most massive fraud in the history of the United States. (It is more a conspiracy of ignorance than a conspiracy of secrecy, meaning that most of those involved in the tax industry, including the IRS and tax professionals, are guilty of incompetence and ignorance, rather than intentional deceit.)

This report will use the federal statutes and regulations themselves to document that the scope of the federal income tax is far more limited than the public generally believes. It will be shown that while many types of "income" can be taxable, they can be taxable only if they come from specific taxable activities (a.k.a. "sources"), and it will be shown that the taxable "sources" apply only to those engaged in international or foreign commerce, but do ***not*** apply to United States citizens living and working exclusively within the 50 states.

All non-italicized comments (in brackets) within a citation in this report are comments of the author, and do not appear in the text itself. Also, all **bold** and underlined emphasis within citations has been added by the author.

(Throughout the report there are several "Questions for Doubters" for tax professionals or others who doubt the correctness of this report.)

2) The Basics

The laws enacted by Congress through the legislative process are compiled into **statutes** in the 50 "Titles" of the United States Code. (Each "Title" deals with a category of law, and Title 26 is the federal tax title, often called the "Internal Revenue Code.") A federal agency then has the duty (assigned by Congress) to implement and enforce the statutes by writing and publishing **regulations**, which explain that agency's interpretation of the statutes, as well as setting the rules which govern how the agency will enforce the statutes. The regulations, when published in the Federal Register, are the official notice to the public of what the law requires, and are binding on the federal agencies (including the IRS). For federal taxes, the Secretary of the Treasury is authorized to write such regulations.

> "*Sec. 7805. Rules and regulations*
> *(a) Authorization - … the Secretary* [of the Treasury] *shall prescribe all needful rules and regulations for the enforcement of this title* [Title 26]…" [26 USC § 7805]

(The citation "26 USC § 7805" refers to Section 7805 of the *statutes* of Title 26, with "USC" meaning "United States Code." The symbol "§" means "section." Citations of *regulations* are similar, but contain "CFR" instead, meaning "Code of Federal Regulations.")

Section 1 of the Title 26 statutes imposes the "income tax" in five different categories (unmarried people, married people filing jointly, etc.). In each case, the wording reads "*there is hereby imposed on the **taxable income** of…*" The law generally defines "*taxable income*" in the following section of the statutes:

> "*Sec. 63. **Taxable income defined***
> *(a) In general - …the term "**taxable income**" means **gross income** minus the deductions allowed by this chapter…*" [26 USC § 63]

In other words, when someone determines his "*gross income*," and then subtracts all allowable deductions, the remainder is "*taxable income*." (So for income to be "*taxable income*," it must first be "*gross income*.") The following section of the statutes gives a general definition of "*gross income*":

> "*Sec. 61. **Gross income defined***
> *(a) General definition - … **gross income** means all **income from whatever source derived**, including (but not limited to) the following **items**:*
> *(1) Compensation for services...;*
> *(2) Gross income derived from business;*
> *(3) Gains derived from dealings in property;*
> *(4) Interest;*
> *(5) Rents;*
> *(6) Royalties;*
> *(7) Dividends;...* [more items listed]" [26 USC § 61]

This is the point at which many tax "experts" err, either by assuming that the "items" of income listed constitute "sources" of income, or by assuming that "*from whatever source derived*" means that all of the "items" of income listed, *regardless of where they come from*, are subject to the "income tax." Both of these assumptions are provably incorrect. (The difference and relationship between "items" and "sources" will be explained below.)

3) English vs. Legalese

In our system of written law, Congress may use a term to mean almost anything, as long as the law itself defines that meaning. When the written law explains the meaning of a term used in the law, standard English usage becomes irrelevant. For example, by the definition in 26 USC § 7701(a)(1), the term "*person*" includes estates, companies and corporations. While no one would call Walmart a "person" in everyday conversation, Walmart is a "person" under federal tax law. The legal use of a term is often significantly different from basic English, and therefore reading one section of the law alone can be very misleading.

As a good example, 26 USC § 5841 states that "[t]*he Secretary* [of the Treasury] *shall maintain a central registry of* ***all firearms*** *in the United States which are not in the possession or under the control of the United States*." The law has a far more limited application than this section by itself would seem to imply. In 26 USC § 5845(a) it is made clear that the term "*firearm*" in these sections does ***not*** include the majority of rifles and handguns (while the term "firearm" in basic English obviously would), but *does* include poison gas, silencers and land mines. The average citizen reading the law will naturally tend to assume that he already knows what the words in the law mean, and may have difficulty accepting that the *legal* meaning of the words used in the law may bear little or no resemblance to the meaning that those words have in common English. For example, reading the phrase "*all firearms*" in Section 5841 in a way that *excludes* most rifles and handguns is contrary to instinctive reading comprehension. (But any lawyer reviewing Sections 5841 and 5845 would confirm that such a reading would be absolutely correct.) Reading one section of the law without being aware of the *legal* definitions of the words being used can give an entirely incorrect impression about the application of the law.

As demonstrated, sometimes the apparent meaning of a simple phrase in the law is very different from the legal meaning. The "income tax" is imposed on "*income from whatever* ***source*** *derived*." If the law did not explain what constitutes "***sources*** *of income*," then the law would be interpreted using basic English. However, the law ***does*** explain what the term means, and therefore standard English usage is irrelevant.

4) Sources of Income

To review, the "income tax" is imposed on "*taxable income*," which means "*gross income*" minus deductions. "*Gross income*" is defined in 26 USC § 61 as "*all income from whatever* ***source*** *derived*." The phrase "*from whatever* ***source*** *derived*" may initially appear all-encompassing, but for the specifics about "*income from* ***sources***," the reader of the law is repeatedly referred to Section **861** and following (of the statutes) and the related regulations. For example, in the full version of Title 26 (with all notes and amendments) which appears on Congress' own web site, Section 61 *itself* has the following cross-reference:

"***Income from sources*** -
Within *the United States, see* ***section 861*** *of this title.*
Without the United States, see section 862 of this title."

So the section which generally defines "gross income" specifically refers to 26 USC § 861 regarding income from "sources" within the United States. A similar reference is also found in the indexes of the United States Code, which (although they vary somewhat in the exact wording) have entries such as:

"*Income tax*
Sources *of income*
Determination*, 26 §* ***861*** *et seq…*
Within *the U.S., 26 §* ***861***"

Again, income from "sources" within the United States is specifically dealt with by Section 861, and "*determination*" of sources of income is also dealt with by Section 861 and the following sections. In addition, Sections 79, 105, 410, 414 and 505 each identify Section **861** as the section which determines what constitutes "*income from* ***sources*** *within the United States,*" and Section 306 even uses the phrase "*part I of subchapter N (sec.* ***861*** *and following, relating to* ***determination of sources of income****).*"

As shown, 26 USC § 861 and following (which make up Part I of Subchapter N of the Code) are very relevant to determining what is considered a "source of income," and Section 861 in particular deals within income from "sources" ***within*** the United States. Not surprisingly, Section 861 is entitled "*Income from* ***sources*** *within the United States,*" and the first two subsections of Section 861 are entitled "***Gross income*** *from sources within the United States*" and "***Taxable income*** *from sources within the United States*." Section 861 is also the first section of Subchapter N of the Code, which is entitled "*Tax based on* ***income from sources*** *within or without the United States*." Clearly this is relevant to a tax on "***income*** *from whatever* ***source*** *derived*."

As mentioned before, the *statutes* passed by Congress are interpreted and implemented by *regulations* published in the Code of Federal Regulations ("CFR") by the Secretary of the Treasury. The Index of the CFR, under "*Income taxes,*" has an entry that reads "*Income from* ***sources*** *inside or outside U.S.,* ***determination of sources of income****, 26 CFR 1 (****1.861-1****--1.864-8T).*" This is the *only* entry in the Index relating to income from sources *within* the United States, and the regulations listed (26 CFR § 1.861-1 and following) correspond to Section 861 of the *statutes*. (The "*26*" refers to Title 26, the "*1*" after "*CFR*" refers to Part 1 of the regulations ("Income Taxes"), and the "*.861*" refers to Section 861 of the statutes.) These regulations fall under the heading "***Determination of sources of income***." The following is how these regulations begin:

"*Sec. 1.861-1* ***Income from sources within the United States.***
*(a) Categories of income. Part I (****section 861*** ***and following****), subchapter N, chapter 1 of the Code,* ***and the regulations thereunder determine the sources of income for purposes of the income tax.***" [26 CFR § 1.861-1]

The meaning of this is unmistakable. The "income tax" is imposed on "*income from whatever **source** derived*," and Section 861 and following, and the related regulations, determine what is considered a "***source***" of income "*for purposes of the income tax*." The first sentence of the regulations under 26 USC § 861 has stated this since 1954, when Section 861 first came into existence. Note that these define "***the***" sources of income subject to the tax, meaning ***there are no others***. Therefore, the meaning of "*income from whatever **source** derived*" (the definition of "*gross income*" in Section 61) ***is*** limited by Section 861 (and following sections) and the related regulations. The meaning of the phrase "***whatever** source*" depends completely on the meaning of the word "***source***." The word "*whatever*" does not expand the meaning of "*source*" any more than the phrase "***all** firearms*" (in the example above) expands the legal meaning of the word "*firearm*."

The above section of regulations also refutes the common but incorrect position that the "*items*" of income listed in Section 61 are "*sources*," since Section 61 is obviously **not** the section which determines the "*sources*" of income for purposes of the income tax.

(There is a chart at the end of this report showing the outline of Part I of Subchapter N and related regulations, and showing many of the citations used in this report.)

While the significance of Section 861 and the related regulations may be obvious, the point needs to be thoroughly proven, since most tax professionals concede that Section 861 and its regulations are ***not*** about the income of United States citizens living and working exclusively within the United States. (Below it will be shown ***why*** it is so significant that "*section 861 and following... and the regulations thereunder, determine the sources of income for purposes of the income tax*.")

This is also suggested by the title of Part I of Subchapter N (of which 861 is the first section), "*Source rules and other general rules relating to **foreign** income*." Under the usual overly-broad (and incorrect) interpretation of the legal scope of the term "*gross income*," this would appear as a contradiction, since "*Income from sources **within** the United States*" (the title of Section 861) would at first glance seem to be the opposite of "***foreign** income*." The specific taxable sources shown later demonstrate that income from *within* the United States can be taxable only if received by certain individuals ***outside*** of the United States, thus making the income ***foreign*** income.

While the title of a part of the statutes may indicate what that part is about, it should be mentioned that 26 USC § 7806(b) states that such titles do not change the actual meaning of the law ("*nor shall any… descriptive matter relating to the contents of this title be given any legal effect*"). The above explanation for the title of Part I, Subchapter N is therefore not crucial, but does give a possible explanation of why the title is as it is.

(Question for Doubters #1: *Does Part I (Section 861 and following) of Subchapter N, and related regulations, determine what is considered a "source" of income for purposes of the federal income tax?*)

5) Determining Taxable Income

In addition to the fact that Section 861 and following, and related regulations, determine what is considered a "*source*" of income subject to the income tax, the regulations also repeatedly state that these are also the specific sections to be used to determine "*gross income*" and "*taxable income*" from sources within and/or without the United States.

> "*Rules are prescribed for **determination of gross income and taxable income** derived from sources **within and without** the United States, and for the allocation of income derived partly from sources within the United States and partly without the United States or within United States possessions. **§§ 1.861-1 through 1.864**. (Secs. **861-864**; '54 Code.)*" [Treasury Decision 6258]

The sections which are specifically for determining *taxable* income from sources *within* the United States are **26 USC § 861(b)** of the statutes, and the corresponding regulations found at **26 CFR § 1.861-8**. (The regulations under Section 63, the section defining "*taxable income*," do *not* explain how to determine taxable income.) While the relevance of these sections may quickly become obvious, the repeated documentation is important since most tax professionals are already aware that these sections are ***not*** about the income of most Americans.

Section **861(b)** (as mentioned above) is entitled "***Taxable income** from sources within the United States*." This section states that taxable income from sources within the United States is the gross income described in 861(a) minus allowable deductions. The regulations under Section 861 state (in the first paragraph):

> "*The statute provides for the following three categories of income:*
> *(1) **Within** the United States. The **gross income** from sources within the United States… See Secs. 1.861-2 to 1.861-7, inclusive, and Sec. 1.863-1. **The taxable income from sources within the United States**… shall be determined by deducting therefrom, in accordance with sections **861(b)** and 863(a),* [allowable deductions]. *See Secs. **1.861-8** and 1.863-1.*" [26 CFR § 1.861-1(a)(1)]

(The other two categories of income are income from "*without*" (outside of) the United States, dealt with by Section 862 and related regulations, and income from sources partly within and partly without the U.S., dealt with by Section 863 and related regulations.)

As the above citation states, items of "gross income" from sources within the U.S. are dealt with by 861(a) of the statutes and 1.861-2 through 1.861-7 of the regulations. Taxable income is determined by **861(b)** of the statutes, and the corresponding regulations in **1.861-8**. These regulations are predictably entitled "*Computation of **taxable income from sources within the United States** and from other sources and activities*," and reiterate the point:

> "*Sections **861(b)** and 863(a) state in general terms **how to determine taxable income of a taxpayer from sources within the United States** after gross income from sources within the United States has been determined*." [26 CFR § 1.861-8]

In the regulations under Section 863 (concerning income from sources inside and outside the U.S.), the following is stated:

> "***Determination of taxable income***. *The taxpayer's taxable income from sources* ***within or without*** *the United States* ***will be determined under the rules of Secs. 1.861-8 through 1.861-14T*** *for determining taxable income from sources* ***within*** *the United States.*" [26 CFR § 1.863-1(c)]

(The vast majority of tax professionals ***do not use these sections*** to determine taxable income from sources within the United States. At this point, the average citizen reading this report may guess that there must be some "context," or some other section, or something *somewhere* which would justify the tax professionals blatantly disregarding and disobeying the clear language used in the citations shown above. There is not.)

Note how sections **1.861-8** and following of the regulations are identified as the sections "*for determining taxable income from sources* ***within*** *the United States,*" as well as being the sections to be used whether the income is from sources within ***or*** without the United States. A similar structure occurs in the regulations under Section 862 (dealing with income from outside of the United States):

> *"(b) Taxable income. The taxable income from sources* ***without*** *the United States… shall be determined on the same basis as that used in* ***Sec. 1.861-8 for determining the taxable income from sources within the United States***." [26 CFR § 1.862-1]

Section 1.863-6 of the regulations (dealing with income from within a foreign country or federal possession) also identifies sections 1.861-1 through 1.863-5 as applying "[t]*he principles… for determining the* ***gross and the taxable income*** *from sources within and without the United States*." Over and over again it is shown that **26 USC § 861(b)** of the statutes and **26 CFR § 1.861-8** of the regulations are to be used to determine the taxable income from sources within the United States.

