CAVEAT:
THIS MEMORANDUM WAS PREPARED AND WRITTEN FOR ONE SPECIFIC CASE AND MAY NOT APPLY TO OTHERS.
IT IS NOT OFFERED AS ADVICE NOR AS A LEGAL OPINION RELATIVE TO ANYONE OTHER THAN THE PARTY IN THIS CASE AND FOR THE ISSUES PRESENTED BY THIS PARTICULAR PROCEEDING.
THE READER SHOULD OBTAIN INDEPENDENT ADVICE FROM A LICENSED ATTORNEY BEFORE RELYING ON THE APPLICABILITY OF ANY AUTHORITIES CITED HEREIN INSOFAR AS THEY MAY OR MAY NOT APPLY TO THE READER.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

UNITED STATES OF AMERICA	CASE NO. 06-50164-01
V.	JUDGE: HICKS
TOMMY K. CRYER, Defendant	MAGISTRATE: HORNSBY

MEMORANDUM IN SUPPORT
OF
DEFENDANT'S FOURTH MOTION TO DISMISS INDICTMENT

MAY IT PLEASE THE COURT:

STATEMENT OF THE CASE

On October 25, 2006, the government filed herein an indictment charging defendant, TOMMY K. CRYER, hereinafter "Cryer", with two counts of tax evasion, alleging that during the years 2000 and 2001 Cryer had received taxable income but had knowingly and willfully failed to timely file tax returns for said years and that, as an "affirmative act" of evasion Cryer had failed to file tax returns for the Tommy K. Cryer Trust, which, the indictment claims, had received taxable income, thereby (presumably) concealing income and misleading the Internal Revenue Service, hereinafter IRS, into believing that Cryer had no income for the years 2000 and 2001, all in violation of 26 U.S.C. § 7201.

Defendant now files this motion pursuant to Rule 12(b) to dismiss both counts of the indictment, with prejudice, on the basis that as a matter of law revenues received by him are not taxed or taxable under the provisions of the Income Tax laws and regulations

thereunder promulgated, nor are any revenues received by him within the powers of the federal government to tax and that the revenues received by him are exempt from taxation by excise under the Constitution of the United States and that, therefore, an essential element of the charges, a "tax due and owing", is absent in this case.

ARGUMENT AND LAW

There are three essential elements to the crime of tax evasion, namely (1) willfulness; (2) existence of a tax deficiency; and (3) an affirmative act constituting an evasion or attempted evasion of the tax. *Sansone v. United States*, 380 U.S. 343, at 351, 85 S.Ct. 1004, at 1010 (1965); *United States v. Bishop*, 264 F.3d 535 (5th Cir. 2001); *United States v. Dack*, 747 F.2d 1172, at 1174 (7th Cir. 1984); and *United States v. Mal*, 942 F.2d 682, at 687 (9th Cir. 1991); *United States v. Silkman*, 156 F.3d 833 (8th Cir. 1998). See also *Lawn* v. *United States*, 355 U.S. 339, at 361, 78 S.Ct. 311 (1958). Mr. Cryer strenuously denies all three elements, but the absence of any one element constitutes a defense and is fatal to the charge.

Reserving all rights and objections to the indictment previously raised, it is respectfully submitted that there is, as a matter of law, no tax deficiency due and owing by defendant.

TAX LAWS SUBJECT TO STRICT CONSTRUCTION

Tax laws are clearly in derogation of personal rights and property interests and are, therefore, subject to strict construction, and any ambiguity must be resolved against

imposition of the tax. In *Billings v. U.S.*, 232 U.S. 261, 34 S.Ct. 421 (1914), the Supreme Court clearly acknowledged this basic and long-standing rule of statutory construction:

