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Frequently Asked Questions Concerning the Federal Income Tax

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John R. Luckey
Legislative Attorney
American Law Division

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Summary

This report addresses some of the frequently asked historical, constitutional, procedural, and legal questions concerning the federal income tax.

The constitutional questions include a discussion of: Congress's taxing power; the difference between a direct and an indirect tax; Fifth Amendment protection against self-incrimination and tax returns; Fourth Amendment protection against unreasonable searches and seizures and tax collection practices; Thirteenth Amendment protections against involuntary servitude and tax withholding; Equal Protection and Due Process questions; and the legality of the ratification of the Sixteenth Amendment.

Other questions addressed include: whether title 26 of the United States Code is positive law; the taxability of wages; the voluntary or involuntary nature of the income tax; what is meant by the income tax "being in the nature of an excise tax;" when was the Internal Revenue Service established; the authority of the Internal Revenue Service to operate outside of the District of Columbia; what is meant by the term United States or United States citizen in the context of the Internal Revenue Code; what is the "Liberty Amendment;" the use of the revenues raised through the federal tax on telephone usage; taxation without representation; the repeal of the original withholding act; and the frivolous tax return penalty.

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Frequently Asked Questions Concerning the Federal Income Tax

1. What Specific Limitations on the Power of Congress to Tax Are Found in the Constitution?

There is only one express exception to federal taxing power found in the United States Constitution. Article I, Section 9 provides "No tax or duty shall be laid on articles exported from any State."

The Constitution divides all taxes into two classifications: direct taxes and indirect taxes. Direct taxes must be levied according to the rule of apportionment and indirect taxes must be levied according to the rule of uniformity.

It is important to note and emphasize that these are classifications for purposes of how taxes may be levied, *not* denials of taxing power. The federal government may enact direct taxes, but if it does so, they must be apportioned among the states.

The classification of direct taxes and the rule of apportionment are set forth in Article I, Section 9, Clause 4 of the Constitution, which states:

> No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census of Enumeration herein before directed to be taken.

There are two types of direct taxes that therefore have to be apportioned: taxes on property (real or personal) and "Capitation" taxes (head taxes). Congress has in the past levied taxes on property. In 1813, Congress levied a direct tax on property totaling three million dollars, which the statute apportioned among the 18 states and then among the counties (parishes) of each state.[1] Thus, for example, $369,018.44 was apportioned to Virginia and $6,354.50 of that amount apportioned to Fairfax County. Provisions for assessing and collecting the tax were contained in the Act of July 22, 1813.[2] A direct tax on property totaling $20 million was levied in 1861, apportioned among the states, territories, and the District of Columbia.[3] Congress has never enacted a "head tax."

The classification of indirect taxes and the rule of uniformity are set forth in Article I, Section 8, Clause 1 of the Constitution, which states:

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[1] Act of August 2, 1813, 2 Stat. 53.

[2] 3 Stat. 22 (1813).

[3] Act of August 5, 1861, § 8, 12 Stat. 295.

> The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

All taxes which are not direct are indirect and subject to the rule of uniformity. The rule of uniformity requires that an indirect tax not discriminate geographically.[4] For example, it would violate the rule of uniformity to enact a special income tax rate for residents of the State of Texas; however, it does not violate the rule to have a special income tax rate for individuals who make over $50,000 per year.

2. Is the Federal Income Tax a Direct or Indirect Tax?

The most direct answer to this question is that, since the ratification of the Sixteenth Amendment, it makes no practical difference which classification one gives to the income tax. As stated above, the only distinction between a direct tax and an indirect tax is that the direct tax must be apportioned. As discussed below, the Sixteenth Amendment, without classifying the income tax, empowers Congress to lay and collect taxes on incomes, from whatever source, without apportionment.

Prior to the ratification of the Sixteenth Amendment, the question of classification of the income tax was central to the determination as to its constitutionality. In *Pollock* v. *Farmers' Loan and Trust Company,*[5] the Supreme Court struck down the Income Tax Act of 1894.[6] The 1894 Act imposed a federal income tax on:

> the gains, profits, and income received in the preceding calendar year by every citizen of the United States...whether said gains, profits, or income be derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere....

After extensive examination of the history of the constitutional provisions dealing with the federal taxing power, the Court found that the Constitution had sought to avoid the levy of a burdening tax on accumulations of property, real or personal, except as subject to the "regulation of apportionment."[7] The Court concluded that a tax imposed on the rents or income of real estate was not significantly distinct from a tax on the property itself and was, therefore, a direct tax within the meaning of the Constitution.[8]

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[4] *United States* v. *Ptasynski*, 462 U.S. 74 (1983).

[5] 157 U.S. 429, *rehearing* 158 U.S. 601 (1895).

[6] 28 Stat. 509 (1894).

[7] 157 U.S. at 581.

[8] *Id.* at 583.

The *Pollock* Court did not, however, hold that all income taxes were direct taxes. Rather, it held that although income taxes are generally indirect taxes in the nature of excises (subject only to the rule of uniformity), income taxes on the gains derived from investments in real or personal property had so substantial an impact on the underlying assets that they should be viewed as direct taxes falling on the property. In this respect, the 1894 tax would have been valid to the extent that it was imposed on "gains, profits, or income...derived from... salaries, or from any profession, trade, employment, or vocation..."[9] Nonetheless, on rehearing *Pollock*, the Court struck down the entire 1894 Act because it believed that to void only the tax on income derived from investments in real and personal property and leave the tax burden solely upon wages and other forms of compensation income would be contrary to the congressional intent.[10]

Some uncertainty followed in the years after *Pollock*. The Court held repeatedly that various taxes imposed by the Congress were indirect in nature and could be levied without regard to the rule of apportionment.[11]

The Sixteenth Amendment to the United States Constitution was ratified in 1913, and provides that:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

The Congress immediately took advantage of this perceived clarification of its power and enacted another federal income tax substantially similar to the 1894 tax.[12] The 1913 tax was imposed on:

> gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devises or descent.

In 1916, the Supreme Court examined the new income tax in light of the Sixteenth Amendment and the other constitutional provisions discussed above and found that it was constitutional in its entirety. The review of the 1913 income tax

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[9] 28 Stat. 509.

[10] 158 U.S. at 637.

[11] See, *Nicol* v. *Ames*, 173 U.S. 509 (1899) (tax on certain sales and exchanges of property); *Knowlton* v. *Moore*, 178 U.S. 41 (1900) (estate tax); *Patton* v. *Brady*, 184 U.S. 609 (1902) (tax on manufactured tobacco); and *Flint* v. *Stone Tracy Co.*, 220 U.S. 108 (1911) (tax on corporate franchise).

