

“Income” Tax or “Source” Tax?

by Alfred Adask

The tax “avoidance” movement has recently produced a hot, refined versions of the “861” defense. This defense argues that under Section 861 of the IRS Code (26 USC 861), most income *sources* are not subject to an income tax.

Roughly speaking, research (going all the way back to 1916 original income tax laws) indicates that if the “source” of your income is a transaction involving “alcohol, tobacco, firearms” and few other privileged activities, then you are obligated to pay income tax on earnings derived from those activities. On the other hand, if the *source* of your income is ordinary, non-privileged economic activity (like carpentry, running a day care center or managing a sole proprietorship), your earnings are not subject to income taxation. In other words, a lawful income tax is not imposed directly on the *people*, or even on their “income,” but rather on the *sources* of their income. Some sources are taxable, other sources are not.

If the 861 argument is correct, it implies that 95% of American workers have no duty to pay income tax since their income is not derived from privileges “sources”.

Another “frivolous” argument?

As often happens with “patriot” arguments, the “861 defense” seems too good to be true. If the income tax was only intended to apply to those few people engaged in *privileged* activities (like the production of alcohol, tobacco and firearms)—but had no lawful application to the other 95% of American workers who earned their livings from ordinary, non-privileged “sources”—how could government have tricked the other 95% into paying?

One explanation involves the Victory Tax imposed during World War II. That tax asked the American workers to voluntarily contribute a portion of their weekly pay for two years to help win the war against Germany and Japan. The Victory tax also asked employers to voluntarily collect their workers’ contributions and forward those contributions to the national government. Thus, the Victory Tax gave average Americans their first taste of “withholding”—the idea that workers would voluntarily contribute and employers would voluntarily collect a portion of their weekly incomes and send it to Washington.

The Victory Tax was intended to last for just two years. But two years, and then two decades came and went, and the tax intended to win WWII continued to be collected long after the war ended and even after we'd reestablished alliances with our former enemies.

It's easy to imagine how all patriotic Americans—wanting to help win WWII—would agree to voluntarily contribute a portion of their income as “taxes” even though their incomes were not lawfully taxable. It's likewise easy for cynics (or realists, depending on your point of view) to imagine that self-serving government would take advantage of patriotic Americans' and continue to demand their financial “contributions” long after the original purpose for those contributions had disappeared.

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Most people can't believe our government could defraud the American people. Even if you're willing to concede that *government* might be that greedy, unlawful and prone to extortion—you still have to accept the astonishing belief that the American *people* were fool enough to

allow themselves to be tricked into such an incredible deception. Is it really possible that the American people could be that *dumb*?

Seems so. To paraphrase P.T. Barnum, “There's a voter born every minute.”

The implications are depressing. If Americans are that gullible, what faith could we place in the idea of “democracy”? If Americans can be tricked for over half a century into paying an income tax that has no foundation in law, then you have to admit the average American is so ignorant that his “informed” votes are only marginally superior to the votes of most monkeys.

Nuthin' up my sleeve (or in the statutes, either)

However, if the 861 “source of income” defense is valid, then government's unlawful application of income tax can be easily stopped. After all, if government actually *tricked* us into paying income taxes on “sources” which aren't lawfully taxable, then it follows that there must be no underlying law to justify those taxes. In other words, why would government resort to *trickery* if the relevant law actually exists?

This question implies an important axiom: Whenever you find evidence of governmental deception, it almost certainly means there is no relevant underlying law. Thus, if you can learn to identify the government's lies and deceptions, that identification may constitute a “get out of jurisdiction free” card.

Further, once government starts a deception (and there's no underlying law), it's unlikely that government will later pass a relevant law. Once the deception starts, going back and changing the law would not only admit the deception, it might even provoke folks to wake up, vote intelligently, and possibly return to the pre-WWII condition where most Americans paid no income tax.

My point is that *if* government has imposed the income tax on most Americans through trickery since 1943, it's a virtual certainty that there's still *no law* to support that taxation.

And that's exactly what the Section 861 defense contends. There is *no law* declaring that the vast majority of American's incomes are derived from taxable sources.

Will the 861 defense work?

I don't know.

But I do know and respect the judgment of several researchers who claim the 861 defense is hot and valid.

More importantly, I know that (so far) government has shrieked that the 861 argument is flawed, impossible, and contrary to common sense. They've raised clouds of dust, smoke and a host of mirrors to discredit the 861 argument. But (so far) government has not issued a persuasive denial of the 861 "sources" argument based on nothing more than existing statutes and case law. I am persuaded that the 861 defense is valid because (so far) government's done nothing to deny that defense but scream like a wounded animal.

Reclamation now!

And I can see why government would scream. If the 861 defense works, it won't merely allow people to *stop* paying income tax—it will allow them to *reclaim* income taxes paid to Washington for at least the *last three years*. Those trying to reclaim previously paid taxes reportedly file *amended* tax returns that indicate the previously paid taxes were paid by *mistake*. They claim they didn't know the *source* of their income was not taxable, and therefore (Dear Mr. Taxman), would you please send a refund in full?

This tax reclamation movement is not confined to impoverished tax resisters. At least one Hollywood movie star is trying to employ the 861 argument to regain \$24 million in taxes paid over the last three years. Can you imagine what will happen if that movie star wins? The publicity will be unstoppable and the cat will be absolutely out of the IRS's bag.

Imagine how many people would file amended income tax returns if they thought they could regain all the money they paid to the IRS over the last *three* years. For the average person, that might amount to half a year's pay. I'd say that's a serious incentive.

Caveat emptor

The 861 defense isn't new. Reportedly, it's been used before and defeated. What is new is the depth of research that's gone into making "new and improved" 861 arguments. Some researchers have traced

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the relevant law all the way back to 1916.

Nevertheless, if you choose to use the 861 sources strategy, be cautious. Make sure that whatever strategy you employ is based on a complete analysis of IRC Section 861 and *all* underlying law and federal regulations.

More importantly, recognize that if the 861 strategy is valid, it will *destroy* the IRS. That means that the IRS will fight tooth and nail to ignore, refute or defeat anyone who tries to use this strategy. For the IRS, the 861 “source of income” argument may be a “life or death” issue. That being so, the IRS can be expected use any means available—within the law or otherwise—to not only defeat but *punish* anyone attempting to use this strategy.

Time will tell whether the 861 strategy is valid or flawed. I recommend that anyone concerned with income taxes start studying the 861 strategy now with the intention of possibly applying it six months from now. By then, the validity of this strategy should be obvious to all.

For now, I can't say I'm not absolutely convinced that they Section 861 “sources of income” argument is valid, but everything suggests that this strategy may be explosive.

The next article is written by Larken Rose, a principal in the research and propagation of the 861 defense. His article offers a more technical foundation for understanding the 861 defense. ■

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