> "**Tax statutes . . . should be strictly construed, and, if any ambiguity be found to exist, it must be resolved in favor of the citizen.** *Eidman* v. *Martinez*, 184 U.S. 578, 583; *United States* v. *Wigglesworth*, 2 Story, 369, 374; *Mutual Benefit Life Ins. Co*. v. *Herold*, 198 F. 199, 201, aff'd 201 F. 918; *Parkview Bldg. Assn*. v. *Herold*, 203 F. 876, 880; *Mutual Trust Co*. v. *Miller*, 177 N.Y. 51, 57."
>
> (Id at p. 265, emphasis added)

Again, in *United States v. Merriam*, 263 U.S. 179, 44 S.Ct. 69 (1923), the Supreme Court clearly stated at pp. 187-88:

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. **But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used**. **If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer**. *Gould* v. *Gould*, 245 U.S. 151, 153."
>
> (emphasis added)

This rule of strict construction against the taxing authority was reiterated in *Tandy Leather Company v. United States*, 347 F.2d 693 (5th Cir. 1965), where Judge Hutcheson of our 5th Circuit eloquently and unequivocally proclaimed at p. 694-5:

> ". . . In ruling as he did, that the *taxpayer had the obligation to show that sales of the articles in suit were not subject to the excise taxes collected*, the district judge was misled by the erroneous contention of the tax collector into misstating the rule of proof in a tax case. This is: that the burden in such a case is always on the collector to show, in justification of his levy and collection of an excise tax, that the statute plainly and clearly lays the tax; that, in short, the fundamental rule is that taxes to be collectible must be clearly laid.
>
> "The Government's claim and the judge's ruling come down in effect to the proposition that the state of construction of appellants' kits had reached

such an advanced level that the tax levied on the finished products could be collected on their sale, though none had been clearly laid thereon by statute. Shades of Pym and John Hampden, of the Boston tea party, and of Patrick Henry and the Virginians! There is no warrant in law for such a holding. *Gould v. Gould*, 245 U.S. 151, at p. 153, 38 S.Ct. 53, 62 L.Ed. 211. In 51 American Jurisprudence, "Taxation", Sec. 316, "Strict or Liberal Construction", supported by a great wealth of authority, it is said:

> 'Although it is sometimes broadly stated either that tax laws are to be strictly construed or, on the other hand, that such enactments are to be liberally construed, this apparent conflict of opinion can be reconciled if it is borne in mind that the correct rule appears to be that where the intent of meaning of tax statutes, or statutes levying taxes, is doubtful, they are, unless a contrary legislative intention appears, to be construed ***most strongly against the government and in favor of the taxpayer or citizen***. Any doubts as to their meaning are to be resolved against the taxing authority and in favor of the taxpayer. * * *'

"The judgment was wrong. It is, therefore, reversed and the cause is remanded with directions to enter judgment for plaintiffs and for further and not inconsistent proceedings."

(emphasis is the Court's)

See also: *Gould v. Gould*, 245 U.S. 151, 38 S.Ct. 53, 153 (1917); *Royal Caribbean Cruises v. United States*, 108 F.3d 290 (11th Cir. 1997); *B & M Company v. United States*, 452 F.2d 986 (5th Cir. 1971); *Kocurek v. United States*, 456 F. Supp. 740 (1978)*; Norton Manufacturing Corporation v. United States*, 288 F. Supp. 829 (1968)*; Grays Harbor Chair and Manufacturing Company v. United States*, 265 F. Supp. 254 (1967); *Russell v. United States*, 260 F. Supp. 493 (1966).

Thus, as we enter into the labyrinth of the Internal Revenue Code and its related regulations, we must do so mindful of the hornbook rule that tax laws are strictly construed

and that when the letter of the law is subject to more than one interpretation, it must be construed against the imposition of the tax, the rule of interpretation of taxes being:

> ***"that the burden in such a case is always on the collector to show, in justification of his levy and collection of an excise tax, that the statute plainly and clearly lays the tax; that, in short, the fundamental rule is that taxes to be collectible must be clearly laid."*** *Tandy Leather Company, supra,* at 694.
>
> (emphasis added)

THE INCOME TAX LAW DOES NOT "PLAINLY AND CLEARLY LAY" ANY TAX UPON DEFENDANT OR HIS REVENUE

The Internal Revenue Code does not "Plainly and Clearly Lay" any liability for an income tax on defendant.