[12] 38 Stat. 166.

came in *Brushaber* v. *Union Pacific Railroad Company*,[13] in which a stockholder of the Union Pacific Railroad Company sought to enjoin the corporation from paying the recently-imposed income tax on the grounds that the tax was unconstitutional. The Supreme Court, in a decision written by Chief Justice White, first noted that the Sixteenth Amendment did not authorize any new type of tax, nor did it repeal or revoke the tax clauses of Article I of the Constitution, quoted above. Direct taxes were, notwithstanding the advent of the Sixteenth Amendment, still subject to the rule of apportionment and indirect taxes were still subject to the rule of uniformity. Rather, the Court found that the Sixteenth Amendment sought to restrain the Court from viewing an income tax, because of its close effect on the underlying property, as a direct tax.

The Court noted that the inherent character of an income tax was that of an indirect tax, stating:

> Moreover in addition the conclusion reached in the *Pollock Case* did not in any degree involve the holding that income taxes generically and necessarily came within the class of direct taxes on property, but on the contrary recognized the fact that taxation on income was in the nature an excise entitled to be enforced as such unless and until it was concluded that to enforce it would amount to accomplishing the result which the requirement as to apportionment of direct taxes was adopted to prevent, in which case the duty would arise to disregard form and consider substance alone and hence subject the tax to the regulation as to apportionment which otherwise as an excise would not apply to it.[14]

The language of the Sixteenth Amendment, the Court found in *Brushaber*, was solely intended to eliminate:

> the principle upon which the *Pollock Case* was decided, that is, of determining whether a tax on income was direct not by a consideration of the burden placed on the taxed income upon which it directly operated, but by taking into view the burden which resulted on the property from which the income was derived since in express terms the Amendment provides that income taxes, from whatever source derived, shall not be subject to the regulation of apportionment.[15]

3. What Does the Court Mean When it States That the Income Tax Is in the Nature of an Excise Tax?

An excise tax is a tax levied on the manufacture, sale, or consumption of a commodity or any of various taxes on privileges often assessed in the form of a license or fee. In other words, it is a tax on a property transaction or on an activity, not a tax on the property itself. A sales tax is a clear example of an excise tax. The tax is not on the property directly, but rather it is a tax on the transaction.

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[13] 240 U.S. 1 (1916).

[14] *Id.* at 16-17.

[15] *Id.* at 18.

When a court refers to an income tax as being in the nature of an excise, it is merely stating that the tax is not on the property itself, but rather it is a tax on the transaction of receiving gain from the property or labor. The tax is based upon the amount of the gain, not on the value of the property.

4. Was the Sixteenth Amendment Properly Ratified?

A. Did the President sign the resolution which became the Sixteenth Amendment?

President Taft did not sign the resolution which became the Sixteenth Amendment to the Constitution of the United States.

The Supreme Court ruled in 1798 that resolutions of Congress proposing amendments to the Constitution need not be submitted to the President.[16] Therefore, the failure of President Taft to sign the proposed amendment has no effect upon the constitutionality or legality of the Sixteenth Amendment.

B. Do clerical errors in the ratifying resolutions of the various state legislatures negate the ratification of the Sixteenth Amendment?

The Sixteenth Amendment became part of the Constitution of the United States in 1913 when certified by the Secretary of State, Philander C. Knox.[17] Recently it has been alleged by several defendants in tax litigation that the Sixteenth Amendment is not properly part of the Constitution because it was improperly ratified by a number of states, in that the ratification resolutions of these States contained variations from the resolution enacted by Congress in punctuation, capitalization, and/or spelling.

Secretary Knox certified adoption of the amendment pursuant to Section 205 of the Revised Statutes of the United States which provided:

> Whenever official notice is received at the Department of State that any amendment proposed to the Constitution of the United States has been adopted, according to the provisions of the Constitution, the Secretary of State shall forthwith cause the amendment to be published in the newspapers authorized to promulgate the laws, with his certificate, specifying the States by which the same may have been adopted, and that the same has become valid, to intents and purposes, as part of the Constitution of the United States.[18]

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[16] *Hollingsworth* v. *Virginia*, 3 U.S. 378 (1798). This case involved the Bill of Rights, which had been referred to the States without having been presented to President Washington.

[17] 38 Stat. 785 (1913).

[18] Act of April 20, 1818, ch. 80, § 2, Rev. Stat. § 205 (2d ed. 1878)(amended version codified

(continued...)

The Supreme Court has held that certification under this statute is conclusive upon the courts.[19] *Leser* v. *Garnett* involved a challenge to the ratification of the Nineteenth Amendment. The Secretary of State had certified its adoption. It was contended, however, that the ratifying resolutions of Tennessee and West Virginia were inoperative because the resolutions of those states had been adopted in violation of their rules of legislative procedure. In answer to this contention the Court held:

> The proclamation by the Secretary certified that from official documents on file in the Department of State it appeared that the proposed Amendment was ratified by the legislatures of thirty-six States, and that it "has become valid to all intents and purposes as a part of the Constitution of the United States." As the legislatures of Tennessee and of West Virginia had power to adopt the resolutions of ratification, official notice to the Secretary, duly authenticated, that they had done so was conclusive upon him, and, being certified by his proclamation, is conclusive upon the courts.[20]

In support of this conclusion the Court relied upon the reasoning of *Field* v. *Clark*.[21] In that case the Court held that an enrolled bill was conclusive evidence of statutory enactment. The Court noted that such a bill is signed by the Speaker and the President of the Senate, an attestation that it passed Congress as signed, and when the President signs, it also indicates his attestation that the measure was properly passed by Congress. "The respect due to coequal and independent departments requires the judicial department to act upon the assurance, to accept, as having passed Congress, all bills authenticated in the stated manner."[22] The Court, in *Leser*, felt the same respect must be given the certification by the Secretary of State.[23]

More recently, in *Baker* v. *Carr*,[24] the Supreme Court set out a list of formulations which may identify the existence of a political question in a given case:

> It is apparent that several formulations which vary slightly according to the setting in which the questions arise may describe a political question, although each has one or more elements which identify it as essentially a function of separation of powers. Prominent on the surface of any case held to involve a political question is found a textually demonstrable constitutional commitment of the issue to a coordinate political department; or a lack of judicially discoverable and manageable standards for resolving it; or the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or the impossibility of a court's undertaking independent resolution without expressing

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[18] (...continued)
at 5 U.S.C. § 160 (1940))(repealed Oct. 31, 1951); current version, as amended, at 1 U.S.C. § 106b.

[19] *Leser* v. *Garnett*, 258 U.S. 130 (1922).

[20] *Id.* at 137.

[21] 143 U.S. 649 (1892).

[22] *Id.* at 672.

[23] *Leser* v. *Garnett*, 258 U.S. 130, 137 (1922).

[24] 369 U.S. 186 (1962).