(Question for Doubters #2: *Are 26 USC § 861(b) and 26 CFR § 1.861-8 the sections to be used to determine taxable income from sources within the United States?*)

6) Specific Sources

Section 861 of the statutes uses general language that at first seems to apply to all income coming from within the United States, by saying "*The following* ***items*** *of gross income* ***shall be treated as income from sources within the United States:***" The section then lists similar "items" of income to those listed in Section 61 (while specifying that they are coming from within the United States). As with Section 61, it is easy to misconstrue this list of "items" as being a list of "sources," which it is not. The regulations related to Section 861 contradict this possible misinterpretation. (And, as will be shown later, the older regulations and statutes make the correct application of the law crystal clear.)

The regulations in Section 1.861-8 begins by saying that Section 861(b) of the statutes describes "*in general terms*" how to determine taxable income from sources within the United States. These same regulations later specify that Section 861 is about items of income derived from "***specific*** *sources*."

> "*(ii) Relationship of sections 861, 862, 863(a), and 863(b). Sections* ***861, 862, 863(a), and 863(b)*** *are the four provisions applicable in* ***determining taxable income from specific sources****."* [26 CFR § 1.861-8(f)(3)(ii)]

In the first paragraph of Section 1.861-8 of the regulations (the section "*for determining taxable income from sources within the United States*"), it is again made clear that the section applies only to the listed "*items*" of income when derived from "***specific*** *sources*."

> *"The rules contained in this section apply in determining* ***taxable income*** *of the taxpayer from* ***specific sources*** *and activities…*" [26 CFR § 1.861-8(a)]

Again, a few paragraphs later, in defining the term "*statutory grouping*," these regulations *again* state that taxable income must come from a "***specific*** *source*."

> "*…the term '****statutory grouping****' means the gross income from a* ***specific source*** *or activity* ***which must first be determined in order to arrive at 'taxable income'*** *from which* ***specific source*** *or activity…*" [26 CFR § 1.861-8(a)(4)]

In 26 CFR § 1.861-8(f)(1) it is ***again*** made clear that Section 1.861-8 (the section "*for determining taxable income from sources within the United States*") is applicable only to income derived from "***specific*** *sources*."

> ***"****…the determination of taxable income of the taxpayer from* ***specific sources*** *or activities and which gives rise to* ***statutory groupings*** [see previous citation] ***to which this section is applicable****…"* [26 CFR § 1.861-8(f)(1)]

From these it is clear that the term "*source*" as used in Sections 61 and 861 does not simply mean any activity from which income is derived. If it did, there would be no need for Section 861 and following, and related regulations, to "*determine the sources of income for purposes of the income tax*." The following citations show that Section 1.861-8(f)(1) lists the "*specific sources*" of income subject to the income tax.

Again, the first paragraph of 26 CFR § 1.861-8 states the following (the meaning of "*operative section*" will be explained below):

> "*The rules contained in this section apply in determining* ***taxable income*** *of the taxpayer from* ***specific sources*** *and activities under other sections of the Code, referred to in this section as operative sections.* ***See paragraph (f)(1) of this section*** *for a list and description of operative sections.*" [26 CFR § 1.861-8(a)(1)]

The definition of "statutory grouping" (mentioned above) also refers to "*paragraph (f)(1)*" as the list of "specific sources."

> *"…the term 'statutory grouping' means the gross income from a **specific source** or activity which must first be determined in order to arrive at 'taxable income' from which **specific source** or activity under an operative section. (**See paragraph (f)(1) of this section**.)*" [26 CFR § 1.861-8(a)(4)]

The regulations twice identify "***paragraph (f)(1) of this section***" (26 CFR § 1.861-8(f)(1)) as the list of specific sources. Paragraph (f)(1) itself confirms this again, and then lists the "*specific sources*" subject to the income tax:

> "*The operative sections of the Code which require the **determination of taxable income** of the taxpayer from **specific sources** or activities and which gives rise to statutory groupings to which this section is applicable include the sections described below.*
> *(i) Overall limitation to the **foreign** tax credit…*
> *(ii) [Reserved]*
> *(iii) **DISC** and **FSC** taxable income…* [international and foreign sales corporations]
> *(iv) Effectively connected taxable income. **Nonresident alien individuals and foreign corporations** engaged in trade or business within the United States…*
> *(v) **Foreign** base company income…*
> *(vi) **Other operative sections**. The rules provided in this section also apply in determining--*
> *(A) The amount of **foreign** source items…*
> *(B) The amount of **foreign** mineral income…*
> *(C) [Reserved]*
> *(D) The amount of **foreign** oil and gas extraction income…*
> *(E)* (deals with **Puerto Rico** tax credits)
> *(F)* (deals with **Puerto Rico** tax credits)
> *(G)* (deals with **Virgin Islands** tax credits)
> *(H) The income derived from **Guam** by an individual…*
> *(I)* (deals with **China Trade Act** corporations)
> *(J)* (deals with **foreign** corporations)
> *(K)* (deals with insurance income of **foreign** corporations)
> *(L)* (deals with countries subject to **international boycott**)
> *(M)* (deals with the **Merchant Marine Act** of 1936)" [26 CFR § 1.861-8(f)(1)]

None of these "sources" apply to United States citizens who live and work exclusively within the United States. (Federal "possessions," such as Guam, Puerto Rico, etc., are considered "foreign" under the law.) This is the only list of "sources" in Part I of Subchapter N, or the regulations thereunder, which (as the regulations say) "*determine the sources of income for purposes of the income tax.*"

The next subsection (1.861-8(g)) gives examples about how 26 CFR § 1.861-8 works, and states that "[i]*n each example, unless otherwise specified, the **operative section** which is applied and gives rise to the statutory grouping of gross income is the overall limitation to the **foreign** tax credit under section 904(a),*" again showing that there must be some "operative section" in order for the section to apply, and in order for there to be taxable income.

So, to review, the sections which "*determine the **sources** of income for **purposes of the income tax***" (namely, 861 and following and related regulations) apply only to income from the "***specific sources***" listed in 26 CFR § 1.861-8(f)(1). Most people do not receive income from these "*sources of income for purposes of the income tax,*" and most people do not, therefore, receive "*income from whatever **source** derived*" (the general definition of "*gross income*") subject to the income tax.

(Question for Doubters #3: *Under 26 USC § 861 and 26 CFR § 1.861-8, is income taxable only if derived from "specific sources" related to international and foreign commerce (including federal possessions)?*)

7) Operative Sections

The earlier sections of Title 26 (26 USC 61 and following) deal with types of *income* that may be taxable (such as compensation for services). However, these sections do not specify where the transaction is taking place, or who is receiving the income. Obviously not everyone on earth who receives "compensation for services" is taxable under U.S. law. A separate part of the law, found in Subchapter N, deals with what types of commerce generate taxable income.

Subchapter N is entitled "*Tax based on **income** from **sources** within or without the United States.*" As the title suggests, this subchapter explains when income from within or without the United States is subject to the income tax. But on examining Subchapter N, it is readily apparent that it relates only to international and foreign commerce, but not to citizens who receive all of their income from within the 50 states. This can be seen by the titles of the five "Parts" of Subchapter N, which are "*Source rules and other general rules relating to **foreign** income*" (Part I), "***Nonresident aliens** and **foreign** corporations*" (Part II), "*Income from sources **without*** [outside of] *the United States*" (Part III), "*Domestic **international** sales corporations*" (Part IV), and "***International** boycott determinations*" (Part V).

The *statutes* of Part I of Subchapter N (beginning with 26 USC § 861) give general rules about "within" and "without," but the *regulations* thereunder make it quite clear that these rules apply only to the taxable activities described throughout the *other* "Parts" of Subchapter N.

> "*(ii) Relationship of sections 861, 862, 863(a), and 863(b). Sections **861, 862, 863(a), and 863(b)** are the four provisions applicable in **determining taxable income from specific sources**.*" [26 CFR § 1.861-8(f)(3)(ii)]

This term "*specific sources*" is used in three other places in the regulations, every one of which specifically refers to taxable activities described in the "operative sections" of the statutes throughout Subchapter N (which are listed in 1.861-8(f)(1) of the regulations). In other words, while the ***regulations*** list the taxable activities all in one place (26 CFR § 1.861-8(f)(1), the ***statutes*** describe those taxable activities in numerous sections throughout all of Subchapter N. The "*specific sources*" listed in the regulations each refer specifically to sections of the statutes (called "*operative sections*") describing those activities. For example, item "*(iv)*" on the list in 1.861-8(f)(1) specifically refers to sections 871(b)(1) and 882(a)(1) of the statutes, which state the following:

> "*A **nonresident alien individual engaged in trade or business** within the United States… **shall be taxable** **as provided in section 1**…*" [26 USC § 871(b)(1)]
>
> "*A **foreign corporation engaged in trade or business** within the United States… **shall be taxable** as provided in section 11…*" [26 USC § 882(a)(1)] (Section 11 imposes the income tax on corporations, while Section 1 imposes it on individuals)

Here the statutes state that these specific activities (or "sources") may produce taxable income. If an "*item*" of income (such as compensation for services) derives from the activity described in this "operative section," that income is subject to the income tax. The "*shall be taxable*" phrase would be entirely unnecessary if "*from whatever source derived*" had the broad meaning that the usual (and incorrect) interpretation of the law gives it.

There is no such "*shall be taxable*" phrase, nor any "*operative section*" describing an activity in which a United States citizen living and working exclusively within the 50 states receives income from within the 50 states. The regulations under Section 861 make it clear that the "*items*" of income must derive from a taxable source or activity described in an "operative section" of the statutes in order to be taxable. Other income does not legally constitute "*income from whatever **source** derived*."

The following analogy may help to clarify the matter of "items" of income and "sources" of income. Suppose that there was a law imposing a tax on "Zonkos," and that the law defined "Zonkos" as "all **toys** from whatever **store** derived, including the following toys: plastic cars, dolls, yoyos," etc. Then the law stated that another section "determines the **stores** for purposes of the Zonko tax," and that section listed "Bob's Toys," "Toy City," and "ToyWorld" as "toy stores."

In this example, there would be two distinct aspects of the term "Zonko": whether an item is a taxable "**toy**," and whether it comes from a taxable "**store**." **Both** criteria would have to be met for it to legally constitute a "Zonko." For example, a baby bottle bought at ToyWorld would **not** be a "Zonko" (even though it came from a "store"), if baby bottles are not within the legal definition of "toys." Also, a doll bought from "Chuck's Bargain Basement" also would **not** be a "Zonko" (even though it is a "toy"), as it did not come from something within the legal meaning of "store." A yoyo from Toyworld *would* be a "Zonko" as it is both a "toy" *and* comes from a "store."

Similarly, if an "item" of income (such as dividends) does not come from a taxable "source" or activity (such as a foreign corporation doing business within the United States), it does not constitute "gross income." While the law goes to great length to specify which "items" of income may be included in "gross income," the other condition must still be met in order for those items to be taxable: they must derive from a taxable "source" or activity under an "operative section" of Subchapter N (as explained in Section 1.861-8(f)(1) of the regulations). (Note that the definition of "*gross income*" includes both criteria: "*all **income** from whatever **source** derived*.")

8) Summary of Current Law

The current statutes and regulations show the correct, limited application of the "income tax" imposed by 26 USC § 1, which is in conflict with what the public generally believes regarding the matter.

To summarize,

26 USC § 1 imposes the income tax on "*taxable income*."
26 USC § 63 defines "*taxable income*" generally as "*gross income*" minus deductions.
26 USC § 61 defines "*gross income*" generally as income "*from whatever source derived*."
26 USC §§ 861 - 865, and related regulations, determine the taxable "*sources of income*."
26 CFR § 1.861-8 shows that the taxable "*sources of income*" apply only to those engaged in international or foreign commerce (including commerce within federal possessions).

9) Taxing Power

While the current statutes and regulations document the limited application of the federal income tax, it is important to explain the reason why such a limit exists. Without an explanation of *why* the law is as it is, the conclusion may be unbelievable to some (regardless of the actual evidence). Certainly the limitation was not due to Congress not *wanting* to tax all income. Without some obstacle to Congress' power, the tax which most people now believe exists (a tax on the income of most Americans) would certainly have been imposed.

According to the Supreme Court, the broad and general wording which Congress used to define "gross income" was intended to tax all income within their power to tax.

> "*This Court has frequently stated that this language* [defining "gross income"] *was used by Congress to exert in this field '**the full measure of its taxing power**.'*" [Commissioner v. Glenshaw Class Co., 348 U.S. 426 (1955)]

This ruling is speaking specifically of Section 22(a) of the Internal Revenue Code of 1939, which is the predecessor to the current 26 USC § 61. Congress has stated that the scope of "gross income" did not change when the law was rearranged and reworded. (It should be mentioned that the current tax code is basically just the income tax of 1913, but with many amendments over the years adding, removing, rewording, and renumbering various sections. The fundamental nature and origin of the tax remains intact.)

The general language of the definition of "gross income" (past and present) may give an initial impression of an unlimited tax on the income of every individual. However, the meaning of a statute passed by Congress is limited to those matters which the Constitution puts under federal jurisdiction.

> "*It is elementary law that every statute is to be read in the light of the constitution.* ***However broad and general its language, it cannot be interpreted as extending beyond those matters which it was within the constitutional power of the legislature to reach.***" [McCullough v. Com. Of Virginia, 172 U.S. 102 (1898)]

(Notice that this is not some radical decision, but is considered "*elementary law*.")

In other words, a statute may be more restricted that its general wording suggests. The above case goes on to say that Constitutional restrictions are to be *assumed* when reading a statute (state or federal), even though they are not stated.

> "*So, although **general language** was introduced into the statute of 1871, **it is not to be read as reaching to matters in respect to which the legislature had no constitutional power**, but only as to those matters within its control. And, if there were, as it seems there were, certain special taxes and dues, which, under the existing provisions of the state constitution, could not be affected by legislative action, **the statute is to be read as though it in terms excluded them** from its operation.*"
> [McCullough v. Com. Of Virginia, 172 U.S. 102 (1898)]

So a federal statute is to be read as though it specifically *excludes* matters which the Constitution does not put under federal jurisdiction. So while, as the Supreme Court said, Congress intended to use the "*full measure of its taxing power*" by using such a generally-worded definition of "*gross income*," the Supreme Court also admits that the income tax "*cannot be applied to any income which Congress has no power to tax*" [William E. Peck & Co. v. Lowe, 247 U.S. 165 (1918)]. So the general wording must be interpreted in light of the Constitutional limits on Congress' power. But this could pose a problem for the average citizen. How is he to know what the Constitutional limits are on Congress' power (when even federal judges disagree with each other on the matter)?