The Income Tax Law, Subtitle A of Title 26, United States Code, imposes a tax on the taxable income of certain individuals in § 1:

"***26 U.S.C. § 1.*** **Tax Imposed.**

"(a) Married individuals filing joint returns and surviving spouses

"There is hereby imposed **on the taxable income** of —

"(1) every married individual (as defined in section 7703) who makes a single return jointly with his spouse under section 6013, and

"(2) every surviving spouse (as defined in section 2(a)),

a tax determined in accordance with the following table:

. . .

"(b) Heads of households

"There is hereby imposed **on the taxable income** of every head of a household (as defined in section 2(b)) a tax determined in accordance with the following table:

. . .

"(c) Unmarried individuals (other than surviving spouses and heads of households)

"There is hereby imposed **on the taxable income** of every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703) a tax determined in accordance with the following table:

. . .

"(d) Married individuals filing separate returns

"There is hereby imposed **on the taxable income** of every married individual (as defined in section 7703) who does not make a single return jointly with his spouse under section 6013, a tax determined in accordance with the following table: . . ."

(emphasis added)

but this section does not designate anyone as liable for the payment of the tax.

It should be noted at this point that titles and headings, such as "Married individuals and surviving spouses filing joint returns" and "Heads of households" are not part of the law and have absolutely no legal effect. 26 U.S.C. § 7806. Therefore, the actual statute commences with "There is hereby imposed . . ." The imposition of the tax is on taxable income, only, not on any person or entity. In contrast, see 26 U.S.C. § 884, discussed more fully *infra*, which does impose a tax on an entity.

Subtitle A does, however, designate partners as liable for the taxes on income of a partnership, but only in their "individual" capacities (26 U.S.C. § 701) while certain partnerships are declared liable for excess recapture of credits (26 U.S.C. 704).

Foreign corporations are specifically designated as the party liable for payment of the "Branch profits tax" imposed by 26 U.S.C. § 884 (which, incidentally, does impose the tax on "any foreign corporation").

The only other party that is identified in the income tax law as liable for the payment of any income tax is revealed in 26 U.S.C. § 1461:

"***Sec. 1461. Liability for withheld tax***

"Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the

> claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter."
>
> (emphasis added)

"This chapter" is "Chapter 3 - Withholding Tax on Nonresident Aliens and Foreign Corporations". Thus the liable party in this instance is anyone withholding tax on nonresident aliens and foreign corporations.

There are no other references in Subtitle A (the income tax law) to anyone being liable for the tax imposed by § 1 other than those: partners (but only in their "individual" capacity); certain large partnerships in certain excess credit situations; foreign corporations; and those withholding taxes on nonresident aliens and foreign corporations.

There is only one other party that is identified as being liable for the income tax, but to find that party we have to journey outside the realm of the income tax law to "Subtitle C – Employment Taxes", where we find:

> "**Sec. 3403. Liability for tax**
>
> "The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter [*"Subtitle C – Employment Taxes; Chapter 24 – Collection of Income Tax at Source on Wages"*], and shall not be liable to any person for the amount of any such payment."
>
> (emphasis and [*bracketed material*] added)

Thus, the only persons being assigned any liability for the income tax imposed by § 1 are those five instances — partners, certain large partnerships, foreign corporations, withholders of taxes on nonresident aliens and foreign corporations and those employers required by Chapter 24 of Subtitle C to withhold taxes on employees.