> lack of the respect due coordinate branches of government; or an unusual need for unquestioning adherence to a political decision already made; or the potentiality of embarrassment from multifarious pronouncements by various departments on one question.[25]

Courts of Appeals in several circuits have, within the last few years, considered the question of the ratification of the Sixteenth Amendment and its certification by Secretary Knox. Applying the precedent, discussed above, these courts have uniformly rejected these challenges, holding that correctness of the Secretary's certification is a political question and therefore his certification is conclusive upon the courts.[26]

5. Do Taxpayers Have the Right, under the Fifth Amendment, Not to Answer Questions on Their Tax Returns?

Yes, taxpayers do have protection of the Fifth Amendment when filing their tax returns. However, this has never been interpreted to permit a blanket refusal to give any information on the return.

The Fifth Amendment states:

> No person...shall be compelled in any criminal case to be a witness against himself.

The Supreme Court has held that the privilege against self-incrimination, though founded in the Constitution itself, does not free a taxpayer from the obligation to file an income tax return.[27] An individual may, however, refuse to provide a specific item of information if that information would tend to incriminate the individual. For instance, while the amount of income a person received in a year would not be protected, the source of the income might be incriminating and therefore the privilege could be invoked.[28]

The Court has set out the appropriate procedures to be followed by a taxpayer who wishes to assert the privilege against self-incrimination with respect to an item which should otherwise be reported on an individual's tax return. The taxpayer should assert the privilege on the return, submitting all other information. If the Internal Revenue Service brings criminal charges against the taxpayer for failure to

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[25] *Id.* at 217.

[26] See, *United States* v. *Stahl*, 792 F.2d 1438 (9th Cir.), cert. den., 107 S.Ct. 888 (1986); *United States* v. *Ferguson*, 793 F.2d 828 (7th Cir.), cert. den., 107 S.Ct. 406 (1986); *United States* v. *Foster*, 789 F.2d 457 (7th Cir.), cert. den., 107 S.Ct. 273 (1986); *Stubbs* v. *Commr.*, 797 F.2d 936 (11th Cir. 1986); and *Sisk* v. *Commr.*, 791 F.2d 58 (6th Cir. 1986).

[27] *United States* v. *Sullivan*, 274 U.S. 259 (1926).

[28] *Garner* v. *United States*, 424 U.S. 628 (1976).

file a complete return, the taxpayer may raise the privilege against self-incrimination in defense. The judge would then determine whether or not the privilege was justified and, if it was justified, the criminal charges would not be permitted to stand. However, the IRS may recompute the income tax of a taxpayer who refuses to provide requested data. If the IRS determines from its own investigation that a taxpayer owes additional taxes, it may assess a deficiency. In this case, the taxpayer has the burden to establish the correct liability. Absent evidence supplied by the taxpayer, the assessment by the IRS will be presumed accurate.[29] In this respect, the taxpayer may assert the privilege against self-incrimination to prevent being compelled to give certain information, but one result may be a liability for additional income taxes.

6. Is Title 26 of the United States Code (Internal Revenue) Law?

This question stems from the fact that some titles of the United States Code (U.S.C.) have been enacted into what is called "positive law" and others have not. Title 26, Internal Revenue, has not been enacted into positive law.

The U.S.C. is divided into fifty titles. Of these fifty titles, twenty and part of another have been enacted into positive law. If a title has been so enacted, the text of that title constitutes legal evidence of the laws in that title. If the title has not been so enacted, the title is only prima facie evidence of the actual law. The courts could require proof of the statutes underlying the title, which are the positive law when the title has not been enacted into positive law.

The Office of Law Revision Counsel, which has the responsibility for preparing titles for enactment into positive law, states that titles are chosen for enactment into positive law on two bases. Some are chosen because of congressional mandate that the laws be codified. Otherwise, the Office of Law Revision Counsel prefers to select titles which cover areas of minimal legislative activity. The tax laws do not meet either one of these criteria.

The underlying statute, and the positive law, for the tax code is the Internal Revenue Code of 1986[30] as amended. Title 26 of the U.S.C. is an editorial codification of this act prepared and published under the supervision of the House Judiciary Committee, pursuant to statute.[31] The courts, in short, have the discretion to recognize the title 26 as the applicable law, or require proof of the underlying statute.[32]

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[29] *Id.*

[30] P.L. 99-514, 100 Stat. 2085, 99th Cong., 2nd Sess. (1986).

[31] *See*, 1 U.S.C. § 202.

[32] *Young* v. *IRS*, 596 F.2d 141, 149 (N.D. Ind. 1984).

7. Are Wages Taxable as Income?

Yes, wages are taxable as income. The question is usually based on one of two arguments, historical or definitional.

The historical argument derives from the congressional debates on the Sixteenth Amendment in 1909. Most of the debate centered on the taxing of income from capital assets and the taxing of corporations. The proponents of the position that wages are not taxable income claim that the Sixteenth Amendment was therefore only intended to allow taxation of income from capital.

The fallacy of this argument is that taxation of wages had never been found unconstitutional and therefore an amendment to the Constitution was not necessary to permit this type of taxation. The Sixteenth Amendment was enacted in response to the Supreme Court decision in *Pollock* v. *Farmers' Loan and Trust Company,*[33] in which the Income Tax Act of 1894[34] was struck down. The 1894 Act imposed a federal income tax on:

> the gains, profits, and income received in the preceding calendar year by every citizen of the United States...whether said gains, profits, or income be derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere....

The Court, in *Pollock*, found that the Constitution had sought to avoid the levy of a burdening tax on accumulations of property, real or personal, except as subject to the "regulation of apportionment."[35] The Court concluded that a tax imposed on the rents or income of real estate was not significantly distinct from a tax on the property itself and was, therefore, a direct tax within the meaning of the United States Constitution.[36]

The *Pollock* Court did not, however, hold that all income taxes were direct taxes. Rather, it held that although income taxes are generally indirect taxes in the nature of excises (subject only to the rule of uniformity), income taxes on the gains derived from investments in real or personal property had so substantial an impact on the underlying assets that they should be viewed as direct taxes falling on the property. In this respect, the 1894 tax would have been valid to the extent that it was imposed on "gains, profits, or income...derived from... salaries, or from any profession, trade, employment, or vocation..."[37] Nonetheless, on rehearing *Pollock*, the Court struck down the entire 1894 Act because it believed that to void only the tax on income derived from investments in real and personal property and leave the tax burden solely upon wages and other forms of compensation income would be contrary

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[33] 157 U.S. 429, *rehearing* 158 U.S. 601 (1895).

[34] 28 Stat. 509 (1894).

[35] 157 U.S. at 581.

[36] *Id.* at 583.

[37] 28 Stat. 509.

to the congressional intent.[38] Therefore, since only the taxation of income derived from capital had been found to be unconstitutional unless apportioned, the debate on the Sixteenth Amendment centered on the taxation of this type of income.

The definitional argument concerning the taxation of wages is based on the contention that labor worth a certain amount is exchanged for money worth the same amount and therefore there is no income to be taxed. This argument fails from lack of understanding of the concept of taxable income. There are three basic requirements which must be satisfied before income is considered taxable income. The requirements are gain, realization, and recognition.