As mentioned at the beginning of this report, the Secretary of the Treasury is empowered (by statute) to implement and *interpret* the law. When the Treasury regulations are published in the Federal Register, that becomes the official notice to the public of what the law requires. Therefore, while the *statutes* may use general language (which might at first glance seem to include matters outside of federal jurisdiction), the *regulations* must give specifics.

Though it is phrased somewhat differently than the current 26 USC § 61, the definition of "gross income" found in Section 22(a) of the 1939 Code appears all-encompassing. The regulations under the 1939 Code, however, are very telling. (The term "net income" was used back then, which would later become "taxable income.")

> "*Sec. 29.21-1. Meaning of net income. The tax imposed by chapter 1 is upon income. Neither income exempted by **statute** or **fundamental law**... enter into the computation of net income as defined by section 21.*"

The term "fundamental law" refers to the Constitution (as countless court rulings show). While the general wording of the statutes makes no such reference, here the regulations imply that some income not exempted by statute is nonetheless exempt from taxation under the Constitution. Note the distinction between income exempted by *statute*, and income exempted by the *Constitution*. This occurs again later in the same section:

> "*(b) Gross income, meaning income (in the broad sense) less income which is by **statutory provision** or **otherwise** exempt from the tax imposed by chapter 1. (See **section 22**.)*"

Again, the regulations are admitting that some things *not* exempted by *statute* are nonetheless exempt from federal taxation. The above citation refers us to Section 22 (of the 1939 Code) for the meaning of "gross income." The regulations under that section begin as follows:

> "*Sec. 29.22(a)-1. What included in gross income.*
> *Gross income includes in general* [items of income listed] *derived from any source whatever,* ***unless exempt from tax by law****. (****See section 22(b)*** *and 116.)*"

This refers the reader to Section 22(b) to learn what income is "exempt from tax." After saying that certain items are specifically exempted by statute, the regulations under section 22(b) (referred to in the previous citation) state:

> "*No* ***other*** *items* ***are exempt from gross income except*** *(1) those items of income which are,* ***under the Constitution, not taxable by the Federal Government****; (2) those items of income which are exempt from tax on income under the provisions of* ***any Act of Congress*** *still in effect; and (3) the income exempted under the provisions of section 116.*"

Again the regulations explicitly state that some income is not constitutionally taxable, even though it is ***not*** specifically exempted by any statute passed by Congress. The *statutes* need not mention this, because (as shown above), the Constitutional limitations are to be *assumed* when reading any statute. But because the *regulations* must give specifics, the fact that some income not exempt by statute is exempted by the Constitution is specifically stated in the regulations. (Many tax professionals are at a loss to explain this; they are unable to identify anything which is *not* taxable under the constitution, but which is *not* exempted by *statute*.)

(Question for Doubters #4: *What types of income not exempted by statute are nonetheless, under the Constitution, not taxable by the federal government?*)

10) Constitutional Limits

At this point it is reasonable to consider what types of income might be (as the older regulations state) "*under the Constitution, not taxable by the Federal Government*." While the public seems largely ignorant of this fact, Congress has legal power over only those few matters which the Constitution puts under federal jurisdiction (and the Tenth Amendment clearly states this). Within the 50 states, Congress has legal control over only those matters listed in Article I, Section 8 of the Constitution.

> "*We start with first principles. The Constitution creates a Federal Government of enumerated powers. See* ***U.S. Const., Art. I, 8****. As James Madison wrote, "****[t]he powers delegated by the proposed Constitution to the federal government are few and defined****. Those which are to remain in the State governments are numerous and indefinite." The Federalist No. 45, pp. 292-293 (C. Rossiter ed. 1961).*"
> [United States v. Lopez, 514 U.S. 549 (1995)]

In the 1995 case cited above, the Supreme Court threw out the "Gun Free School Zone" law (18 USC § 922(q)) as unconstitutional, on the grounds that it was outside of Congress' enumerated powers described in Article I, Section 8. Not only did the court say this, but the lawyers on the *other* side tried to argue that the law was about regulating "interstate commerce" (which Article I, Section 8 puts under federal jurisdiction), demonstrating that they *agreed* that the law had to be based on something in Article I, Section 8.

Article I, Section 8 *does* include the "*power to lay and collect taxes,*" but does not say *what* may be taxed by Congress. This allows for two options. The first option is that there are essentially ***no*** limitations on what Congress can tax (though there are certain rules on *how* "direct" and "indirect" taxes must be imposed). The problem with this option is that it would essentially negate the entire Constitution, as this option would give Congress the jurisdiction and power to control *anything and everything*, provided it exerted that control through ***tax*** legislation. For example, if this option were true, in response to the Lopez decision mentioned above, Congress could simply impose a $1,000,000 ***tax*** on carrying a firearm near a school, to get around the restriction that would otherwise exist.

The Supreme Court seems to agree that this option cannot be. The court said that they could not allow Congress to control by ***tax*** legislation matters which they have no jurisdiction to *regulate*. (Congress was attempting, in this case, to control "child labor" within the states through tax legislation.) The Supreme Court said the following:

> "*Grant the validity of this law, and all that Congress would need to do, hereafter, in seeking to take over to its control any one of the great number of subjects of public interest, jurisdiction of which the states have never parted with, and which are reserved to them by the* ***Tenth Amendment****, would be to enact a detailed measure of complete regulation of the subject and* ***enforce it by a socalled tax*** *upon departures from it.* ***To give such magic to the word 'tax' would be to break down all constitutional limitation of the powers of Congress*** *and completely wipe out the sovereignty of the states.*"
> [Bailey v. Drexel Furniture Co., 259 U.S. 20 (1922)]

In the same year, the court also ruled on the Future Trading Act, which imposed a tax "on all contracts for the sale of grain for future delivery." The court quoted the citation above, and immediately afterward said this:

> "*This has complete application to the act before us, and requires us to hold that the provisions of the act we have been discussing* ***cannot be sustained as an exercise of the taxing power of Congress conferred by section 8, article 1****.*"
> [Hill v. Wallace, 259 U.S. 44 (1922)]

Clearly the court saw that Congress' power to lay and collect taxes does *not* grant unlimited jurisdiction over everything within the states. To ignore the limits of federal jurisdiction when reading the taxation clause would lead to concluding that Congress can control *everything* by tax legislation. (In fact, this reading would also mean that Congress has the power to tax everyone in China, since the taxing clause does not mention *geographical* jurisdiction either.)

The second option is that "*the power to lay and collect taxes*" applies only to matters ***otherwise*** under federal jurisdiction. For example, Article I, Section 8 specifically puts international commerce under federal jurisdiction, and Article IV, Section 3 gives Congress control of federal possessions. However, "intrastate" commerce (commerce that happens entirely within a single state) is *not* under federal jurisdiction. So the power to tax, together with the clauses giving Congress jurisdiction over international commerce, and commerce within federal possessions, would give Congress the power to tax income from international commerce, and income from federal possessions.

The Supreme Court made an interesting comment in 1918 related to this. The case concerned the income tax act of 1913 (which is the basis of the current tax), and how it applied to a domestic corporation in the business of buying things in the states and selling them in foreign countries. The corporation was arguing that the tax in this case violated the provision of the Constitution which forbids the federal government from taxing exports from any state.

> "[T]*he act obviously* ***could not impose a tax forbidden by the Constitution****... The Constitution broadly empowers Congress not only '****to lay and collect taxes****, duties, imposts, and excises,'* ***but also 'to regulate commerce with foreign nations****.' So, if the prohibitory clause* [meaning the clause forbidding taxes on exports from states] *invoked by the plaintiff be not in the way, Congress undoubtedly* ***has power to lay and collect such a tax as is here in question****.*"
> [William E. Peck & Co. v. Lowe, 247 U.S. 165 (1918)]

In other words, if not for the question about whether this was a tax on state exports, this income would be taxable because Congress is given the general power "*to lay and collect taxes*," and is given *specific* jurisdiction over "*regulat*[ing] *commerce with foreign nations*." The court obviously thought the second clause was relevant to whether Congress could tax such income.

The courts have long argued over the concept that "the power to tax is the power to destroy," meaning that the ability to tax something implies the ability to regulate it or to forbid it entirely. This conversely implies that if a government has no jurisdiction to *regulate* or *forbid* an activity, then it also has no jurisdiction to *tax* that activity. There are numerous Supreme Court cases dealing with the concept.

> "[N]*o state has the right to lay a tax on interstate commerce in any form... and the reason is that such* ***taxation*** *is a burden on that commerce, and amounts to a* ***regulation*** *of it, which belongs solely to congress. This is the result of so many recent cases that citation is hardly necessary.*" [Leloup v. Port of Mobile, 127 U.S. 640 (1888)]

In this case the court is stating the restrictions on what a *state* can tax, but the underlying logic is clear. Taxing commerce is a burden on that commerce, and amounts to a *regulation* of commerce. While Congress is authorized to regulate *interstate* commerce (commerce crossing state lines) and international commerce, it has no jurisdiction over *intrastate* commerce (commerce occurring entirely within a single state). By the simple logic above, that means Congress cannot tax income from intrastate commerce.

> "*No interference by Congress with the business of citizens transacted within a state is warranted by the Constitution, except such as is strictly incidental to the exercise of powers clearly granted to the legislature*." [License Tax Cases, 72 U.S. 462 (1866)]

It is true that the opinions of the courts have fluctuated significantly on this, from saying that the power to tax requires the power to regulate, to saying that Congress may tax things it cannot regulate, provided that taxation does not amount to *regulation* under the guise of a "tax." But considering the massively complex "social engineering" in the income tax laws (punishing some behaviors and rewarding others) it would be difficult to argue that it would not constitute an attempt to regulate behavior.

However, the courts' position on the matter is ultimately irrelevant. Regardless of what the courts think Congress *could* tax, the statutes and regulations show what Congress *did* tax. Whether the courts think Congress has the constitutional power to tax the income of all Americans is only relevant if Congress attempts to *impose* such a tax, which has not occurred. (The courts cannot expand the scope of a tax just by saying that Congress *could* have taxed more if they had wanted to.)

Brief mention should be made of the 16th Amendment to the Constitution, since there is a common but erroneous belief that the 16th Amendment expanded Congress' power to tax incomes. The purpose of the 16th Amendment, according to the Supreme Court in Brushaber v. Union Pacific (240 U.S. 1), and again in Stanton v. Baltic Mining (240 U.S. 103) was to make it clear that the income tax is, and has always been, an indirect "excise" tax, which never required apportionment. The Secretary of the Treasury agreed with the Court in Treasury Decision 2303:

> "*The Sixteenth Amendment.* ***The provisions of the sixteenth amendment conferred no new power of taxation****, but simply prohibited* [Congress' original power to tax incomes] *from being taken out of the category of indirect taxation,* ***to which it inherently belonged****, and being placed in the category of direct taxation subject to apportionment.*" [Treasury Decision 2303]

An in-depth explanation of direct and indirect taxes, and how they must be imposed, is not necessary here. The only relevant point is that Congress' taxing jurisdiction was ***not*** expanded by the 16th Amendment.

(Question for Doubters #5: *Under Article I, Section 8 (first clause) of the Constitution, can Congress control anything and everything within the 50 states, provided that that control is exerted through tax legislation?*)

11) Exempt Income

The above issue of Constitutional limits on Congress' taxing power is ***not*** intended to dispute the constitutionality of the income tax. In fact, the opinion of this author, the readers, and even the courts regarding the question of taxing jurisdiction ends up being irrelevant in this case. The statutes of Congress, together with the regulations of the Secretary of the Treasury (which must also be approved by Congress), show that they believe their jurisdiction to tax incomes was limited to individuals involved in international and foreign commerce.

("International commerce" means trade which crosses country borders, such as income from *within* the United States going to **non**resident aliens. "Foreign commerce" means trade which happens entirely *outside* of the United States, such as a U.S. citizen working and getting paid in a foreign country, or in a federal possession.)

As discussed above, the regulations under 22(a) of the 1939 Code show that the meaning of "gross income" does not include income which is exempt by statute, or other income which is "*under the Constitution, not taxable by the Federal Government*." But, as stated before, the regulations must *specifically* inform the public of what is required, rather than leaving people to *guess* at what is Constitutionally taxable. The following is the first paragraph of the 1945 regulations under the section of statutes defining "gross income":

> *"39.22(a)-1* ***What included in gross income*** *(a) Gross income includes in general* [items of income listed] *derived from any source whatever,* ***unless exempt from tax by law****. See sections* ***22(b)*** *and 116.* [the regulations under the cited section states that some income **not** exempted by statute is "under the Constitution, not taxable by the Federal Government"] *In general,* ***income*** [not "gross income"] *is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.* ***Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income****; but special provisions are made for* ***nonresident aliens and foreign corporations*** *by sections 211 to 238, inclusive, and, in certain cases, by section 251, for citizens and domestic corporations* ***deriving income from sources within possessions*** *of the United States. Income may be in the form of cash or of property.*"

Keeping in mind the matter of taxing jurisdiction, it becomes clear that the Secretary of the Treasury in these regulations was informing the public of which matters are constitutionally taxable by the federal government. This list of taxable activities is completely absent from 22(a) of the 1939 *statutes*. As the Supreme Court has stated, "*the statute is to be read as though it in terms exclude*[s]" matters not within the constitutional power of the government to tax. At the same time, the *regulations* must give specifics to the public of what the law requires, and here they do so. Not surprisingly, the list of taxable activities in these regulations matches precisely those matters which the Constitution puts under federal jurisdiction (international and foreign commerce, and federal possessions).

Anyone claiming that this list of taxable activities is *not* exclusive (claiming instead that other types of income are also taxable) encounters a logical problem. One must then claim that the regulations specifically *say* that some income not exempt by statute *is* exempt under the Constitution, but that those regulations never give any indication as to *what* income is meant. If this list is *not* the explanation of what is constitutionally taxable, then no further explanation seems to exist (which would violate the requirement that the regulations specifically state what the law requires).

In addition, one would be hard pressed to explain why these regulations bother to specifically point out these taxable activities (when the statutes do not), if this is not a complete list of what the Secretary believed to be constitutionally taxable.