The absence, or near absence, of a statutory provision specifying exactly who is liable for a tax imposed is not customary. 26 U.S.C. §§ 2032A and 2056A specifically state who is liable for the Estate Tax; 26 U.S.C. § 3102(b) specifically states who is liable for the FICA tax;: 26 U.S.C. § 3202 specifically states who is liable for the Railroad Retirement Tax; 26 U.S.C. § 3505 specifically imposes liability for Employment Taxes; 26 U.S.C. §§ 4002 and 4003 specify not only who is primarily liable, but who is secondarily liable for the Luxury Passenger Automobile Excise Tax. See also: 26 U.S.C. §§ 4051 and 4052 (Heavy Trucks and Trailers Excise Tax); 26 U.S.C. § 4071 (Tire Manufacture Excise Tax); 26 U.S.C. § 4219 (Manufacturers Excise Tax); 26 U.S.C. § 4401 (Tax on Wagers); 26 U.S.C. § 4411 (Wagering Occupational Tax); 26 U.S.C. § 4483 (Vehicle Use Tax); 26 U.S.C. § 4611 (Tax on Petroleum); 26 U.S.C. § 4662 (Tax on Chemicals); 26 U.S.C. § 4972 (Tax on Contributions to Qualified Employer Pension Plans); 26 U.S.C. § 4980B (Excise Tax on Failure to Satisfy Continuation Coverage Requirements of Group Health Plans); 26 U.S.C. § 4980D (Excise Tax on Failure to Meet Certain Group Health Plan Requirements); 26 U.S.C. § 4980F (Excise Tax on Failure of Applicable Plans Reducing Benefit Accruals to Satisfy Notice Requirements); 26 U.S.C. § 5005 (Gallonage Tax on Distilled Spirits); 26 U.S.C. § 5043 (Gallonage Tax on Wines); 26 U.S.C. § 5232 (Storage Tax on Imported Distilled Spirits); 26 U.S.C. § 5364 (Tax on Wine Imported in Bulk); 26 U.S.C. § 5418 (Tax on Beer Imported in Bulk); 26 U.S.C. § 5703 (Excise Tax on Manufacture of Tobacco Products); and 26 U.S.C. § 5751 (Tax on Purchase, Receipt, Possession or Sale of Tobacco Products), to name a few.

Considering the "standard in the drafting of taxation laws industry", particularly in view of the requirement of strict construction, the limitation of liability to those five instances cannot be assumed to have been an oversight. In this instance the only ones liable are those specifically named as liable, just as in any other tax provision.

In *United States v. Calamaro*, 354 U.S. 351, 77 S.Ct. 1138 (1957), the Supreme Court reviewed the conviction of a "pick-up man" in a numbers game operation. Calamaro had been convicted of failure to pay an occupational tax, imposed not only on persons who are subject to the excise tax on being "engaged in the business" of wagering, but also on those who are "engaged in receiving wagers" on behalf of one subject to the excise tax.

Although the "pick-up man", Calamaro, was the person who actually received the money from the players, handed out the betting slips to the players and was acting on behalf of the "banker", the Supreme Court held that the he was not one who "engaged in receiving wagers" because "receiving wagers" meant accepting or entering into the wager, not receiving the money for the wager. See also *Griffin v. United States*, 588 F.2d 521 (5th Cir. 1979); *Fine v. United States*, 206 F.Supp. 520 (Colo. 1962); *Drake v. United States*, 355 F.Supp. 710 (ED Mo. 1973); and *United States v. Mobil Corp*, 543 F. Supp. 507 (ND Tex. 1981) (26 U.S.C. 6001 and 26 CFR 31.6001 stating records "shall at all times be available for inspection" by revenue officers did not permit IRS blanket access, without warrant or summons, to browse through employee W-4's).