The Sixteenth Amendment clarified the power of Congress to lay and collect taxes on income, from whatever source derived.[39] Income has been defined as gain derived from capital, from labor, or from both combined.[40] The operative word in this definition is gain. Gain, in the tax context, is the surplus when the basis of an item (in many cases basis is synonymous with cost) is subtracted from the item's fair market value. For example: John Doe purchases a piece of real estate with a fair market value of $5,000 for a cost of $5,000. One year later the property has appreciated in value to a fair market value of $6,000. Mr Doe has a gain of $1,000 (current fair market value, $6,000 minus $5,000 basis).

The gain in the example above is not a taxable gain though, because it has not been realized. The Supreme Court has ruled that income is not taxable until it has been realized, i.e., received or the right to receive has been established.[41] Therefore if Mr. Doe sold his property for $6,000 he would realize his gain of $1,000.[42]

The next question which must be answered is whether Congress has determined that this type of gain should be taxed. In other words, should this gain be recognized. Congress has determined, by enacting Internal Revenue Code (IRC) section 61(a), that every type of gain should be taxed unless it has been specifically excluded in some other part of the tax code. Section 61(a) provides:

> Except as otherwise provided in this subtitle, gross income means all income from whatever source derived....

The "except as otherwise provided" clause anticipates specific nonrecognition provisions. A good example of a nonrecognition provision is IRC § 103 which excludes the interest from certain state and local bonds from gross income. Interest on these bonds is gain and when paid, or constructively received, it is realized, but Congress has specifically decided not to recognize it.

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[38] 158 U.S. at 637.

[39] *Brushaber* v. *Union Pacific Railroad Co.*, 240 U.S. 1 (1916).

[40] *Eisner* v. *Macomber*, 252 U.S. 189 (1920).

[41] *Id.*

[42] It should be noted that Mr. Doe does not have to receive money for the property for there to be a realization of his gain. As long as the total value of money, property, and money's worth he receives is greater than his basis, he has realized a gain.

There are nonrecognition provisions which could affect the transaction in the above example. For instance, if the property was Mr. Doe's principal residence and he sold it and within two years bought another principal residence of comparable value, his gain would not be currently recognized under IRC § 1034.

Wages to be taxable must pass the same type of examination. For example, if John Doe works 5 hours for $5.00 per hour, is the $25.00 he receives taxable income to him? As we have seen in the above analysis, we must determine if there has been a gain which is realized and recognized.

To see if there was a gain we do not look only to the fair market value of the labor, but rather we determine the difference between what was received and the basis (cost) in the labor. Generally one has a zero basis in one's own labor. Therefore, Doe's gain is $25.00 minus 0, or $25.00. This gain is realized when Doe is paid or has right to receive payment.

The gain is recognized specifically in IRC § 61(a)(1) (compensation for services) and there is no nonrecognition section which is generally applicable to wages. Therefore, John Doe has $25.00 of taxable income.

8. Do We Have a Voluntary Tax System?

We do not have a voluntary tax system in the sense that payment of taxes is optional. There are specific provisions of law which require the payment of income taxes. There are civil and criminal penalties for failing to pay these taxes or file the required returns. Several rather tenuous arguments have been put forward to support the contention that paying income tax is optional.

First, statements by many, including some by past IRS Commissioners, have been taken out of context to support this position. The phrase "voluntary tax system" is commonly used in discussion of our tax compliance system. The United States does have a system of collecting taxes that depends to a certain extent upon voluntary compliance. Although this country does have withholding on certain types of income, much of the income tax revenues come from tax on other sources of income (such as interest, dividends, self-employment, etc.) where the individual must supply the information for the system to function efficiently. Supplying this information is not voluntary in the meaning of optional. However, if a large percentage of the citizenry did not report their income, our system of collection would not work efficiently, leading to the often misunderstood statement that we rely upon voluntary compliance in our tax system.

Another argument which purports to support the optional nature of our tax system is based upon the Privacy Act notice contained in the IRS 1040 Form. The Privacy Act of 1974[43] requires, among other things, that each agency soliciting information from the public state the authority which authorizes the solicitation, whether the disclosure requested on the form is mandatory or voluntary, and the

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[43] P.L. 93-579, 88 Stat. 1896 (1974).

effect of not providing the information. The Privacy Act notice in the IRS 1040 Form instruction booklet does not use the word mandatory. Therefore, the argument is put forth that filing the return is voluntary.

The Privacy Act notice in the IRS 1040 Form instruction booklet states that the authority to seek the information is found in IRC § 6001 and 6011 and their regulations; that one must file a return, show a Social Security Number, and fill in all parts of the form that apply; and that a criminal or civil penalty may result from failure to do so. The federal courts have specifically found that use of the word "mandatory" is not required and that the notice in the 1040 Form meets the requirements of the Privacy Act.[44]

Another semantic argument put forth in this area revolves around the use of the word "liable" in tax acts. The contention is made that the income tax statute does not use the magic words "individual is made liable" and therefore an individual is not liable for income taxes. The federal courts have not had much time for this argument, characterizing it as "arrogant sophistry"[45] and "blatant nonsense."[46] The first description is perhaps the most apt. The proponent of this argument has set up a standard that all taxes must meet. The income tax does not meet this standard. He, therefore, concludes there is something wrong with the income tax. The problem is not in the income tax, but in the standard. There is no requirement in fact or law that a tax act must use the proponent's magic words.

The federal income tax is imposed, in IRC § 1, on the taxable income of every individual. Taxable income is defined in IRC § 63. Every individual whose gross income exceeds specified amounts is required to file an income tax return under IRC § 6012. Gross income is defined in IRC § 61. When a return is required by the IRC, the person required to make such return is required, without assessment or notice and demand of the Secretary, to pay such tax to the internal revenue officer with whom the return is filed under IRC § 6151. These sections, working together, make an individual liable for income taxes.

9. Do the Internal Revenue Service's Collection and Auditing Procedures Violate the Fourth Amendment?

The Fourth Amendment to the Constitution states:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and

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[44] *See*, for example, *United States* v. *Wilber*, 696 F.2d 79 (8th Cir. 1982).

[45] *See*, *Donelin* v. *Commr.*, T.C. Memo. 1984-131, and *Schiff* v. *Commr.*, T.C. Memo. 1884-223.

[46] *See*, *Newman* v. *Schiff*, 778 F.2d 460 (8th Cir. 1985).

particularly describing the place to be searched, and the persons or things to be seized.

The present procedures followed by the IRS in assessment of income tax deficiencies and the collection of unpaid taxes have generally been sustained by the courts as valid and as not violative of the Fourth Amendment.