While the regulations specifically mention the Constitutional limitations, and the limits are to be *assumed* when reading the statutes, this is not to say that the statutes give no indication of the limited nature of the tax. While the general statutory definition of "gross income" by itself may be misleading, there is plenty of evidence in the statutes that shows that Congress knew the limits of its power, and stayed within those bounds. Most notably, the entire structure and contents of Subchapter N ("*Tax based on **income from sources** within or without the United States*") indicates that it is about international and foreign commerce.

12) Intent to Deceive

Following the current statutes and regulations, and arriving at the conclusion that most Americans do not receive taxable income, admittedly can be a somewhat complicated task. While the evidence speaks for itself, there is another factor that needs to be addressed to give credence to the conclusions of this report.

The taxable sources of income are listed in a part entitled "*miscellaneous matters*," buried deep in a confusing jumble of regulations where most tax professionals have never looked. Regardless of how solid the citations are supporting this claim, such a claim cannot be credibly made without also openly accusing the authors of the law of making a concerted effort to deceive the public. It would be absurd to claim that a law that is this difficult to decipher came about purely by accident. At the same time, an accusation that the lawmakers set out to deceive the public certainly requires supporting evidence. Such evidence is abundant.

There are many matters discussed previously in this report which would suggest an attempt to deceive. Did the authors not know that the phrase "*from whatever source derived*" would be read by most as meaning "no matter where it comes from"? Is it coincidence that the taxable "items" are listed near the very beginning of the law, but the taxable "sources" are not described until several *thousand* pages later? How did it happen that the list of taxable sources ended up under the unobtrusive heading "*miscellaneous matters*" in 26 CFR § 1.861-8(f)(1)? If the goal of the lawmakers was to convey the truth, the current statutes and regulations would ***not*** have been the result. The following is intended to expose efforts to conceal the truth (referred to below as "the Great Deception"), while having the law remain literally correct, as it must be.

Reviewing a situation at various points in time can be more informative than simply looking at the situation from one point in time. For example, if the license plate of a stolen car (but not the car itself) is found in a garage, that may not be conclusive evidence of a crime. However, a series of pictures taken over a period of days can be very telling; an empty garage one day, a car fitting the description of the stolen car in the garage the next day, a welding machine next to the car the next day, pieces of a car there the next day, etc.

Similarly, looking at "snapshots" of certain parts of the law at different times, seeing how they were reworded, rearranged, etc., can give a clearer picture of the Great Deception. While the current statutes and regulations certainly indicate intent to deceive, a longstanding and ongoing attempt to cover up the truth becomes apparent when tracing the law backwards in history.

13) Cover-Up of 1954

In 1954, the Code underwent a major rearranging and renumbering (and to some extent, rewording). This change-over did not substantially change the law itself, but simply rearranged it. While there have been several amendments, the current Code retains the same general structure, numbering and content of the 1954 Code. At the time of the 1954 "transformation" of the Code, several changes helped to conceal the truth about the limited application of the federal income tax.

As shown above, the regulations in 1945 specifically stated (twice) that some income not exempt by statute was nonetheless exempt from federal taxation because of the Constitution. The 1945 regulations under the definition of "gross income" began as follows:

> "*Sec. 29.22(a)-1. What included in gross income.*
> *Gross income includes in general* [items of income listed] *derived from any source whatever,* ***unless exempt from tax by law****."* [1945 regulations]

Those regulations then went on to explain that this refers to income exempt by statute or "*fundamental law*," meaning the Constitution. The current corresponding regulations begin in a similar manner:

> "*Sec. 1.61-1 Gross income. (a) General definition. Gross income means all income from whatever source derived,* ***unless excluded by law***." [26 CFR § 1.61-1]

However, no mention of the Constitution remains. The phrase "*unless excluded by* ***law***" is now read as being synonymous with "unless excluded by **statute**." The Constitutional limitations still apply (there have been no subsequent constitutional amendments relative to the taxing power), but the present regulations under 26 USC § 61 do not explicitly say that this is part of the "law" which exempts certain income. Instead, they use the general wording that leaves the reader free to assume that only income specifically exempted by *statute* is exempt from taxation.

But this was only one part of a major shift in the structure of the Great Deception that occurred in 1954. Prior to 1954, the regulations stated that "gross income" included everything not exempt, and then made clear that some types of income were not taxable by the federal government because of the Constitution. The regulations regarding "*What included in gross income*" then went on to say the following:

> "*Profits of citizens, residents, or domestic corporations derived from sales in* ***foreign commerce must be included in their gross income****; but special provisions are made for* ***nonresident aliens*** *and* ***foreign corporations****... and, in certain cases... for citizens and domestic corporations* ***deriving income from sources within possessions*** *of the United States.*"

This list of taxable activities is absent from the current regulations under 26 USC § 61. However, something very similar is found in the current regulations under Section 861. The regulations under Section 861 twice define the term "*class of gross income*," saying that a "*class of gross income*" "*may consist of one or more* ***items****… of gross income enumerated in* ***section 61***." The regulations then refer the reader to "*paragraph* ***(d)(2)*** *of this section which*

*provides that a **class of gross income** may include **excluded** income*." In other words, the "*items*" of income listed in Section 61 are not necessarily taxable, but may be "exempt" or "excluded" from the federal income tax. Paragraph (d)(2) states only "*[Reserved]*" (meaning there is no current regulation) but refers the reader to paragraph (d)(2) of the temporary regulations at 26 CFR § 1.861-8T. This section describes what is meant by exempt income.

> "*(ii) Exempt income and exempt asset defined--(A) In general. For purposes of this section, the term **exempt income** means any income that is, in whole or in part, **exempt, excluded, or eliminated for federal income tax purposes***."
> [26 CFR § 1.861-8T(d)(2)(ii)]

The section then goes on to specify what is not exempt. The following should be read carefully, since it starts with a double negative. If a certain kind of income is ***not** exempt*, it means it ***is*** subject to the federal income tax. Therefore, after being told that "*items*" of income (which make up "*classes of gross income*") may not be taxable, a list is given of the types of income which ***are*** subject to the federal income tax:

> "*(iii) Income that is **not** considered tax **exempt**. The following items are **not** considered to be **exempt**, eliminated, or excluded income and, thus, may have expenses, losses, or other deductions allocated and apportioned to them:*
> *(A) In the case of a **foreign** taxpayer…*
> *(B) In computing the combined taxable income of a **DISC or FSC**…*
> *(C) For all purposes under **subchapter N** of the Code… the gross income of a **possessions** corporation…*
> *(D) **Foreign earned income** as defined in **section 911** and the regulations thereunder…*"
> [26 CFR § 1.861-8T(d)(2)(iii)]

This is the entire list of non-exempt income. The idea that other types of income are also taxable (not exempt), despite not being listed, is contradicted by the regulations stating that paragraph (d)(2) "*provides that a **class of gross income*** [consisting of the "items" of income listed in 26 USC § 61] *may include **excluded** income*." Unless those types of income not listed are exempt, paragraph (d)(2) does **not** show that the "items" of income listed in Section 61 may be exempt. (A basic principle of law is that such a list is assumed to be exclusive and complete, unless a phrase such as "*including, but not limited to…*" is used.)

While it is arranged and worded differently, this list of non-exempt income is essentially the same as the regulations under the old statute defining "gross income." It lists foreign earned income of citizens, income from within possessions, and income of foreigners. But while the 1945 regulations listed these "non-exempt" activities under the regulations defining "gross income," they are currently buried in dozens of pages of less prominent regulations under 26 USC § 861. So while the 1945 statute and regulation defining "gross income" *by themselves* indicated the limited application of the law, the trail to find the truth in the current law is more involved (though the end conclusion is the same).

The basic shift in the Great Deception (in 1954) can be summed up as this: While the *older* version showed the limitations of the law in "step one" (the definition of "gross income"), the *current* statute and regulation defining "gross income" use the word "source" without further explanation, and *additional* steps must be followed to discover that the meaning of that term ("source") is determined by 26 USC § 861 and following, and related regulations.

Prior to 1954, the regulations did not say that Section 119 (predecessor to the current 861) and its regulations "determined the sources of income for purposes of the income tax." Instead, the regulations under 22(a) (defining "gross income") list the *exact same activities* as Section 119 when discussing income from *within* the United States. In effect, both the regulations defining "gross income," ***and*** Section 119 and related regulations "determined the sources of income for purposes of the income tax."

(The regulations defining "gross income" mention "***nonresident aliens*** *and* ***foreign corporations*** *by sections 211 to 237, inclusive, and, in certain cases, by* ***section 251*** *for citizens and domestic corporations deriving income from sources within* ***possessions*** *of the United States*." At the same time the regulations under 119 mention "***nonresident alien individuals***, ***foreign corporations***, *and citizens of the United States or domestic corporations entitled to the benefits of* ***section 251***.")

In 1954, the admission of the limited application vanished from the regulations defining "gross income," but remained in the regulations under 26 USC § 861, and (to maintain literal accuracy) the regulations began to say that 861 and following and related regulations "***determine the sources of income for purposes of the income tax***." This change removed any chance of the regulations under Section 61 raising suspicions.

(The way federal law works, there is no requirement that a section which *uses* a term point to where the definition or explanation of that term can be found. As ludicrous as it seems, it would be perfectly legal for Section 1 of some law to impose a tax "on the transfer of each automobile," and then have Section 14523(g)(4)(iii) say that "for the purposes of Section 1, the term 'automobile' means a blue Corvette owned by a foreigner." That is in essence how the Great Deception has been structured since 1954.)

While this makes the truth more difficult (but certainly not impossible) to demonstrate with the current statutes and regulations alone, in retrospect it strongly confirms the limited nature of the tax, by showing that while the structure of deception has changed, the conclusion remains the same.

But the regulations defining "gross income" were not the only place where the truth became less clear during the 1954 "transformation." When the statutes were being rearranged and renumbered, Section 119 of the 1939 Code became all of Part I of Subchapter N. The Senate report on the 1954 Code states the following:

"*SUBCHAPTER N - TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES*

PART I - Determination of Sources of Income

§ 861. Income from sources within the United States
§ 862. Income from sources without the United States
§ 863. Items not specified in section 861 or 862
§ 864. Definitions

These sections*, which are identical with sections 861-864 of the House bill,* ***correspond to section 119 of the 1939 Code****.* ***No substantive change is made****, except that section 861(a)(3) would extend the existing 90-day $3,000 rule in the case of a nonresident alien employee of a foreign employer to a nonresident alien employee of a foreign branch of a domestic employer*."

Congress here states that the application of the law *did not change* (except for the specific detail mentioned). As would be expected, the statutes are nearly identical.

Sec. 119. [1939 Code] ***Income from sources within the United States***
(a) Gross Income from Sources in United States.
The following items of gross income shall be treated as income from sources within the United States:...

Sec. 861 [current Code]***. Income from sources within the United States***
(a) Gross income from sources within United States
The following items of gross income shall be treated as income from sources within the United States:...

Section 119 of the old statutes and Section 861 of the current statutes use general terms that could easily be misread as applying to any income from within the United States. But while the statutes did not change, the honesty of the *regulations* corresponding to these sections changed dramatically. The older regulations admitted the truth so plainly and so often that no step-by-step explanation is needed. The following is the equivalent of the current 26 CFR § 1.861-1, *in its entirety*.

> "*Sec. 29.119-1.* ***Income from sources within the United States.***
> ***Nonresident alien individuals, foreign corporations****, and citizens of the United States or domestic corporations* ***entitled to the benefits of section 251*** [this applies only to those who receive a large percentage of their income from within federal possessions] *are taxable only upon income from sources within the United States. Citizens of the United States and domestic corporations* ***entitled to the benefits of section 251*** *are, however, taxable upon income* ***received*** *within the United States, whether derived from sources within or without the United States. (See sections 212(a), 231(c), and 251.)*
>
> *The Internal Revenue Code divides the income of* ***such taxpayers*** *into three classes:*
> *(1) Income which is derived in full from sources* ***within*** *the United States;*
> *(2) Income which is derived in full from sources* ***without*** *the United States;*
> *(3) Income which is derived* ***partly from sources within and partly from sources without*** *the United States.*
>
> *The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.*"

Note that the second paragraph in the old regulations under Section 119 states that the Code (specifically Section 119) is for determining taxable income of "***such taxpayers***," meaning those deriving income from specific taxable activities. The general language of the statutes is applicable *only* to those involved in certain types of international and foreign commerce.

The subsequent sections of the older regulations (like the current regulations) then deal with specific "items" of income. The sections of regulations following that (which correspond to the current 26 CFR § 1.861-8) then deal with determining taxable income from sources within the United States. Again, the regulations clearly show the limited application of the law.

> *"Sec. 29.119-9. Deductions in general.*
> *The deductions provided for in chapter 1 shall be allowed to* ***nonresident alien individuals*** *and* ***foreign corporations*** *engaged in trade or business within the United States, and to citizens of the United States and domestic corporations* ***entitled to the benefits of section 251****, only if and to the extent provided in sections 213, 215, 232, 233, and 251.*
>
> *Sec. 29.119-10. Apportionment of deductions.*
> *From the* ***items*** *specified in sections 29.119-1 to 29.119-6, inclusive, as being derived specifically from sources within the United States there shall, in the case of* ***nonresident alien individuals*** *and* ***foreign corporations*** *engaged in trade or business within the United States, be deducted* [allowable deductions]. ***The remainder shall be included in full as net income from sources within the United States****…"*

Regarding income from *within* the United States, the older regulations defining "*gross income*" describe the exact same taxable activities as the regulations of that time related to "*income from sources within the United States*" (namely, nonresident aliens and foreign corporations getting income from within the United States, and citizens and domestic corporations who receive much of their income from within federal possessions). "No substantive change" was made when Section 119 became Sections 861 and following, which implies that Section 119 and its regulations "*determine*[d] *the sources of income for purposes of the income tax*" (as the current regulations state). The older regulations did not need to say this, since the regulations defining "gross income" also specifically listed what activities could generate taxable income. So in 1945, the regulations defining "gross income" ***and*** the regulations under the old Section 119 "*determine*[d] *the sources of income for purposes of the income tax*." Today only the regulations under Section 861 list the taxable activities.

(There is a chart at the end of this report showing the outline and excerpts from Part I of Subchapter N and related regulations, and another chart showing the outline and excerpts from the corresponding statutes and regulations from before 1954.)