In *Calamaro*, the government cited a parallel regulation that more clearly included the "pick-up" man as one who "engaged in receiving wagers", which the Supreme Court effortlessly dismissed:

> "Finally, the Government points to the fact that the Treasury Regulations relating to the statute purport to include the pick-up man among those subject to the § 3290 tax, and argues (a) that this constitutes an administrative interpretation to which we should give weight in construing the statute, particularly because (b) section 3290 was carried over *in haec verba* into § 4411 of the Internal Revenue Code of 1954. We find neither argument persuasive. **In light of the above discussion, we cannot but regard this Treasury Regulation as no more than an attempted addition to the statute of <u>something which is not there</u>**. **As such the regulation can furnish no sustenance to the statute**. *Koshland* v. *Helvering*, 298 U.S. 441, 446-447. Nor is the Government helped by its argument as to the 1954 Code. The regulation had been in effect for only three years, and there is nothing to indicate that it was ever called to the attention of Congress. The re-enactment of § 3290 in the 1954 Code was not accompanied by any congressional discussion which throws light on its intended scope. In such circumstances we consider the 1954 re-enactment to be without significance. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431. *Calamaro*, supra, at 358-9
>
> (emphasis added)

See also, *Water Quality Ass'n v. United States*, 795 F.2d 1303 (7th Cir. 1986), where, citing and quoting *Calamaro*, the court added at p. 1309:

> "**It is a basic principle of statutory construction that courts have no right first to determine the legislative intent of a statute and then, under the guise of its interpretation, proceed to either add words to or eliminate other words from the statute's language**. *DeSoto Securities Co. v. Commissioner*, 235 F.2d 409, 411 (7th Cir. 1956); see also *2A Sutherland Statutory Construction* § 47.38 (4th ed. 1984). Similarly, **the Secretary has no power to change the language of the revenue statutes because he thinks Congress may have overlooked something**."
>
> (emphasis added)

There is no dispute, nor does the government otherwise contend, that defendant, Mr. Cryer, is not a partner in any partnership, is not a large partnership, nor is he a foreign corporation. Mr. Cryer is not required to withhold any taxes on a nonresident alien nor on any foreign corporation, nor is he required by Chapter 24 of Subtitle C to withhold taxes on any fees he receives. Accordingly, the only way the income tax law could be interpreted as imposing any liability for income tax upon Mr. Cryer is by inference or implication.

"But in statutes levying taxes the literal meaning of the words employed is most important, for ***such statutes are not to be extended by implication*** beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer." *Merriam, supra*.

If the provisions of the Internal Revenue Code, even considering those outside the Income Tax Law (Subtitle A) fail to "plainly and clearly" lay liability for the tax upon Mr. Cryer, then they cannot be given that effect through strained interpretations, implication or inference. Nevertheless, the government claims that Mr. Cryer owes income taxes "***though none had been clearly laid thereon by statute***. Shades of Pym and John Hampden, of the Boston tea party, and of Patrick Henry and the Virginians! There is no warrant in law for such a holding." *Tandy Leather, supra*.

It is, therefore, respectfully submitted that there is no statute that renders Mr. Cryer liable for an income tax, and, therefore, he is not so liable. Absent a lawful liability for taxes, the essential element, liability for a tax deficiency, is lacking in this case as a matter

of law, and, accordingly, it is respectfully submitted that both counts of the indictment should be dismissed, with prejudice.

The Internal Revenue Code does not "Plainly and Clearly Lay" a tax on any of defendant's revenues.

The same rigid rule of strict construction laid down by the Supreme Court in *Billings*, *Merriam*, *Gould* and *Calamaro*, *supra*, applies to the question of what is taxed as well as who is made liable for the tax.

Our second foray into the labyrinth begins as the first, with § 1, which imposes a tax "on taxable income." The first order of business is to determine the definition of the terms in order to define the scope of the tax. However, the first observation is stunning. Although the first 1,564 sections of the Internal Revenue Code are devoted to the Income Tax, the term "income", the very subject of the tax, is not defined. Nor is the term defined in any of the related regulations promulgated by the Treasury Department.

Nor is the term "taxable" defined in the Code or regulations.

The closest thing we have to definitions of "income" and "taxable" are all qualified, "hybrid", definitions, income linked with another term. Thus when a body of statutory law fails to provide a definition of a term, we must use its customary meaning. Turning to dictionaries, we find:

Webster's Dictionary:

Income. "A **gain** or recurrent benefit usually measured in money that derives from capital or labor"

(emphasis added)

Black's Law Dictionary:

Income. "The **return** in money from one's business, labor or capital invested; **gains, profits** or private revenue."