The income tax law requires all taxpayers to maintain such records as are deemed by the Treasury Department, through the IRS, to be necessary for the determination of the taxpayer's liability.[47] Furthermore, the IRS is authorized by statute to inspect such records and to demand their presentation in order to determine whether a return is correct and whether a return has been filed.[48] This summons may be enforced by the IRS by means of an action brought in the United States District Court.[49]

The Supreme Court has held that the use of an administrative summons to obtain a taxpayer's records is not a violation of the Fourth Amendment right to be free from unreasonable searches and seizures.[50] However, the IRS must issue such a summons in "good faith," for use in determining the taxpayer's civil liability for income taxes, rather than the taxpayer's criminal liabilities.[51]

The IRS follows a set pattern of procedures for assessing a deficiency in income taxes and collecting those assessed taxes. If a taxpayer is determined to have underpaid his income taxes, the IRS will issue a notice of proposed assessment, giving the taxpayer an opportunity to seek administrative review of the determination within the next thirty days. If the taxpayer fails to request administrative review, or if the review sustains the liability, a notice of deficiency is issued.[52] This notice permits the taxpayer to petition the United States Tax Court for a redetermination of the assessed deficiency without first paying the taxes allegedly due. If no petition is filed by taxpayer within the ninety days from the issuance of the notice of deficiency, the Tax Court loses jurisdiction over the case.[53] At that time, the IRS issues a demand for payment of the tax.[54] Now the taxpayer must legally pay the tax.[55] If the taxpayer fails to do so, the IRS may collect the tax through judicial proceedings or through its power of levy and distraint.

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[47] IRC § 6001.

[48] IRC § 7602

[49] IRC § 7604.

[50] *See, United States* v. *Bisceglia*, 420 U.S. 141 (1975).

[51] *United States* v. *Sullivan*, 274 U.S. 259 (1926).

[52] IRC § 6212.

[53] IRC § 6213.

[54] IRC § 6155.

[55] However, the taxpayer's options for judicial review are not foreclosed. IRC § 7422 provides that after the taxpayer has paid the tax in full, a suit for a refund may be brought in either the appropriate United States District Court or in the United States Claims Court.

The power of levy and distraint gives the IRS the ability to seize the assets of a taxpayer and sell them, applying the proceeds to the outstanding tax liability.[56] The Supreme Court has held that the exercise of these powers is constitutional and that such extra-judicial seizures and sales do not violate the protections of the Fourth Amendment against unreasonable search and seizures because the taxpayer will already have ample opportunity for judicial review of the deficiency.[57] The Court has referred to the power of the IRS to levy on a taxpayer's property as an "essential part of our self-assessment tax system...[which] enhances voluntary compliance in the collection of taxes.[58]

The Supreme Court has noted some constitutional limitations on the exercise of the Government's power of levy and distraint. In *G.M. Leasing* the Court held that the IRS could not make a forced entry onto the taxpayer's premises in order to seize property without a court order. However, the agents could take the taxpayer's property which was not in an inclosed area.[59]

In some limited circumstances, the IRS will levy upon the property of a taxpayer without first providing the opportunities for administrative or judicial review discussed above. The IRS is authorized by statute to dispense with these procedures and immediately seize the property if it believes that the taxpayer intends to remove or hide himself or his property in order to defeat the collection of the tax.[60] This emergency procedure is known as "jeopardy assessment" and has been sustained by the Supreme Court against a Fourth Amendment challenge.[61]

10. Do Such Aspects of the Federal Income Tax as Graduated Rates, Deductions, and Exemptions Violate the Equal Protection Guarantees of the Constitution?

The Constitution does not contain an express prohibition against the denial by the federal government of a person's equal protection of the laws. The Fifth Amendment does, however, preclude the United States from depriving any person of "life, liberty, or property, without due process of law..." The Supreme Court has determined that this assurance also precludes the United States from denying persons equal protection of the laws.[62]

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[56] *See*, IRC §§ 6331-6345.

[57] *Phelps* v. *United States*, 421 U.S. 330 (1975).

[58] *G.M. Leasing Corp.* v. *United States*, 429 U.S. 339 (1977).

[59] *Id.*

[60] *See*, IRC §§ 6851-6864.

[61] *Laing* v. *United States*, 423 U.S. 161 (1976).

[62] *See*, *Buckley* v. *Valeo*, 424 U.S. 1 (1976); and *Weinberger* v. *Weisenfeld*, 420 U.S. 636 (continued...)

The prohibition against denial of equal protection of the laws, however, does not preclude Congress from creating reasonable classifications among taxpayers. The Court has stated that the Congress is to be given wide discretion in classifying taxpayers for purposes of tax deductions, exemptions, rates and other features. Such classifications are to be sustained unless they are arbitrary and capricious.[63] The Court has, for example, upheld as reasonable classifications within the tax laws the graduated nature of the income tax rates, imposing higher proportionate burdens on more wealthy taxpayers[64] and the taxation of domestic corporations in a fashion distinct from foreign corporations.[65]

The latitude granted to Congress in tax matters was emphasized in the Supreme Court's decision in *Commissioner* v. *Kowalski*[66] in which the Court ruled that highway patrol officers were required to pay tax on meal allowances granted them, even though similar allowances granted military personnel were expressly tax-free by statute. In relation to this disparity of treatment, the Court stated that:

> arguments of equity have little force in construing the boundaries of exclusions and deductions from income, many of which, to be administrable, must be arbitrary.[67]

11. Has the Withholding Act Been Repealed (Victory Tax Act Questions)?

The original withholding act for withholding on wages was enacted as part of the Victory Tax Act of 1942.[68] This act was a temporary act and was scheduled to expire at the cessation of hostilities (World War II). The act did not expire, but was instead repealed by the Income Tax Act of 1944.[69] Previous to this repealing act, the Withholding Tax Act of 1943[70] had been enacted containing a withholding provision and not subject to an expiration date.

The present withholding provisions were enacted as part of the Internal Revenue Act of 1954[71] and continued as part of the Internal Revenue Code of 1986. While they have been amended, they have not been repealed.

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[62] (...continued)
(1975).

[63] *Helvering* v. *Indiana Life Ins. Co.*, 292 U.S. 371 (1934).

[64] *Brushaber* v. *Union Pacific Railroad Co.*, 240 U.S. 1 (1916).

[65] *National Paper Co.* v. *Bowers*, 266 U.S. 373 (1924).

[66] 434 U.S. 77 (1977).

[67] *Id.* at 95-96.

[68] Ch. 619, 56 Stat. 798, 77th Cong., 2nd Sess (1942).

[69] Ch. 210, 58 Stat. 231, 78th Cong., 2nd Sess (1944).

[70] Ch. 120, 57 Stat. 126, 78th Cong., 1st Sess. (1943).

[71] Ch. 736, 65A Stat. 1, 83rd Cong., 2nd Sess. (1954).

12. When Was the Internal Revenue Service Established and Where Does it Get its Power to Tax?

The Office of the Commissioner of Internal Revenue was established on July 1, 1862 by act of Congress.[72] There was an appropriation for the Bureau of Internal Revenue as early as 1870.[73] The Bureau's name was officially changed to the Internal Revenue Service in 1953.[74]

The Internal Revenue Service does not have the power to tax. Rather, it has been charged by Congress with the responsibility of administering and enforcing the internal revenue laws and related statutes which have been enacted by Congress.