(Question for Doubters #6: *Do the older regulations under the predecessor of 26 USC § 861 show income of U.S. citizens living and working within the 50 states as taxable?*)

Can it be considered an accident that the current regulations are so overly-complex and confusing, while the older regulations blurted out the truth in plain English in the very first sentence? The fact that the statutes apply only to income from certain "specific sources" (relating to international and foreign commerce) is still stated in the current regulations, but rather than being in first sentence, it is buried deep in the jumbled mess:

> *"(ii) Relationship of sections 861, 862, 863(a), and 863(b). Sections* ***861, 862, 863(a), and 863(b)*** *are the four provisions applicable in* ***determining taxable income from specific sources****."* [26 CFR § 1.861-8(f)(3)(ii)]

In fact, even here it does not specify to which "*specific sources*" it is referring; the meaning of that term has to be discovered by searching elsewhere in the regulations. (Three other sections of the regulations say that "*specific sources*" means the taxable activities described in the "operative sections" throughout Subchapter N.) The regulations prior to 1954 were short, plain, and very clear about who they applied to. (While many tax professionals are now aware of the correct application of Section 861 and its regulations, it certainly is not evident at first glance.)

When the regulations changed in 1954, they did ***not*** change directly into what the regulations are today. The current maze of "*statutory groupings*," "*specific sources*," "*operative sections*," etc. did not come about until 1978. Of particular note is how the regulations in 26 CFR § 1.861-8 appeared just after the change in 1954, and how the corresponding regulations appeared prior to 1954. The wording was only very slightly changed, but gives one of the most obvious examples of intent to deceive.

BEFORE 1954

29.119-10 Apportionment of deductions.

From the **items specified in sections 29.119-1 to 29.119-6**, inclusive, as being derived specifically from sources within the United States there **shall, in the case of nonresident alien individuals and foreign corporations engaged in trade or business within the United States, be deducted** the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which cannot definitely be allocated to some item or class of gross income. **The remainder shall be included in full as net income from sources within the United States.** The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income.

Example. A **nonresident alien individual** engaged in trade or business within the United States whose taxable year is the calendar year derived gross income from all sources for 1942 of $180,000, including there-in:

Interest on bonds of a domestic corporation	$9,000
Dividends on stock of a domestic corporation	4,000
Royalty for the use of patents within the United States	12,000
Gain from sale of real property [in U.S.]	11,000
Total	36,000

[remainder of example omitted]

AFTER 1954

1.861-8 Computation of Taxable Income from Sources Within the United States

(a) General. From the **items of gross income specified in §§ 1.861-2 to 1.861-7**, inclusive, as being income from sources within the United States there **shall be deducted** the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which cannot definitely be allocated to some item or class of gross income. **The remainder, if any, shall be included in full as taxable income from sources within the United States.** The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income

Example. A **taxpayer** engaged in trade or business receives for the taxable year gross income from all sources in the amount of $180,000, one-fifth of which ($36,000) is from sources within the United States, computed as follows:

Interest on bonds of a domestic corporation	$9,000
Dividends on stock of a domestic corporation	4,000
Royalty for the use within the United States of patents	12,000
Gain from sale of real property [in U.S.]	11,000
Total	36,000

[remainder of example omitted]

The wording is nearly identical, except for two changes. The phrase stating that the whole section applies only to *nonresident aliens* and *foreign corporations* simply ***vanished***. In addition, while the specifics of the example in the regulation remained *identical*, the phrase "*a nonresident alien individual*" was replaced with "*a taxpayer*." As Congress stated, the application of the law ***did not change*** in 1954, but some key phrases in the regulations were removed so as to make the truth less obvious. A similar disappearance of a phrase occurred at the same time in the section of regulations dealing with the "item" of interest. The wording remained *identical* except for the disappearing phrase.

BEFORE 1954	**AFTER 1954**
29.119-2. Interest. There shall be included in the gross income from sources within the United States, **of nonresident alien individuals, foreign corporations, and citizens of the United States, or domestic corporations which are entitled to the benefits of section 251**, all interest received or accrued, as the case may be, from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except...	1.861-2 Interest. (a) General. There shall be included in the gross income from sources within the United States all interest received or accrued, as the case may be, from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except...

(Interest is the only "item" of income for which the regulations specifically mentioned who was receiving it. But the regulations cited above state that in the case of *all* of the "items" of income, the deductions and determination of taxable income can be done only by those engaged in the specific taxable activities.)

14) Other Cover-Ups

The current income tax is based upon the income tax of 1913. Though the original laws, and how they were portrayed to the public, were already deceptive, there are numerous examples, from the beginning of the tax up to today, of things being moved, reworded, renumbered and changed, in such a way to make the correct application of the laws more and more difficult to find.

1921

As shown above, some very telling phrases simply vanished from the regulations in 1954. But it was not only the regulations that lost some honesty along the way. The statutes found in the Revenue Act of 1921 show why the regulations said what they said up until 1954. But just as happened with the regulations, a telling phrase that existed in 1921 is no longer found in the statutes. The current Section 861 and its predecessors have remained basically the same for more than 70 years. The text begins "*The following items of gross income shall be treated as income from sources within the United States*:" The section then lists "items" of income (interest, dividends, compensation for labor, rents and royalties, etc.). In 1921 the section was very similar, but it began "*That* ***in the case of a nonresident alien individual or of a citizen entitled to the benefits of section 262****, the following items of gross income shall be treated as income from sources within the United States*:..."

(While Section 217 itself mentions only *individuals*, Section 232 of the Act states that "[i]*n the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in* ***section 217***." As the current regulations and historical regulations state, the section is applicable to nonresident aliens, foreign corporations, and citizen or domestic corporations which receive much of their income from within federal *possessions*.)

1921 Code	1939 Code	Current Code
Net income of nonresident alien individuals Sec. 217. (a) That **in the case of a nonresident alien individual or of a citizen entitled to the benefits of section 262**, *the following items of gross income shall be treated as income from sources within the United States*: (1) Interest... (2) The amount received as dividends... (3) Compensation for labor or personal services performed in the United States. (4) Rentals or royalties... (5) Gains, profits, and income from the sale of real property... - (b) From the items of gross income specified in subdivision (a) there shall be deducted [allowable deductions]. **The remainder, if any, shall be included in full as net income from sources within the United States.**	Sec. 119. Income from sources within United States (a) Gross income from sources in United States. *The following items of gross income shall be treated as income from sources within the United States*: (1) Interest... (2) Dividends... (3) Personal services - Compensation for labor or personal services performed in the United States... (4) Rentals and royalties... (5) Sale of real property... (6) Sale of personal property... - (b) Net income from sources in United States From the items of gross income specified in subsection (a) of this section there shall be deducted [allowable deductions]. **The remainder, if any, shall be included in full as net income from sources within the United States.**	Sec. 861. Income from sources within the United States (a) Gross income from sources within United States *The following items of gross income shall be treated as income from sources within the United States*: (1) Interest... (2) Dividends... (3) Personal services - Compensation for labor or personal services performed in the United States... (4) Rentals and royalties... (5) Disposition of United States real property interest... (6) Sale or exchange of inventory property... (7) Amounts received as underwriting income... (8) Social security benefits... - (b) Taxable income from sources within United States From the items of gross income specified in subsection (a) as being income from sources within the United States there shall be deducted [allowable deductions]. **The remainder, if any, shall be included in full as taxable income from sources within the United States**....
(c) The following items of gross income shall be treated as income from sources **without** the United States:... - (d) From the items of gross income specified in subdivision (c) there shall be deducted [allowable deductions]. **The remainder, if any, shall be treated in full as net income from sources without the United States**.	(c) Gross income from sources **without** United States The following items of gross income shall be treated as income from sources **without** the United States:... - (d) Net income from sources without the United States - From the items of gross income specified in subsection (c) of this section there shall be deducted [allowable deductions]. **The remainder, if any, shall be treated in full as net income from sources without the United States**.	Sec. 862. Income from sources **without** the United States (a) Gross income from sources without United States The following items of gross income shall be treated as income from sources **without** the United States:... - (b) Taxable income from sources without United States - From the items of gross income specified in subsection (a) there shall be deducted [allowable deductions]. **The remainder, if any, shall be treated in full as taxable income from sources without the United States**...
(e) Items of gross income, expenses, losses and deductions, **other than those specified in subdivisions (a) and (c)**, shall be allocated or apportioned to sources within or without the United States...	(e) Income from sources partly within and partly without United States Items of gross income, expenses, losses and deductions, **other than those specified in subsections (a) and (c)** of this section, shall be allocated or apportioned to sources within or without the United States... (f) Definitions...	Sec. 863. Special rules for determining source (a) Allocation under regulations Items of gross income, expenses, losses, and deductions, **other than those specified in sections 861(a) and 862(a)**, shall be allocated or apportioned to sources within or without the United States... Sec. 864. Definitions and special rules... Sec. 865. Source rules for personal property sales...

Although it is obvious to whom this section applied in 1921, some may question whether this is at all relevant to current law. Treasury Decision 8687, in discussing what the regulations under the *current* 26 USC § 863 should say (regarding sales of natural resources), specifically refer to Section 217 of the 1921 Code in trying to determine the "legislative intent" of Congress.

> "*The legislative history to section 863's predecessor, section **217**(e) of the **Revenue Act of 1921**, also reflects an intention that...*" [Treasury Decision 8687]

This Treasury Decision, passed in late ***1996***, confirms that Section 217 of the Revenue Act of 1921 is the predecessor of the current Part I of Subchapter N, and shows that the IRS still refers to the 1921 Code to determine the proper application of the *current* Code. The Internal Revenue Manual shows that the courts, as well as the IRS, considers legislative history when determining the correct application of the law.

> "*The courts give great importance to the literal language of the Code but the language does not solve every tax controversy. **Courts also consider the history of a particular code section**...*" [Internal Revenue Manual, (4.2)7.2.1.1]

When the phrase disappeared from the statutes after 1921, the application of the law did not change. What changed was how easily the truth could be found.

1978

In 1978, the wording of 26 CFR § 1.861-8 was changed significantly, and the title was changed from "*Computation of Taxable Income from Sources Within the United States*" to "*Computation of taxable income from sources within the United States **and from other sources and activities***." Some have suggested that the current title implies that one should not be using this section unless he has income *both* from within the United States *and* from "other sources and activities." The older title, as well as the text of the current regulations, shows that this is not the case.

In addition to the title change, the section also went from less than one page in length to more than ***forty*** pages, with the appearance of the current maze of "*operative sections*," "*statutory groupings*," "*specific sources*," etc. There were no significant changes in the statutes in 1978 that would explain this sudden expansion of the related regulations. This sudden explosion in size and complexity of these regulations seems to serve no purpose other than to confuse matters and obfuscate the truth.

1988

Prior to 1988, the title of Part I of Subchapter N (which begins with Section 861) was "*Determination of sources of income*" (which is still the heading of the related regulations). In 1988, this title was changed to "*Source rules and other general rules relating to **foreign** income*." It should be mentioned that while titles of parts may give an indication of what the part is about, the title has no effect on the actual legal application.

"*...nor shall any **table of contents**, table of cross references, or similar outline, analysis, or **descriptive matter** relating to the contents of this title **be given any legal effect**.*"
[26 USC § 7806(b)]

So when the title was changed (but the text of the law was not), the application of the law did *not* change. What changed was the appearance of the table of contents. Prior to the change, in light of the fact that the income tax applies to "***income*** *from whatever* ***source*** *derived*," the table of contents made the relevance of 26 USC § 861 obvious:

Subtitle A, "*Income taxes*"
Chapter 1, "*Normal taxes and surtaxes*"
Subchapter N, "*Tax based on income from sources within or without the United States*"
Part I, "***Determination of sources of income***"
Section 861, "*Income from sources within the United States*"
(a) "*Gross income from sources within the United States*"
(b) "*Taxable income from sources within the United States*"

When the title of Part I was changed, and the new title stated that the part was about "***foreign** income*," it no longer appeared to be an obvious place for most people to look when determining their taxable income. This would certainly have the effect of drawing attention away from Section 861. Many tax professionals concede that Section 861 and the related regulations show income to be taxable only when it comes from certain activities related to international and foreign commerce. The new title gives the appearance that the part has no relevance to most people, and should not even be examined.

But this change resulted in a curious situation: a part whose title says it is about "***foreign** income*" is identified as the part which (along with the related regulations) "*determine*[s] *the sources of income for purposes of the income tax*."

1995

The Paperwork Reduction Act of 1980 requires that every form used by the federal government to collect information from the public first be approved by the Office of Management and Budget ("OMB"). The regulations at 26 CFR § 602.101 contain a table listing the OMB-approved forms for each section of regulations. The regulations at 26 CFR § 1.1-1 are entitled "*Income tax on individuals*," and correspond to 26 USC § 1 (which imposes the "income tax"). Up until 1995, the first line in this table identified Form 2555, "***Foreign Earned Income***," as the only approved form under 26 CFR § 1.1-1. In 1995, after many "tax resistance" groups had become aware of this, the listing for "1.1-1" was removed from the list, in order to avoid "confusion," according to the Department of the Treasury. The process of applying for, and receiving OMB approval for a form makes the possibility of an error extremely remote. The Department of the Treasury *requested* that Form 2555 be approved for 1.1-1, and the Office of Management and Budget *approved* it. When the entry drew too much attention, it was removed. At present no forms are approved for use with 26 CFR § 1.1-1.

15) Clues and Hints

There are numerous other bits of information that hint at the correct application of the law, a few of which are included here as supporting evidence.

On the Record

As the Supreme Court and the Secretary of the Treasury have repeatedly stated, the federal income tax is (and has always been) an indirect excise tax. Excises, generally speaking, are taxes imposed on certain activities or privileges. In light of this, there are some interesting comments in the Congressional Record from March 27, 1943 (page 2580). A statement is included by a "*Mr. F. Morse Hubbard, formerly of the legislative drafting research fund of Columbia University, and a former* ***legislative draftsman*** *in the Treasury Department*" (clearly someone whose job would require a comprehensive understanding of the proper application of the law). His comments include the following:

> "*The income tax is, therefore,* ***not*** *a tax on* ***income*** *as such. It is an* ***excise*** *tax with respect to* ***certain activities and privileges*** *which is measured by reference to the income which they produce. The* ***income is not the subject of the tax****: it is the basis for determining the amount of the tax.*"

The income tax is imposed on "***income*** *from whatever* ***source*** *derived*" (minus deductions). The mere receipt of income, by itself, is *not* (and could not be) the subject of this excise tax. It is the "*source*" which is the subject of the tax, and the amount of income received from that "*source*" is what is used to determine the amount of tax due. The above citations coincide well with the fact that the section of regulations for determining taxable income (26 CFR § 1.861-8) states that it applies only to income "***from specific sources and activities***." And the statutes and regulations under the part which "*determine*[s] *the* ***sources*** *of income* ***for purposes of the income tax***" all apply only to these same "*specific sources and activities*," which are all related to international or foreign commerce.