(emphasis added)

and, since federal law provides no definition, we look to other laws:

Louisiana Civil Code:

"Art. *551*. Kinds of fruits

"Fruits are things that are produced by or derived from another thing without diminution of its substance.

"There are two kinds of fruits; natural fruits and civil fruits.

"Natural fruits are products of the earth or of animals.

"Civil fruits are revenues **derived from a thing** by operation of law or by reason of a juridical act, such as rentals, interest, and certain corporate distributions."

(emphasis added)

In the Code we find hybrid definitions for "ordinary income" and "gross income":

***"26 U.S.C. § 64*. Ordinary Income Defined.**

> "For purposes of this subtitle, the term "ordinary income" includes any **gain** from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b). Any gain from the sale or exchange of property which is treated or considered, under other provisions of this subtitle, as "ordinary income" shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b)."

and

***"26 U.S.C. § 61*. Gross Income Defined.**

> "General Definition — Except as otherwise provided in this subtitle, gross income means all income [*income means income*] from whatever source derived, including (but not limited to) the following items:
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items; . . ."

(emphasis and [*bracketed material*] added)

While the significance or import of the phrase "from whatever source derived" will be more fully discussed below, it is important at this point to at least note that the phrase "from whatever source derived" is tracked from the Sixteenth Amendment, which provided that an income tax could not be classified as a direct tax by virtue of the source of that income. *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 36 S.Ct. 236 (1916); *Tyee Realty Co. v. Anderson, 240 U.S. 115, 36 S.Ct. 281 (1916; Stanton v. Baltic Mining Co., 240 U.S. 103, 36 S.Ct. 278 (1916)* This Amendment was adopted in order to overrule *Pollock v. Farmers' Loan and T. Co., 157 U.S. 537, 15 S.Ct. 673 (1895)*, which held that a tax on income derived from property burdened the property and was, therefore, a direct property tax

subject to the requirement of apportionment. Therefore, the reference to "from whatever source derived" is not an indication that Congress may tax any income from any source, but is only an indication that an *income* tax (and a tax only on income) is not to be classified as a direct tax, subject to the requirement of apportionment, by virtue of the source of the income. This is not to say that the tax is to be applied and charged against all income without regard to its source.

The 16th Amendment **did not expand the scope of Congress' power to tax** (*Brushaber, Stanton, Tyee, supra* et al.), thus although the source of income is no longer a factor in determining whether the tax is direct or indirect, neither the jurisdiction of the federal government nor its taxing authority was enlarged to include authority to tax activities and privileges that it could not have taxed before the 16th Amendment. Source of income, then, is still a factor in determining the scope of the taxing authority of the federal government. (See discussions of *Bailey v. Drexel Furniture Co*., 259 U.S. 20, 36 S.Ct. 236 (1916); *McCulloch v. Maryland, 17 U.S. 316 (1819)*; and others, *infra*) As we will see, those factors were also taken into consideration in the determination of taxable income in the Code and regulations.

The obvious common usage for the term "taxable", although not readily found in Websters, is "able to be taxed", i.e., within the authority of a government to tax.

And finally, we have the hybrid definition of "taxable income":

***26 U.S.C. § 63*. Taxable Income Defined.**

(a) In general

> Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

Thus, when we combine the definitions we have, now, we have:

Income = gains, profits, from capital, labor or both

Taxable = within the authority of the government to tax

Thus, "taxable income" would be all gain [from activities that are within the authority of the federal government to tax] derived from capital, from labor, or from both combined from whatever source [that is within the authority of the federal government to tax] derived, and including certain enumerated items such as gains, or profits, from compensation for services, minus the deductions allowed by this chapter (other than the standard deduction).