13. Does the Internal Revenue Service Have Authority to Operate Outside of the District of Columbia (Seat of Government Act Questions)?

Questions concerning the authority of the Internal Revenue Service to operate outside of the District of Columbia generally are premised upon an incorrect reading of the requirements of the Seat of Government Act.[75] The Act provides:

> All offices attached to the seat of government shall be exercised in the District of Columbia, and not elsewhere, except as otherwise expressly provided by law.[76]

This Act was first enacted in 1790 for the purpose of centralizing the national government.[77] The Act did not (and does not) require that a department or agency only have authority within the seat of government, but rather that the department or agency be physically located at the seat of government. The same Congress which passed the Act set up districts for the collection of tariffs and taxes located outside the seat of government.[78]

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[72] Ch. 119, 12 Stat. 432, 37th Cong., 2nd Sess. (1862).

[73] Ch. 56, 16 Stat. 83, 84, 41st Cong., 2nd Sess. (1870).

[74] Treasury Department Order 150-29 (July 9, 1953).

[75] 4 U.S.C. §§ 71-73.

[76] 4 U.S.C. § 72.

[77] Ch. 28, 1 Stat. 130, 1st Cong., 2nd Sess. (July 16, 1790). The Act established Philadelphia as the temporary seat of government until the first Monday in December of 1800 when the seat of government would become the District of Columbia.

[78] *See*, Ch. 35, 1 Stat. 145, 1st Cong., 2nd Sess. (August 4, 1790).

The Department of the Treasury is an office attached to the seat of government.[79] The IRS is a part of the Department of the Treasury.[80] Therefore the IRS must have its office in the District of Columbia unless otherwise expressly provided by law. The IRS does have its national headquarters within the District of Columbia.

There are several provisions of law which expressly authorize the IRS to operate outside of the District of Columbia. Two of the more general such authorizations are found in sections 7621 and 7803 of the Internal Revenue Code. The first of these provides for the establishment by the President of internal revenue districts throughout the states for the purpose of administering the tax laws.[81] In the second, the Secretary of the Treasury is authorized to employ such number of persons as the Secretary deems proper for the administration and enforcement of the tax laws and to designate and determine the posts of duty of such persons inside and outside of the District of Columbia.[82]

14. What Is the Liberty Amendment?

The Liberty Amendment is a proposed amendment to the United States Constitution which has been introduced several times over the past 40 years. The proposal would repeal the Sixteenth Amendment (which authorized Congress to levy an income tax without apportionment among the states) and would preclude Congress from levying taxes on persons, incomes, estates, and/or gifts. It would also preclude the federal government from engaging in any business, professional, commercial, financial, or industrial enterprise except as specified in the Constitution.

15. Is the Federal Telephone Excise Tax Used to Fund the Military?

The revenue from the telephone excise tax[83] goes into the general revenues of the federal government. It is not specifically earmarked for the military.

This question is based on the fact that this excise tax was increased from 3% to 10% in 1966,[84] at the request of the Johnson administration, to help meet the expense of the military effort in Vietnam.

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[79] *See*, 31 U.S.C. § 301(a).

[80] *See*, 26 U.S.C. § 7802.

[81] 26 U.S.C. § 7621.

[82] 26 U.S.C. § 7803.

[83] IRC §§ 4251-4254.

[84] P.L. 89-368, 80 Stat. 38, 89th Cong., 2nd Sess. (1966).

Protesters of the war in Vietnam, and later those opposed to military spending in general, have used this tax as a vehicle for their protest because of the above mentioned historical connection with military funding and because it is a tax levied on most of the population which does not have a withholding system of collection. Refusal to pay the tax may, of course, result in the imposition of civil and/or criminal penalties.

16. Does Withholding on Wages Constitute Involuntary Servitude in Violation of the Thirteenth Amendment?

The Thirteenth Amendment provides that "[n]either slavery nor involuntary servitude....shall exist in the United States...." Although the Supreme Court has upheld the constitutionality of income tax withholding, in the context of the corporate income tax, as early as 1916,[85] a few taxpayers have still contended, unsuccessfully, that to require an employer, without compensation, to withhold income taxes from the wages of employees places the employer in involuntary servitude in violation of the Thirteenth Amendment.[86] The courts have consistently and repeatedly held that a requirement of governmental service of this character does not constitute involuntary servitude. A government has the right to require certain actions of its citizens, including income tax withholding, jury service, and military service.[87]

17. Are Not Individuals Who Are Too Young to Vote or Who Are Residents of the District of Columbia Unconstitutionally Subjected to Taxation Without Representation?

The argument has been suggested that individuals who are not 18 years of age and individuals residing in the District of Columbia should not be subject to federal taxes because they do not have voting representation in Congress. Individuals who are not 18 years of age cannot vote for members of Congress or the President, and residents of the District of Columbia cannot elect voting representatives to Congress, although they may vote in Presidential elections.

The concept of no taxation without representation was a factor in the creation of this country and was embodied in the Declaration of Independence, but it is not an express guarantee of the Constitution. Rather, the Constitution establishes a representative form of government with elected officials for all adults, except those

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[85] *Brushaber* v. *Union Pacific Railroad Co.*, 240 U.S. 1 (1916).

[86] *See*, for example, *Lorre, Jr.* v. *United States*, 40 A.F.T.R. 2d 5664 (W.D. Tex. 1977); and *United States* v. *Awerkamp*, 34 A.F.T.R. 2d 5086 (7th Cir. 1974).

[87] *See*, *Arver* v. *United States*, 245 U.S. 366 (1918); *Butler* v. *Perry*, 240 U.S. 328 (1916); and *Robertson* v. *Baldwin*, 165 U.S. 275 (1897).

residing in the District of Columbia. As such, the Constitution permits taxation of both residents of the District and individuals who are disenfranchised because of age. This principle was clearly expressed by the Supreme Court in its decision in *Loughborough* v. *Blake*[88] in which Chief Justice Marshall stated:

> The difference between requiring a continent, with immense population, to submit to be taxed by a government having no common interest with it, separated from it by a vast ocean, restrained by no principle of apportionment, and associated with it by no common feelings; and permitting the representatives of the American people, under the restrictions of our Constitution, to tax a part of society, which is either in a state of infancy advancing to manhood, looking forward to complete equality as soon as that state of manhood shall be attained, as is the case with the territories; or which has voluntarily relinquished the right of representation, and has adopted the whole body of Congress for its legitimate government, as is the case with the district, is too obvious not to present itself to the minds of all.[89]

18. What Is Meant by the Term United States in the Context of the Internal Revenue Code?

This question has often appeared as a form letter which questions the meaning of the term "United States" as used in the Internal Revenue Code. These letters generally follow the form of: (1) a statement of confusion as to the meaning of the term resulting from their review of the IRC and some court decisions; (2) citation to three definitions of the term from the Supreme Court opinion of *Hooven & Allison Co.* v. *Evatt*[90]; (3) question as to which of the cited meanings is applicable to an Internal Revenue Service regulation;[91] (4) citation to a portion of the Supreme Court opinion of *United States* v. *Cruikshank*[92] concerning the different obligations and rights stemming from federal and state citizenship; and (5) concluding with a plea for immediate response to end their confusion.