Section 306

Section 306 of the statutes deals with individuals receiving income from selling certain stocks. After dealing with the income itself, the section discusses the "source" of income.

> "*Sec. 306. Dispositions of certain stock*
> *(a) General rule*
> *If a shareholder sells or otherwise disposes of section 306 stock…*
> *(1) Dispositions other than redemptions -*
> *If such disposition is not a redemption…*
> *(A) The amount realized shall be treated as* ***ordinary income****…*
> *(f)* ***Source*** *of gain - The amount treated under subsection (a)(1)(A) as ordinary income shall,* ***for purposes of part I of subchapter N (sec. 861 and following, relating to determination of sources of income)****, be treated as derived from the same source as would have been the source if money had been received from the corporation as a dividend at the time of the distribution of such stock. If under the preceding sentence* ***such amount is determined to be derived from sources within the United States****, such amount shall be considered to be fixed or determinable annual or periodical* ***gains, profits, and income within the meaning of section 871(a) or section 881(a)****, as the case may be.*" [26 USC § 306(f)]

The section states that if the income comes from "sources within the United States," then it constitutes "gains, profits, and income" under Section 871(a) or 881(a). Sections 871 and 881 deal exclusively with nonresident aliens and foreign corporations, respectively (both are found in Part II of Subchapter N, "*Nonresident aliens and foreign corporations*"). The wording of Section 306 implies that if the income in question comes from "sources within the United States," then it must apply to one of these sections. If a citizen living and working in the United States receives the type of income dealt with in Section 306, and believes it constitutes "income from sources within the United States," halfway through the last sentence the reader is left in limbo. The sentence structure is "if A, then B." Using the usual overly-broad interpretation of the Code, if a ***citizen*** receives income from the type of stock mentioned from "sources within the United States," then that income "*shall be considered to be*" taxable for ***nonresident aliens*** or ***foreign corporations***. A contradiction exists, *unless* one realizes that the term "sources of income" has a restricted meaning, which in this case would apply only to foreigners.

Strange Links

In various sections of the statutes, Section 911 is referenced where it does not seem to fit in (if one accepts the common, overly-broad interpretation of the Code). One example exists in Section 1 itself (the section imposing the income tax on individuals). Subsection (g) of Section 1 deals with certain income of children being treated as income of that child's parents, and shows that the term "earned income" is defined in 26 USC § 911(d)(2).

> *"(g) Certain unearned income of minor children taxed as if parent's income…*
> *(4) Net unearned income*
> *For purposes of this subsection--*
> *(A) In general*
> *The term "net unearned income" means the excess of--*
> *(i) the portion of the adjusted gross income for the taxable year which is not attributable to* ***earned income*** *(****as defined in section 911(d)(2)****)…*" [26 USC § 1(g)]

This section (26 USC § 1(g)) is referred to later in Section 59(j), and Section 911(d)(2) is again mentioned as the section which defines "earned income." Other sections, such as 26 USC § 66(d) and 26 USC § 469(e), also refer to Section 911(d)(2) for the definition of "earned income." There is nothing peculiar about the definition in 26 USC § 911(d)(2) itself, which states:

> *"(d) Definitions and special rules*
> *For purposes of this section--*
> *(2)* ***Earned income***
> *(A) In general*
> *The term "****earned income****" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include…*" [26 USC § 911(d)]

What is interesting is the location of the definition:

Subchapter N -- Tax based on income from sources within or without the United States
*Part III -- Income from sources **without** the United States*
*Subpart B -- **Earned income of citizens or residents of United States***
Sec. 911**. Citizens or residents of the United States **living abroad

While it is true that the location of such a definition does not legally change the meaning of the definition, it is still somewhat telling that the definition is found in Subchapter N, rather than in Subchapters A and B (which impose the tax, and define "gross income" and "taxable income"). It is also telling that the definition itself (even though the definition is also "borrowed" by other sections) says that the definition is "*for purposes of this section*," meaning Section 911, which deals exclusively with the "*foreign earned income*" of United States citizens.

Another strange connection occurs in the section regarding "community income," which comes shortly after Section 63 defining "taxable income."

"*Sec. 66. Treatment of community income*
(a) Treatment of community income where spouses live apart
If- (1) 2 individuals are married to each other…;
(2) such individuals-- (A) live apart… (B) do not file a joint return…;
(3) one or both of such individuals have earned income for the calendar year which is community income; and
(4) no portion of such earned income is transferred (directly or indirectly) between such individuals before the close of the calendar year,
*then, **for purposes of this title**, any community income of such individuals for the calendar year shall be treated in accordance with the **rules provided by section 879(a)**."* [26 USC § 66]

Note that this is giving the rules applicable to all of Title 26 regarding "community income." But the section it refers to for such rules reads:

"*Sec. 879. Tax treatment of certain community income **in the case of nonresident alien individuals***
*(a) General rule - In the case of a married couple 1 or both of whom are **nonresident alien** individuals and who have community income for the taxable year, such community income shall be treated as follows:…*" [26 USC § 879(a)]

The text here specifically states that it applies only where one or both are nonresident aliens. To use the same rules for two citizens of the United States, Section 66 would have to say something similar to "shall be treated in accordance with the rules provided by 879(a) regarding nonresident aliens, notwithstanding the fact that the individuals may be citizens or residents of the United States." But it says no such thing, implying that "community income" applies only if at least one partner is a nonresident alien.

Following Instructions

Form 1040 is divided into several categories, such as personal information, "*Filing Status*," "*Exemptions*," "*Income*," etc. In the instruction booklet for that form, there is a section that gives line-by-line instructions. The general category of "Income" begins:

> "***Foreign-Source*** *Income*
>
> *You* ***must report*** *unearned income, such as* ***interest***, ***dividends***, *and pensions, from sources* ***outside the United States*** *unless exempt by law or a tax treaty. You* ***must also report*** *earned income, such as* ***wages*** *and tips, from sources* ***outside the United States***.
>
> *If you worked abroad, you may be able to exclude part or all of your earned income. For details, see Pub. 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad, and Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.*
>
> *Community Property States... **
>
> *Rounding Off to Whole Dollars...*" [1996 Instruction Booklet for Form 1040]

(* - This concerns "*community income*," which is dealt with above. This would apply only to a United States citizen married to a nonresident alien.)

That is all it has to say about the general subject of income. The booklet then tells where the listed "*items*" (interest, dividends, wages, etc.) should be entered on Form 1040. While there is a statement specifically saying that "*you must report*" these items if from sources ***outside*** the United States, there is no statement that these items must be reported if they come from within the United States.

This admission in the booklet is very easy for most readers to simply disregard as irrelevant to them. If there was the need to say that foreign-source income ***must*** be reported, why was there no need to say that any *other* income must be reported? Why did the statement not say that foreign source income "as well as domestic income" must be reported? One is left free to make the incorrect assumption that all income must be reported, when this is not the case.

A similar situation exists with IRS Publication 525, "*Taxable and Nontaxable Income*." The first thing this publication says concerning taxes, which appears on the *cover*, is:

> "*Important Reminder*
> ***Foreign Source Income***
> *If you are a U.S. citizen, you* ***must report*** *income from sources* ***outside*** *the United States (foreign income) on your tax return unless it is exempt by U.S. law.*"

Then, in the introduction (which follows the above "reminder"), the publication states that the publication "*discusses many kinds of* ***income*** *and explains whether they are taxable or nontaxable*." Other than the "foreign source income" reminder, the publication deals only with "*items*" of income, not "*sources*." Again, one is left free to *assume* that income from within the United States is taxable to U.S. citizens, but it is not stated.

Treasury Decision 2313

The Supreme Court's decision in the Brushaber case in 1916 (240 U.S. 1) is often cited by the IRS as demonstrating that the income tax is Constitutional (which it is, *because* of its very limited legal application). What the IRS fails to mention, and what is not apparent from looking at the court's ruling in the case, is that the case concerned income from within the United States accruing to a ***nonresident alien***, which *is* subject to the income tax. Treasury Decision 2313 makes this apparent.

> "*Under the decision of the Supreme Court of the United States in the case of Brushaber v. Union Pacific Railway Co., decided January 24, 1916, it is hereby held that income accruing to* ***nonresident aliens*** *in the form of* ***interest*** *from the bonds and dividends on the stock of* ***domestic corporations*** *is subject to the income tax imposed by the act of October 3, 1913.*" [Treasury Decision 2313]

Note how in this case an "*item*" of income (interest) is subject to the income tax when paid to *nonresident aliens*, because that is one of the legal "*sources*" of taxable income. The decision also states a proper use of Form 1040.

> "*The responsible heads, agents, or representatives of* ***nonresident aliens****, who are in charge of the property owned or business carried on* ***within*** *the United States,* ***shall make a full and complete return of the income therefrom on Form 1040****, revised, and shall pay any and all tax, normal and additional, assessed upon the income received by them in behalf of their* ***nonresident alien*** *principals.*" [Treasury Decision 2313]

While this in itself does not prove that Form 1040 should not be used in any other situation, something telling appears later in the decision. Speaking of the responsibility of fiduciaries of domestic entities, it states:

> "[W]*hen there are two or more beneficiaries,* ***one or all of whom are nonresident aliens****, the fiduciary shall render a return on Form 1041, revised, and a personal return on* ***Form 1040****, revised,* ***for each nonresident alien*** *beneficiary.*"

This both implies that a Form 1041 is not required if there are no nonresident alien beneficiaries (only citizens and residents), as well as implying that a Form 1040 is not to be issued for the citizen and resident beneficiaries.

Other Clues

As mentioned above, the only form ever approved for use with section 26 CFR § 1.1-1 of the regulations (under the Paperwork Reduction Act) was Form 2555, "*Foreign Earned Income*." In addition, the only form approved by the Office of Management and Budget for 26 CFR § 1.861-2 and -3 (which deal with interest and dividends from within the United States) is Form 1040NR, "*U.S.* ***Nonresident Alien*** *Income Tax Return*." Similarly, the only form approved under 26 CFR § 1.861-8 itself is Form 1120-F, "*U.S. Income Tax Return of a* ***Foreign Corporation***."

Below each section of regulations in the CFR there is a citation of the legal authority under which the regulations are made. The statutory authority for 26 CFR § 1.861-8 is listed as 26 USC § 7805 (which is the general rule-making authority for the Secretary, as shown in the first citation of this report), as well as 26 USC § 882(c), which reads:

> "*Tax on income of **foreign corporations** connected with United States business…*
> *(c) Allowance of deductions and credits*
> *(1) Allocation of deductions*
> *(A) General rule... the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in **regulations prescribed by the Secretary**.*" [26 USC § 882(c)]

This matches the fact that only the income tax return for a *foreign corporation* has been approved for use with this section of regulations by the OMB. The newer, temporary regulations in 26 CFR § 1.861-8T cite no *statutory* authority, but instead cite Treasury Decision 8228, which states that the authors of the regulation both work in the "*Office of the Associated Chief Counsel (**International**).*" The scope of the regulations is identified in the first paragraph of Treasury Decision 8228:

> "*Summary: This document provides temporary Income Tax Regulations relating to the allocation and apportionment of interest expense and certain other expenses for purposes of the **foreign tax credit** rules and certain other **international tax provisions**.*" [Treasury Decision 8228]

So the authorities cited as the legal basis for the regulations for "*determining taxable income from sources within the United States*" (temporary and final) show that the regulations are about *international* commerce.

Another legal resource which demonstrates the true applicability of the "income tax" is the annotated index of the United States Code. While there are different versions which vary somewhat in exact wording, under "*Income tax, citizens,*" only things such as citizens "*living abroad*" or "*about to depart from U.S.*" are listed.

Both the indexes and the contents of "Internal Revenue Bulletins" (which contain rulings and decisions by the IRS regarding interpretation of the law) reinforce the conclusions of this report. For example, the 1957-1960 cumulative bulletin has nine listings under "Citizens," every one of which deals with citizens being *outside* of the United States. This same bulletin, under "*Income - Source,*" has **35** listings, all of which deal with specific issues related to *international* commerce, with one exception; and that exception again reinforces the significance of Part I of Subchapter N, and the related regulations:

> "***Within and without United States; determination**. - Rules are prescribed for **determination of gross income and taxable income** derived from sources within and without the United States... §§ **1.861-1 through 1.864**. (Secs. **861-864**; '54 Code) T.D. 6258, C. B. 1957-2, 368.*"

The bulletins show similar patterns year after year, from 1913 (when the basis of the current federal income tax was written) to the present.

Another resource which indicates the true nature of the "income tax" is the Internal Revenue Manual, which is the instruction manual for all divisions of the Internal Revenue Service. The Criminal Investigation Division of the IRS is the division which deals with criminal violations of the federal "income tax" laws, including tax evasion and failure to file a return. Section 1132.55 of the Internal Revenue Manual (entitled "*Criminal Investigation Division*") begins as follows:

> "*The Criminal Investigation Division enforces the criminal statutes applicable to* ***income****, estate, gift, employment, and excise tax laws… involving* ***United States citizens residing in foreign countries*** *and* ***nonresident aliens*** ***subject to Federal income tax filing requirements****…*" [IRM, Section 1132.55 (1991 Ed.)]

Similarly, the federal regulations found in 26 CFR § 601.101(a) describe in general the functions of the Internal Revenue Service. The only specific mention in these regulations of who or what is subject to taxes administered by the Internal Revenue Service reads as follows:

> "*The Director, Foreign Operations District, administers the internal revenue laws applicable to taxpayers* ***residing or doing business abroad****,* ***foreign*** *taxpayers deriving income from sources within the United States, and taxpayers who are required to withhold tax on certain payments to* ***nonresident aliens and foreign corporations****…*" [26 CFR § 601.101(a)]

In keeping with the deceptive structure used throughout the statutes and regulations, the reader is left to *assume* that some other matters are also under IRS jurisdiction, but nothing else is specifically mentioned.

16) The Other Side

As most tax professionals believe that most Americans have taxable income, their position regarding Section 861 and other matters should be explained. The incorrect readings of Section 861, and related regulations, fall into two main categories. The two approaches are in direct conflict with each other, and both approaches are provably incorrect.