"Whatever" does not identify those sources that are within the authority of the federal government to tax, but in checking the index under "Income Tax" we find "sources" and we also find "within the U.S." In order to determine what income is taxable the index of the Code designates the starting point as 26 U.S.C. § 861:

***26 U.S.C. § 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:
>
> [*This section goes on to list **items** of gross income, but does not define source nor does it specify any sources. Following the statutory text, however, we are referred to the Code of Federal Regulations:*]

"CODE OF FEDERAL REGULATIONS

"General regulations, see **26 CFR Sec. 1.861-1.**

". . . .

"**Computation of taxable income from sources within U.S.** and from other sources and activities, see **26 CFR Sec. 1.861-8**."

(emphasis and [*bracketed material]* added)

So, now our journey into the labyrinth continues into the Code of Federal Regulations:

"26 C.F.R. § 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**. These sections **explicitly allocate certain important sources** of income to the United States or to areas outside the United States, as the case may be; and, with respect to the remaining income (particularly that derived partly from sources within and partly from sources without the United States), authorize the Secretary or his delegate to determine the income derived from sources within the United States, either by rules of separate allocation or by processes or formulas of general apportionment. 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 the items of gross income allocated or apportioned to such sources in accordance with section 863(a). See 26 C.F.R. §§ 1.861-2 to 1.861-7, inclusive, and 26 C.F.R. § 1.863-1. **The taxable income from sources within the United States, in the case of such income, shall be determined by deducting therefrom, in accordance with sections 861(b) and 863(a),** 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.** See 26 C.F.R. **§§ 1.861-8** and 1.863-1."

(emphasis added)

There are two distinct provisions contained in this regulation that warrant our attention. First, the section informs us that §§ 861 et seq. are to be used to determine taxable income, but, equally significant, is, second, that besides the deductions of expenses, losses and other deductions referred to in 26 U.S.C. § 63 (taxable income = gross income less deductions), we are now made aware that there are either items or sources of income that CANNOT be (as opposed to "are not") included in gross income to begin with. The inescapable conclusion from this revelation is that not all income is includable in gross income, reaffirming our previous discussion of "from whatever source derived" as being reflective of the 16th Amendment's prohibition of considering the source in classifying the income tax as anything other than an excise, rather than defining the scope of the tax to include "each and every" source.

Now, in order to determine which sources *can* be considered in determining taxable income and, conversely, which sources *cannot* be included in gross income to begin with, § 1.861-1(a)(1) directs us to § 1.861-8:

> ***"26 C.F.R. § 1.861-8*** **Computation of <u>taxable income</u> 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**.
>
> ***[This again confirms that gross income from within the U.S. "whatever" sources derived is not necessarily subject to federal taxation. "Taxable" income, therefore, must be something less than all income from within from "whatever" source. Therefore, some sources within the United States are taxable and some sources within the United States are NOT taxable.]***

"Sections 862(b) and 863(a) state in general terms how to determine taxable income of a taxpayer from sources without the United States after gross income from sources without the United States has been determined. This section provides specific guidance for applying the cited Code sections by prescribing rules for the allocation and apportionment of expenses, losses, and other deductions (referred to collectively in this section as deductions") of the taxpayer**. 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**."

(emphasis and [*bracketed material*] added)

So, what does paragraph (f)(1) of this section identify as those specific sources and activities that determine whether income is taxable?

"(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**.

"(ii) [Reserved]

"(iii) **DISC and FSC taxable income.**

"(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 of tax preference** under section 58(g) determined for purposes of the minimum tax;

"(B) The amount of **foreign mineral income** under section 901(e);

"(C) [Reserved]

"(D) The amount of **foreign oil and gas extraction income** and the amount of foreign oil related income under section 907;

"(E) [Reserved] [The **tax base for citizens entitled to the benefits of § 931** and the § 936 **tax credit of a domestic corporation which has an election in effect under §936** - - deleted by amendment]

"(F) [Reserved] [*The exclusion for **income from Puerto Rico** for residents of Puerto Rico - - deleted by amendment*]

"(G) **The limitation under section 934 on the maximum reduction in income tax liability incurred to the Virgin Islands**;