First it should be noted that neither of the Supreme Court opinions cited in the letters have anything to do with the federal income tax. *Hooven* was a case concerning State taxation of imports. The Constitution prohibits states from taxing imports without the consent of Congress except what may be absolutely necessary for executing its inspection laws.[93] One of the issues in *Hooven* was whether the items which had been taxed by the state had been imported, in that the items in question came from the Philippine Islands, which at that time were a insular possession of the

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[88] 18 U.S. 317 (1820).

[89] *Id.* at 324 to 325.

[90] 324 U.S. 652 (1945).

[91] 26 C.F.R. § 1.1-1(a)(1).

[92] 92 U.S. 542 (1875).

[93] U.S. Const. Art.I, § 10, cl. 2.

United States. It was in this context that the Court entered into a discussion of the meaning of the term "United States" stating:

> The term "United States" may be used in any one of several senses. It may be merely the name of a sovereign occupying the position analogous to that of other sovereigns in the family of nations. It may designate the territory over which the sovereignty of the United States extends, or it may be the collective name of the States which are united under the Constitution.[94]

The Court decided for purposes of this constitutional provision that "United States" did not include the Philippine Islands.

Cruikshank, a case decided 38 years before the ratification of the Sixteenth Amendment and the enactment of the modern income tax, was a criminal case which had nothing to do with taxes of any kind. The quote from the case cited in the letters is part of lengthy section which discusses our federal system of government where individuals are citizens of a state and of the nation and thus have rights and obligations, which may vary, stemming from these two citizenships.[95] If one insists on applying this passage to the subject of taxes, it could best be summarized by saying that an individual has certain rights and obligations under the federal tax laws and certain rights and obligations under the State tax laws and such rights and obligations may not be identical.

The IRC uses the term "United States" several hundred times. It uses the term in all three of the ways mentioned in the *Hooven* case. For example, the IRC refers to the United States Tax Court.[96] This use of the term is obviously not used in the geographical sense. Rather, it is used to indicate that the court is a part of the federal government. In the unemployment tax provisions of the IRC the term is defined to include the States, the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.[97] The general IRC definition of the term states:

> When used in this title,[98] where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, the term "United States" when used in a geographical sense includes only the States and the District of Columbia.[99]

The use of the term which the letters specifically inquire about is not from the IRC, but from the IRS regulations. The regulation in question states in pertinent part:

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[94] *Hooven*, at 671 and 672. It should be noted that the parentheticals in the letters are not from the Court opinion, but rather appear to be interpretations of the definitions supplied by the author and are not necessarily complete or accurate. It should be also noted that the Court does not state or imply that this list of definitions is exhaustive or exclusive.

[95] *See, Cruikshank*, 92 U.S. at 549 to 551.

[96] *See*, e.g., IRC § 7441.

[97] IRC § 3306(i).

[98] The IRC is codified in title 26 of the United States Code.

[99] IRC § 7701(a)(9).

> 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.[100]

The use of the term "United States" in this regulation is that of a modifier of the terms "citizen" and "resident." Further study of this regulation might well have alleviated some of the constituents' confusion. Subsection (b) of this regulation, entitled "Citizens or residents of the United States liable for tax," expands on the discussion quoted above. Subsection (c) of this regulation, entitled "Who is a citizen," goes on to state:

> Every person born or naturalized in the United States and subject to its jurisdiction is a citizen. For further rules governing the acquisition of citizenship, see chapters 1 and 2 of title III of the Immigration and Nationality Act (8 U.S.C. §§ 1401-1459). For rules governing loss of citizenship, see sections 349 to 357, inclusive, of such Act (8 U.S.C. §§ 1481-1489), *Schneider* v. *Rusk*, 377 U.S. 163 (1974), and Rev. Rul. 70-506, C.B. 1970-2, 1. For rules pertaining to persons who are nationals but not citizens at birth, e.g., a person born in American Samoa, see section 308 of such Act (8 U.S.C. § 1408). For special rules applicable to certain expatriates who have lost citizenship with the principal purpose of avoiding certain taxes, see section 877. A foreigner who has become a citizen but who has not yet been admitted to citizenship by a final order of a naturalization court is an alien.[101]

19. May Congress Tax Occupations of Common Law Right?

Yes, Congress may tax "occupations of common law right" and has done so many times, for example the Social Security tax and the federal income tax.

The argument has been made that earning a living is a right, sometimes called a "God given right" or a "common law right," and not a privilege and therefore it cannot be taxed. Sometimes those presenting this argument would distinguish between natural occupations, i.e., farmer or rancher, and occupations created by the government, i.e., government employee or lawyer, the latter being taxable while the others are not. These types of distinctions have never been recognized in the area of taxing power of the states or the federal government. The Supreme Court has specifically rejected a challenge to the Social Security tax based on this type of argument, stating:

> The statute books of the states are strewn with illustrations of taxes laid on occupations pursued of common right. We find no basis for a holding that the

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[100] 26 C.F.R. § 1.1-1(a)(1).

[101] 26 C.F.R.. § 1.1-1(c).

> power in that regard which belongs by accepted practice to the legislatures of the states, has been denied by the Constitution to the Congress of the nation.[102]

In challenges to the federal income tax, the courts have consistently rejected the claim that Congress may not tax occupations of common law right.[103]

20. What Is Meant by the Term "Includes?"

The use of the term "includes" in IRC definitions has given rise to at least two questions concerning the application of the tax code. Does the "State" include the fifty states? Does "employee" include anyone who does not work for the Government or is an officer of a corporation?

The IRC defines "State" to include the District of Columbia.[104] There are those who argue that this means that the term "State" only includes the District of Columbia and not the fifty States of the Union. The IRC defines "employee" to include officers, employees or elected officials of the United States, a State, or any political subdivision thereof, or the District of Columbia or an officer of a corporation.[105] There are those who argue that this means that only those in one of these categories are "employees" for purposes of the income tax.

Each of these arguments displays a basic misunderstanding of the meaning of the term "includes." The term "includes" is inclusive not exclusive. The IRC provides that the terms "includes" and "including" when used in a definition shall not be deemed to exclude other things otherwise within the meaning of the term defined.[106]

The courts have not given any credence to arguments that "includes" implicitly excludes. They have been consistently found to be without merit and frivolous.[107]

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[102] *Steward Machine Co.* v. *Davis*, 301 U.S. 548 at 582 to 583 (1937).