Pay No Attention

The first erroneous "interpretation" which tax professionals have regarding Section 861 is that it is entirely irrelevant to most people, and should therefore be ignored by most people. This approach rests on the misreading of "*from whatever source derived*" (as used in 26 USC § 61) to mean "no matter where it comes from." This interpretation requires the reader to ignore all of the evidence presented in part 4 ("Sources of Income") and part 5 ("Determining Taxable Income") of this report; most notably, the sections of regulations which state that Section 861 and following, and the regulations thereunder, "*determine the sources of income for purposes of the income tax,*" and the sections which state that "*determining taxable income from sources within the United States*" is to be done using 26 USC § 861(b) and 26 CFR § 1.861-8.

This position is the result of backwards logic. The tax professionals start with the incorrect *assumption* that most people receive taxable income. Therefore, when they discover that (for example) 26 CFR § 1.861-8 does ***not*** show most income to be taxable income, they incorrectly conclude (based on a false premise) that that section should not be used by most people, even though the regulations clearly state otherwise. This is usually stated as "that section doesn't apply to you." The following analogy demonstrates the logical flaw with this half-truth.

As shown above (see "*English vs. Legalese*"), one section of the statutes of Subtitle E states that the Secretary shall maintain a central registry of "*all firearms*." But a separate section defines the term "*firearm*," and the legal meaning is far more restrictive than the meaning of the word in common English. For example, a basic hunting rifle is obviously a "firearm" in common English, but is ***not*** considered a "firearm" for purposes of Section 5841. An individual who owns one hunting rifle could, therefore, correctly state that Section 5841 does not impose any obligation on him.

Now imagine someone arguing to him the following: "The definition of 'firearms' **doesn't apply** to your firearm, so you should just ignore the definition in Section 5845. Just look at Section 5841, where it says 'all firearms.' That includes your rifle." Such an argument would be ludicrous, and yet this is precisely the logic (or lack of logic) used by the tax professionals regarding 26 USC § 861.

Section 61 defines "*gross income*" generally as "*all income from whatever **source** derived*," and Part I of Subchapter N (Section 861 and following) and related regulations "*determine the **sources** of income **for purposes of the income tax***." Many tax professionals will argue that Section 861 "**doesn't apply**" to most people, and therefore most readers should *ignore* the sections which "*determine the sources of income for purposes of the income tax*." This is entirely illogical, but it is the only way for the tax professionals to avoid coming face-to-face with their monumental error. Contrary to the evidence, they continue to claim that most citizens receive taxable income.

The main citation used in an attempt to justify this misinterpretation is found in the regulations related to Section 1 of the statutes (which imposes the income tax).

> "*Sec. 1.1-1 **Income tax on individuals**.*
> *(a) General rule. (1) Section 1 of the Code imposes an income tax on the income of **every individual who is a citizen or resident of the United States** and, to the extent provided by section 871(b) or 877(b), on the income of a nonresident alien individual… The tax imposed is upon **taxable income** (determined by subtracting the allowable deductions from **gross income**).*
> *(b) Citizens or residents of the United States liable to tax. In general, **all citizens of the United States, wherever resident**, and all resident alien individuals are liable to the income taxes imposed by the Code whether the income is received from **sources within or without the United States**.*" [26 CFR § 1.1-1]

This section is a masterpiece of deception. While being literally correct (as the law must be), it is likely to give the wrong impression. Stating that a tax is imposed "*on the income of every individual who is a citizen or resident*" of the U.S. gives the impression that all income of these individuals is taxable. But anyone even slightly familiar with tax law knows this is *not* the case. The section goes on to specify that the tax is not on all income, but on "*taxable income*" (which is "*gross income*" minus deductions). As shown above, 26 CFR § 1.861-8 is the section for determining "*taxable income*" from within the United States. The language could just as easily (and just as correctly) stated that "everyone on earth, no matter where he is and no matter where his income comes from, is taxable upon his taxable income." The meaning of the statement is, of course, totally dependent upon the meaning of "taxable income."

Subsection "(b)" also gives a false impression at first glance, while being literally correct. It doesn't matter where someone lives, provided that he receives income from "*sources*" within or without the United States. And Part I of Subchapter N and related regulations "*determine the **sources** of income for purposes of the income tax*."

It is a word game, where what may be *inferred* differs from what is actually *stated*. If someone does not have "*taxable income*," and if someone does not receive "*income from sources*" (as defined by law), then 26 CFR § 1.1-1 becomes irrelevant. Nothing in the section has any effect on the legal meaning of "taxable income" or "sources of income." Instead, the section uses these terms in a context which makes them sound less restricted.

(As a reminder, the only form ever approved for use with the above regulations under the Paperwork Reduction Act was Form 2555, "*Foreign Earned Income*.")

The predecessors of the current regulations were worded slightly differently.

> "*19.11-1 **Income tax on individuals***
> *Chapter 1 of the Internal Revenue Code* [*]... ***imposes an income tax on individuals**, including a normal tax (section 11), a surtax (section 12), and a defense tax* [*]... *The tax is upon **net income** which is determined by subtracting the allowable deductions from the **gross income**. (See generally 21 to 24, inclusive.)*"

[* - Words omitted related only to which years the law was applicable.]

> "*19.11-2 Citizens or residents of the United States liable to tax*
> *In general, citizens of the United States, **wherever resident**, are liable to the tax, and **it makes no difference that they may own no assets within the United States and may receive no income from sources within the United States**. Every resident alien individual is liable to the tax, even though his income is **wholly from sources outside the United States**.*"

The wording of these regulations (from 1945), while deceptive, does not give quite as persuasive a deception as the current regulations. The only solid conclusion which can be inferred from these older regulations is that income from *outside* of the United States can be taxable to United States citizens and residents.

Section 861 Issues

The second erroneous "interpretation" which tax professionals have regarding Section 861 is that it is relevant to everyone, but that it *does* show the income of most people to be taxable. This is due in large part to the general language used in Section 861, which reads:

> "***Sec. 861. Income from sources within the United States***
> *(a) Gross income from sources within United States*
> *The following items of gross income* ***shall be treated as income from sources*** *within the United States: (1) Interest - Interest from the United States... (2) Dividends... (3) Personal services - Compensation for labor...*" [26 USC § 861]

(Interestingly, most tax professionals are aware that the application of this section is *not* as broad as it appears to be at first glance.)

As shown above, this section of the statutes applies only in determining taxable income from "specific sources," which are all related to international and foreign commerce. The history of the regulations and statutes, as shown above, make this point clear. However, certain sections of the regulations (taken out of context) are used to try to support the claim that the tax is not limited to the "specific sources."

(The entire issue of "residual groupings" mentioned below is settled easily using the older regulations, but for the sake of completeness it will also be dealt with using the *current* regulations. The following explanation deals with an issue intended to be confusing; it is included for the purpose of being thorough in documenting and refuting anything likely to be used to try to refute the conclusions of this report.)

The regulations define a "statutory grouping" of gross income as income from a specific source, while "residual grouping of gross income" means income from anywhere else.

> "*…the term 'statutory grouping of gross income' or '****statutory grouping****' means the gross income from a* ***specific source*** *or activity... (See paragraph (f)(1) of this section.)* ***Gross income from other sources or activities is referred to as the 'residual grouping of gross income' or '<u>residual grouping</u>.'***" [26 CFR § 1.861-8(a)(4)]

The argument is that income from somewhere other than the "specific sources" may also be taxable. The idea is that "gross income" must constitute "taxable income" (after deductions are subtracted), since the definition of "taxable income" is "gross income" minus deductions. However, the regulations often use the term "gross income" in a more general way, meaning any income, whether taxable or not. In fact, the regulations specifically state that the "*residual grouping*" may be <u>excluded</u> from federal taxation.

> "*…the residual grouping may include, or consist entirely of,* ***<u>excluded income</u>****. See* ***<u>paragraph (d)(2)</u>*** *of this section with respect to the allocation and apportionment of deductions to excluded income*." [26 CFR § 1.861-8(a)(4)]

A clear example of tax-exempt income being referred to as "gross income" in a "residual grouping" is shown below. As stated in 26 USC § 882(a)(2), foreign corporations are only taxable on "*gross income which is effectively connected with the conduct of a trade or business* ***within*** *the United States*." The following example therefore shows that any regulation which discusses "gross income" (not "taxable income") from the "residual grouping" in no way shows that the residual grouping must be taxable.

> "*(iii) Apportionment Since X is a* ***foreign corporation****, the* ***statutory grouping is gross income effectively connected with X's trade of business in the United States****, namely gross income from sources within the United States, and the* ***residual grouping*** ***is gross income not effectively connected with a trade or business in the United States****, namely gross income from countries A and B.*" [26 CFR § 1.861-8(g), Example 21]

The fact that the regulations refer to income as "gross income" does not mean it is taxable. In discussing an item of income, the regulations state the following:

> "***Gross income*** *from sources within the United States includes compensation for labor or personal services performed in the United States...*" [26 CFR § 1.861-4]

In the generic sense, compensation for labor within the United States is "gross income." However, as the current regulations repeatedly explain, it can only be "taxable income" if it comes from a "specific source." The older regulations dealt with this "item" of income in a very similar way, and the context of the surrounding regulations made it perfectly clear in what situations this "item" could be taxable.

> "*Sec. 29.119-1. Income from sources within the United States.*
> ***Nonresident alien individuals****,* ***foreign corporations****, and citizens of the United States or domestic corporations* ***entitled to the benefits of section 251*** *are taxable only upon income from sources within the United States...*
>
> *The Internal Revenue Code divides the income of* ***such taxpayer*** *into three classes:*
> *(1) Income which is derived in full from sources within the United States;*
> *(2) Income which is derived in full from sources without the United States;*
> *(3) Income which is derived partly from sources within and partly from sources without the United States...*
>
> *Sec. 29.119-2. Interest...*
> *Sec. 29.119-3. Dividends...*
> *Sec. 29.119-4.* ***Compensation for labor or personal services****. - Except as provided in section 119(a)(3),* ***gross income from sources within the United States includes compensation for labor or personal services*** *performed within the United States...*
> *Sec. 29.119-5. Rentals and royalties...*
> *Sec. 29.119-6. Sale of real property...*
>
> *Sec. 29.119-10. Apportionment of deductions.*
> *From the* ***items*** ***specified in sections 29.119-1 to 29.119-6****, inclusive, as being derived specifically from sources within the United States there shall,* ***in the case of nonresident alien individuals and foreign corporations*** *engaged in trade or business within the United States, be deducted* [allowable deductions]. *The remainder* ***shall be included in full as net income*** *from sources within the United States...*"

The fact that income is referred to in the regulations as "gross income" certainly doesn't mean it is taxable. In fact, after stating that the "residual grouping of **gross income**" may or may not be taxable, the regulations refer the reader to "*paragraph (d)(2)*" regarding "excluded income." As shown above, the only types of income listed as not exempt are:

"*(A) In the case of a **foreign** taxpayer…*
*(B) In computing the combined taxable income of a **DISC or FSC**…*
*(C) For all purposes under **subchapter N** of the Code… the gross income of a **possessions** corporation…*
*(D) **Foreign earned income** as defined in **section 911** and the regulations thereunder…*"
[26 CFR § 1.861-8T(d)(2)(iii)]

Deductions must be divided between the "statutory grouping" (income from a specific source) and the "residual grouping" (income from anywhere else). This does not mean that the "residual grouping" is taxable. The regulations show in several places that there must be an "operative section" which applies in order to determine taxable income.

"*A taxpayer to which this section applies is required to allocate deductions to a class of gross income and, then, **if necessary to make the determination required by the operative section of the Code**, to **apportion deductions** within the class of gross income between the statutory grouping of gross income (or among the statutory groupings) and the **residual grouping** of gross income.*" [26 CFR § 1.861-8(a)(2)]

The regulation which states that the "residual grouping" may be exempt from taxation also shows that there must be an "operative section" applicable.

"*In some instances, where **the operative section** so requires, the statutory grouping or the residual grouping may include, or consist entirely of, excluded income.*" [26 CFR § 1.861-8(a)(4)]

This is only logical, based on the simple fact that the section "*for determining taxable income from sources within the United States*" (26 CFR § 1.861-8) states over and over again that it is for determining taxable income from "***specific sources***," not the "residual groupings."

"***The rules contained in this section apply in determining taxable income of the taxpayer from specific sources** and activities under other sections of the Code, referred to in this section as **operative sections**…*" [26 CFR 1.861-8(a)(1)]

"*The **operative sections** of the Code which require the determination of taxable income of the taxpayer from **specific sources** or activities and which give rise to **statutory groupings to which this section is applicable** include the sections described below…*"
[26 CFR 1.861-8(f)(1)]

"*A taxpayer **to which this section applies** is required to allocate deductions to a class of gross income and, then, if necessary to make the determination required by **the operative section** of the Code, to apportion deductions…*" [26 CFR § 1.861-8(a)(2)]

The regulations (and statutes) are not about determining taxable income from anywhere other than the "specific sources." Part of the confusion is from the fact that, in stating that the "residual grouping" *may* consist of excluded income, the regulations imply that it also may be taxable. This is *correct*, but deceptive. The possibility of the "residual grouping" being taxable could easily lead to the erroneous conclusion that income from somewhere *other* than the "specific sources" might be taxable. The assumption is that the "residual grouping" *cannot* be from one of the listed "specific sources." This is not the case.

If person 'A' gets taxable income from **two** "specific sources" (taxable activities described in "operative sections"), the regulations state that all the calculations must be done for each "specific source" *separately*. Paragraph (f)(1) lists the "specific sources" under the "operative sections," and then the next paragraph states the following:

> "*(i) Where more than one operative section applies, it may be necessary for the taxpayer to **apply this section separately for each applicable operative section***." [26 CFR § 1.861-8(f)(2)]

While person 'A' is calculating all the deductions, etc. for the **first** "specific source," his income from the **second** "specific source" falls in the category of "*residual grouping*." Likewise, when he is doing the calculations for the taxable income from the **second** "specific source," the income from the **first** is in the "*residual grouping*." The temporary regulations at 26 CFR § 1.861-8T demonstrate this.

> "*Thus, in determining the separate limitations on the foreign tax credit imposed by section 904(d)(1) or by section 907, the income within a separate limitation category **constitutes a statutory grouping** of income and all other income not within that separate limitation category (whether domestic or **within a different separate limitation category**) constitutes the **residual grouping***." [26 CFR § 1.861-8T(c)(1)]

(The same thing is said again in 26 CFR § 1.861-8T(f)(1)(ii).)

Even an example in the regulations showing that the "residual grouping" may be taxable therefore does **not** imply that income from somewhere other than the "specific sources" may be taxable. The "operative sections" involving individuals receiving income from within federal possessions also makes it possible for a taxpayer to have "taxable income" from within *and* without the United States.

The "residual grouping" argument relies on making assumptions based on something that complex deduction allocation examples might seem to suggest, but do not state (that income **not** from the "specific sources" can be taxable), while at the same time ignoring several sections of regulations which contradict this theory. The over-complexity of these regulations seems designed to cause confusion and uncertainty. But even if the current complicated regulations by themselves, combined with some "creative interpretation," allowed for the "residual grouping" argument to have some credibility, the older regulations (as shown above) erase that credibility entirely.

The 1945 regulations made no mention of "operative sections," "specific sources," "statutory groupings" or "residual groupings," and didn't take dozens of pages to create a jumbled, confusing mess. Since there was nothing about "residual groupings" back then to base an argument on, to use the argument now would require the claim that since 1945 there must have been a massive expansion of what income is taxable, from international and foreign commerce to **all** commerce, and that the Secretary decided to inform the public of this by innuendos hidden in confusing examples about deduction allocation related to the per-country limitation on the foreign tax credit. (And, as shown before, Congress stated that "no substantive change" was made anyway.)

The common "interpretation" of the income tax laws relies on multiple assumptions, as well as simply ignoring various sections which contradict those assumptions. Some may wish to imagine that some other "sources" of income which the law does not mention must also be taxable. Some may like to assume that everything is taxable unless the law specifically says it is not. And some may say that if there is some uncertainty about what the law requires, then the government by default "wins." All of these are in direct conflict with a basic principle of tax law, which has been explained on numerous occasions by the Supreme Court.

> "*In the **interpretation of statutes levying taxes** it is the established rule **not to extend their provisions, by implication**, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters **not specifically pointed out**. In case of doubt they are construed most strongly against the government, and **in favor of the citizen**.*" [Gould v. Gould, 245 U.S. 151 (1917)]

> "*In view of other **settled rules of statutory construction**, which teach that... if doubt exists as to the construction of a taxing statute, **the doubt should be resolved in favor of the taxpayer**...*" [Hassett v. Welch, 303 U.S. 303 (1938)]

The extensive evidence of the correct, limited application of the income tax leaves little room for doubt. But even if the IRS, or others who would challenge the conclusions of this report, could obfuscate and confuse matters to the point where "it could go either way," the Supreme Court makes it clear that such a disagreement is to be settled in favor of the citizen, ***not*** the government.

17) Conclusion

Because of the Constitution, Congress could not impose a tax on all income earned in the United States. What Congress did instead was to impose a tax on matters which they could tax (international and foreign commerce), and write the law in such a way that it would give the *impression* that it also applied to the income of most Americans. The Secretary of the Treasury wrote corresponding regulations with a similar goal: to tell a truth while implying a lie. Despite a longstanding and ongoing effort by some in government to confuse and obfuscate, the literal truth has remained in the law. Though it is a complex process, the current statutes and regulations by themselves do reveal the limited application of the federal income tax laws. The older statutes and regulations then add extensive reinforcement and clarity to the conclusions reached by deciphering the current law. The historical documents also give ample evidence to justify an accusation, against the legislators in Congress and the authors of the regulations at the Department of the Treasury, of ***intent to defraud*** the American people of money not legally owed.

Aside from arguments about specific details, there is one giant hurdle for those who would still insist that most Americans receive taxable income: what is the alternate conclusion that accounts for *every* citation in this report? There is extensive documentation, not only in the current statutes and regulations, but throughout 87 years of statutory and regulatory history, which supports the conclusions of this report. It would be absurd to claim that a tax was imposed on the income of most Americans, and that by mistake or coincidence Congress and the Secretary put into the statutes and regulations such an enormous amount of information, spanning nearly a century, which indicates that the tax applies only to those engaged in international or foreign commerce. Quite simply, there is no conclusion other than the conclusion of this report which explains all of the evidence.

(Question for Doubters #7: *Is there some other "interpretation" of the statutes and regulations which would show domestic income of United States citizens as taxable, and also explain the meaning of all of the citations in this report?*)

Part I of Subchapter N, and the regulations thereunder:

STATUTES	REGULATIONS
Subchapter N - Tax based on **income from sources** within or without the United States Part I - Source rules and other general rules relating to **foreign** income **Sec. 861. Income from sources within the United States** a) Gross income from sources within United States The following items of gross income shall be treated as income from sources within the United States: (1) Interest… (2) Dividends… (3) Personal services - Compensation for labor or personal services… (4) Rentals and royalties… (5) Disposition of United States real property interest… (6) Sale or exchange of inventory property… (7) …underwriting income… (8) Social security benefits… **(b) Taxable income from sources within United States** From the items of gross income specified in subsection (a) **as being income from sources within the United States** there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. **The remainder, if any, shall be included in full as taxable income from sources within the United States**… (c) Foreign business requirements… (d) Special rule for… subsection (a)(2)(B)… (e) Income from certain railroad rolling stock… (f) Cross reference…	Part I - Income taxes **Determination of sources of income** **Sec. 1.861-1 Income from sources within the United States.** (a) Categories of income. **Part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder determine the sources of income for purposes of the income tax**… The statute provides for the following three categories of income: (1) **Within the United States**. The gross income from sources within the United States, consisting of the items of gross income specified in section **861(a)**… [plus part of 863 income] See Secs. 1.861-2 to 1.861-7, inclusive, and Sec. 1.863-1. The **taxable income from sources within the United States**… shall be determined by deducting therefrom, in accordance with sections **861(b)** and 863(a), [allowable deductions]… See Secs. **1.861-8** and 1.863-1. (2) Without the United States… (3) Partly within and partly without… (b) **Taxable income from sources within the United States**. The taxable income from sources within the United States shall consist of the taxable income described in paragraph (a)(1) of this section… [plus part of (a)(3) income] (c) Computation of income… [deals with income from both within and without U.S.] Sec. 1.861-2 Interest. Sec. 1.861-3 Dividends. Sec. 1.861-4 Compensation for labor or personal services. Sec. 1.861-5 Rentals and royalties. Sec. 1.861-6 Sale of real property. Sec. 1.861-7 Sale of personal property. **Sec. 1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.** (a) In general--(1) Scope. **Sections 861(b) and 863(a) state in general terms how to determine taxable income of a taxpayer from sources within the United States** after gross income from sources within the United States has been determined… **The rules contained in this section apply in determining taxable income of the taxpayer from specific sources and activities under other sections of the Code**, referred to in this section as **operative sections**. See **paragraph (f)(1)** of this section for a list and description of operative sections. The operative sections include, among others, sections **871(b)** and **882**… (2) Allocation and apportionment of deductions… (3) Class of gross income. For purposes of this section, the gross income to which a specific deduction is definitely related is referred to as a "class of gross income" and may consist of one or more **items**… of gross income enumerated in **section 61**, namely:… [lists items] (4) Statutory grouping of gross income and residual grouping of gross income. For purposes of this section, the term "statutory grouping of gross income" or **"statutory grouping" means the gross income from a specific source or activity which must first be determined in order to arrive at "taxable income" from which specific source or activity under an operative section. (See paragraph (f)(1) of this section.)**… (5) Effective date… (b) Allocation… [defines "class of gross income" again] **See… paragraph (d)(2) of this section which provides that a class of gross income may include excluded income**. (c) Apportionment of deductions… (d) Excess of deductions and **excluded and eliminated income**… (2) Allocation and apportionment… [Reserved] For guidance, see Sec. **1.861-8T(d)(2)**. (e) Allocation and apportionment… (f) Miscellaneous matters--(1) Operative sections. **The operative sections of the Code which require the determination of taxable income of the taxpayer from specific sources or activities and which give rise to statutory groupings to which this section is applicable include the sections described below**. (i) Overall limitation to the **foreign** tax credit… [26 USC 904] (ii) [Reserved] (iii) **DISC** and **FSC** taxable income… [26 USC 925, 994] (iv) Effectively connected taxable income. **Nonresident alien individuals** and **foreign corporations** engaged in trade or business within the United States, under sections **871(b)(1)** and **882(a)(1)**… (v) **Foreign** base company income… [26 USC 954] (vi) Other operative sections. The rules provided in this section also apply in determining-- (A) The amount of **foreign** source items…; (B) The amount of **foreign** mineral income…; (C) [Reserved]; (D) The amount of **foreign** oil and gas…; (E) [about Puerto Rico]; (F) [about Puerto Rico]; (G) [about Virgin Islands]; (H) The income derived from **Guam**…; (I) [about China Trade Act]; (J) [about foreign corporations]; (K) [about insurance income of **foreign** corporations]; (L) The **international** boycott factor…; (M) [about Merchant Marine Act]… (2) Application to more than one operative section…. (3) Special rules of section 863(b) (i) In general… (ii) Relationship of sections 861, 862, 863(a), and 863(b). Sections **861**, 862, 863(a), and 863(b) are the four provisions applicable in **determining taxable income from specific sources**… (g) General examples. The following examples illustrate the principles of this section. In each example, unless otherwise specified, the operative section which is applied and gives rise to the statutory grouping of gross income is the overall limitation to the **foreign tax credit** under section 904(a)… **Sec. 1.861-8T Computation of taxable income from sources within the United States** and from other sources and activities (temporary). (a) In general… (b) Allocation… (c) Apportionment of deductions… (d) Excess of deductions and **excluded and eliminated items of income**. (1) [Reserved] (2) Allocation and apportionment to exempt, excluded or eliminated income-- (i) In general… (ii) Exempt income and exempt asset defined--(A) In general. For purposes of this section, the term **exempt income means any income that is, in whole or in part, exempt, excluded, or eliminated for federal income tax purposes**… (iii) Income that is not considered tax exempt. The following items are **not** considered to be **exempt**, eliminated, or excluded income and, thus, may have expenses, losses, or other deductions allocated and apportioned to them: (A) In the case of a **foreign** taxpayer… (B) In computing the combined taxable income of a **DISC** or **FSC**… (C) For all purposes under subchapter N… the gross income of a **possessions** corporation… (D) **Foreign earned income** as defined in section 911 and the regulations thereunder… (iv) Prior years…. (e) Allocation and apportionment of certain deductions… (f) Miscellaneous matters--(1) Operative sections… [no list yet]… (g) [Reserved]… Sec. 1.861-9T through 1.861-18 [allocation & special rules, income from aircraft & vessels, research, computer programs, etc.]
Sec. 862. Income from sources **without** the United States…	Sec. 1.862-1 Income specifically from sources **without** the United States. (a) Gross income… [lists items of income] (b) Taxable income. The taxable income from sources without the United States, in the case of the items of gross income specified in paragraph (a) of this section, shall be determined on the same basis as that used in **Sec. 1.861-8 for determining the taxable income from sources within the United States**. (c) Income from certain property…
Sec. 863. Special rules for determining source… [deals with income from sources partly within and partly without the United States]	Sec. 1.863-0 Table of contents… Sec. 1.863-1 Allocation of gross income under section 863(a). (a) In general. Items of gross income other than those specified in section 861(a) and section 862(a)… (b) Natural resources… (c) Determination of taxable income. The taxpayer's **taxable income from sources within or without the United States will be determined under the rules of Secs. 1.861-8 through 1.861-14T for determining taxable income from sources within the United States**. (d) Scholarships, fellowship grants, grants, prizes and awards-- (e) Effective dates… Sec. 1.863-2 through 1.863-5 [about allocation and apportionment, income from sales, transportation services, etc.] Sec. 1.863-6 Income from sources within a foreign country or possession of the United States. The principles applied in **Secs. 1.861-1 to 1.863-5**, inclusive, for **determining the gross and the taxable income from sources within and without the United States** shall generally be applied, for purposes of the income tax, in determining the gross and the taxable income from sources within and without a foreign country, or within and without a possession of the United States. Sec. 1.863-7 Allocation of income attributable to certain notional principal contracts under section 863(a).
Sec. 864. Definitions and special rules…	Sec. 1.864-1 through 1.864-8T [definitions]
Sec. 865. [personal property sales]	Sec. 1.865-1T through 1.865-2T [Loss with respect to personal property]

Predecessor of Part I of Subchapter N, and related regulations (1945)

STATUTES	REGULATIONS
Sec. 119. Income from sources within the United States (a) Gross Income from Sources in United States. - The following items of gross income shall be treated as income from sources within the United States: (1) Interest. - Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including:… (2) Dividends… (3) Personal services. - Compensation for labor or personal services… (4) Rentals and royalties… (5) Sale of real property… (6) Sale of personal property… (b) Net Income from Sources in United States. - From the items of gross income specified in subsection (a) of this section there shall be deducted [allowable deductions]. **The remainder, if any, shall be included in full as net income from sources within the United States.** (c) Gross Income from Sources Without United States… (d) Net Income from Sources Without United States… (e) Income from Sources Partly Within and Partly Without United States… (f) Definitions…	**Sec. 29.119-1. Income from sources within the United States.** **Nonresident alien individuals**, **foreign corporations**, and citizens of the United States or domestic corporations **entitled to the benefits of section 251** [*****] are taxable only upon income from sources within the United States. Citizens of the United States and domestic corporations entitled to the benefits of section 251 [*****] are, however, taxable upon income received within the United States, whether derived from sources within or without the United States. (See sections 212(a), 231(c), and 251.) The Internal Revenue Code divides the income of **such taxpayers** into three classes: (a) Income which is derived in full from sources within the United States; (b) Income which is derived in full from sources without the United States; (c) Income which is derived partly from sources within and partly from sources without the United States. The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States. Sec. 29.119-2. Interest. There shall be included in the gross income from sources within the United States, of nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations which are entitled to the benefits of section 251 [*], all interest received or accrued, as the case may be, from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except:… Sec. 29.119-3. Dividends… Sec. 29.119-4. Compensation for labor or personal services… Sec. 29.119-5. Rentals and royalties… Sec. 29.119-6. Sale of real property… Sec. 29.119-7. Income from sources without the United States… Sec. 29.119-8. Sale of personal property… Sec. 29.119-9. Deductions in general. The deductions provided for in chapter 1 shall be allowed to nonresident alien individuals and foreign corporations engaged in trade or business within the United States, and to citizens of the United States and domestic corporations entitled to the benefits of section 251 [*], only if and to the extent provided in sections 213, 215, 232, 233, and 251. Sec. 29.119-10. Apportionment of deductions. From the items specified in sections 29.119-1 to 29.119-6, inclusive, as being derived specifically from sources within the United States there shall, in the case of nonresident alien individuals and foreign corporations engaged in trade or business within the United States, be deducted [allowable deductions]. **The remainder shall be included in full as net income from sources within the United States**… **[* - One can be entitled to the benefits of section 251 only if he receives a certain percentage of his income from within federal possessions.]**