[103] *See*, for example, *United States* v. *Russell*, 585 F.2d 368 (8th Cir. 1978); *United States* v. *Silkman*, 543 F.2d 1218 (8th Cir. 1976), cert. denied, 431 U.S. 919 (1977); and *Jones* v. *United States*, 551 F. Supp. 578 (N.D.N.Y. 1982).

[104] IRC § 7701(a)(10).

[105] IRC § 3401(c).

[106] IRC § 7701(c).

[107] *See*, *U.S.* v. *Rice*, 659 F.2d 524,528 (5th Cir. 1981), *U.S.* v. *Latham*, 754 F.2d 813, 815 (1st Cir. 1986), *U.S.* v. *Ward*, 833 F.2d 1538 (11th Cir. 1987), and *U.S.* v. *Steiner*, 963 F.2d 381 (9th Cir. 1992).

21. Do the IRC Source of Income Rules Exempt the Income of U.S. Citizens?

The answer to this question is no. The question is based on the claim that the "sources of income" rules of the IRC only apply to nonresident aliens and foreign corporations.[108] This reading of the IRC and regulations contradicts the express language of the IRC and regulations.

The IRC clearly states that "gross income means all income from whatever source derived."[109] The regulations specifically state:

> 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.[110]

The reason that "source of income" rules apply primarily to nonresident aliens and foreign corporations is that they are only taxed on domestic source income. Therefore there is need of rules to determine the source of their income. As stated above, a citizen or resident alien is taxed on all income regardless of the source. Therefore, source rules are unnecessary.

22. What Is the Frivolous Income Tax Penalty?

As part of the Tax Equity and Fiscal Responsibility Act of 1982,[111] Congress enacted a penalty for filing a frivolous income tax return. This penalty is codified at IRC § 6702.

The penalty is $500.00. It may be imposed on any individual who files any document which purports to be a tax return but fails to contain information from which the substantial correctness of the amount of tax shown on the return can be judged, or contains information which on its face indicates that the amount of the tax shown on the return is substantially incorrect and such conduct arises from a frivolous position taken by the taxpayer or a desire of the taxpayer, which is apparent from the face of the return, to delay or impede the administration of the tax laws.[112]

The penalty is immediately assessable. The taxpayer need not be given any advance warning before assessment. To challenge this penalty, the taxpayer must pay 15% of the penalty and file for a refund with the IRS. If the refund is denied, the

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[108] *See*, IRC § 861 and its regulations.

[109] IRC § 61.

[110] Treas. Reg.§ 1.1-1(b).

[111] P.L. 97-248, 97 Stat. 369, 97th Cong., 2nd Sess. (1982).

[112] IRC § 6702.

taxpayer may seek review in the Federal District Courts.[113] The constitutionality of the frivolous return penalty has been upheld against challenge under the First Amendment[114] and the Due Process Clause.[115]

It should also be mentioned that the federal courts may impose penalties for frivolous claims brought before them. These claims range from those which have no basis in fact or law (for example, claiming that payment of income taxes is voluntary) to those which may have been legitimate questions when first raised, but have been so definitively decided by the courts that they are a waste of the courts time to bring them up again (for example, questioning the constitutionality of taxing wages). The Seventh Circuit Court of Appeals has stated:

> The doors of this courthouse are, of course, open to good faith appeals of what are honestly thought to be errors of the lower courts. But we can no longer tolerate abuse of the judicial review process by irresponsible taxpayers who press stale and frivolous arguments, without hope of success on the merits, in order to delay or harass the collection of public revenues or for other nonworthy purposes ... abusers of the tax system have no licence to make irresponsible demands on the courts of appeals to consider fanciful arguments put forward in bad faith. In the future we will deal harshly with frivolous tax appeals and will not hesitate to impose even greater sanctions under appropriate circumstances.[116]

The United States Tax Court has statutory power to assess a penalty of up to $25,000 on a taxpayer who brings a frivolous claim before it.[117]

The following is a list of some of the types of returns where IRC § 6702 has been invoked or arguments which have been found to be frivolous by the courts:

> (1) Fifth Amendment returns–taking the Fifth Amendment on all or most of the lines of the return;[118]
>
> (2) claims of a war tax deduction–reducing the tax due on ones taxable income by the percentage derived by dividing the budget of the Department of Defense by the total Federal budget;[119]
>
> (3) claims that wages are not taxable;[120]

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[113] IRC § 6703.

[114] *Kahn* v. *United States*, 753 F.2d 1203 (3rd Cir. 1985).

[115] *Baskin* v. *United States*, 738 F.2d 975 (8th Cir. 1984).

[116] *Granzow* v. *Commr.*, 739 F.2d 265 at 268-269 (7th Cir. 1984).

[117] IRC § 6673.

[118] *See*, question 5 and the cases cited therein.

[119] *See*, *Wall* v. *United States*, 756 F.2d 52 (3rd Cir. 1985), and *Hollingshead* v. *Commr.*, TC Memo 1984-158 (1984).

[120] *See*, *Wardell* v. *United States*, 757 F.2d 203 (8th Cir. 1985), and question 7 and the cases

(continued...)

(4) gold standard returns–claiming no income because federal reserve notes are not backed by gold or silver;[121]

(5) claims that the federal income tax is a voluntary tax–Privacy Act defects, alleged lack of liability section in the IRC, and misrepresentations of statements concerning voluntary compliance;[122]

(6) claims of defects in the ratification of the Sixteenth Amendment–fraud by the Secretary of State, mistakes in ratification by the various states, failure of President to sign the proposed amendment, improper admission of Ohio into the Union;[123]

(7) failure to sign the return, striking out the perjury clause, or in other ways modifying the income tax return;[124]

(8) claims that the Tax Court system violates the taxpayer's right to trial by jury;[125]

(9) claims that the imposition of an income tax denies the taxpayer the freedom of contract;[126]

(10) establishing a "church" for the sole purpose of tax avoidance;[127] and

(11) claims that the tax laws are not legal because they were not enacted as positive law.[128]

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[120] (...continued)
cited therein.

[121] *See*, *O'Brien* v. *Commr.*, 779 F.2d 50 (6th Cir. 1985).

[122] *See*, *Donelin* v. *Commr.*, TC Memo 1984-131 (1984), and question 8 and the cases cited therein.

[123] *See*, *Pollard* v. *Commr.*, 816 F.2d 603 (11th Cir. 1987), and question 4 and the cases cited therein.

[124] *See*, *Mosher* v. *IRS*, 775 F.2d 1292 (5th Cir, 1985), and *Olson* v. *United States*, 760 F.2d 1003 (9th Cir. 1985).

[125] *See*, *Sauers* v. *Commr.*, 771 F.2d 64 (3rd Cir. 1985).

[126] *Id.*

[127] *See*, *Dummler* v. *Commr.*, TC Memo 1985-224 (1985).

[128] *See*, *Young* v. *IRS*, 596 F. Supp. 141 (N.D. Ind. 1984), and question 6, above.