"(H) [Reserved] [***Income derived from Guam*** *- - deleted by amendment*]

"(I) The **special deduction granted to China Trade Act corporations under section 941**;

"(J) The amount of certain U.S. source income excluded from the subpart F income of a **controlled foreign corporation** under section 952(b);

"(K) The amount of **income from the insurance of U.S. risks** under section 953(b)(5) [*dealing with **foreign** corporations*];

"(L) **The international boycott factor and the specifically attributable taxes and income under section 999**; and

"(M) **The taxable income attributable to the operation of an agreement vessel under section 607 of the Merchant Marine Act of 1936**, as amended, and the Capital Construction Fund Regulations thereunder (26 CFR, part 3). See 26 CFR 3.2(b)(3)."

(emphasis and [*bracketed material*] added)

These sources, then, are what remains after deducting those items that *"cannot"* "be allocated to some item or class of gross income". 26 CFR § 1.861-1

Whence came this acknowledgement that not all income, "from whatever source derived", is to be included in gross income?

Prior to 1954, the income tax was levied upon "net income". Gross income was, pursuant to the preceding act, the 1939 Code, determined in accordance with the 1940 regulations, of which § 19.22(b)-1 provided:

> "(b) **Exclusions from gross income** — The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> "Sec. 19.22(b)-1. **Exemptions—Exclusions from gross income**—Certain items of income specified in section 22(b) are exempt from tax and may be excluded from gross income. These items, however, are exempt only to the extent and in the amount specified. 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. Since the tax is imposed on net income, the exemption referred to above is not to be confused with the deductions allowed by section 23 and other provisions of the Internal Revenue Code to be made from gross income in computing net income. As to other items not to be included in gross income, see sections 112 and 119 [*the predecessor of the current 1.861-1 et seq.*] . . . "
>
> (emphasis and [*bracketed material*] added)

The previous regulations for the income tax laws contained similar, if not identical, acknowledgements that not all income is Constitutionally taxable by the federal government (early versions referred to exempt income being that which is not taxable by the federal government "under fundamental law").

The admission made in these regulations is nothing less than shocking. Gross income is defined in the 1939 Code § 22(a) as virtually everything. Code § 22(b) lists some

exemptions, like tax free interest and life insurance. But then the government admits, mumbling up its sleeve, that some of those things listed in § 22(a) are also exempt because they are, "under the Constitution, not taxable by the federal government." If some of those items are not taxable, then why include them in gross income in the first place?

Not to make light of the gravity of the matter before the Court, but the best way to illustrate the import of this revelation is to imagine a new game show: Welcome to another exciting episode of "What's My Tax" with your host, Manny Hauls. Our contestant today is John Q. Public! Are you up there John? Well, COME ON DOWN! Now, as you can see, Johnny, we have an array of doors here, salaries, compensation for services, rents, dividends, interest, and. . .well, there are too many for us to read them all off, but you can see them.

Now, Johnny, as you can see, we've already marked some of those doors for you, like "life insurance" over there, "tax-free interest" back here, just to get you started, but here's the good news: Some of these other doors are actually Constitutionally EXEMPT! That's right, Johnny, EXEMPT! So here's the deal: You pick one of the doors, and if that door is correct, you get an EXEMPTION!! and you get to keep the money we aren't allowed to take. How's that for a prize? (audience cheers)

But here's the catch: If you choose the wrong door, Beulah the chimp will blow her horn and you get the booby prize: INTEREST and PENALTIES!! (audience goes "Aawwww") This would be funny if it were not true.

Similarly, in the 1939 Code itself, there is a clear indication that not all income is Constitutionally taxable income, notwithstanding the 16th Amendment and its "from whatever source derived" phrase. § 115(f)(1) and (h)(2) of the 1939 Code provide:

> "(f) (1) GENERAL RULE—A distribution made by a corporation to its shareholders in its stock or a right to acquire its stock shall not be treated as a dividend to the extent that it **does not constitute income to the shareholder within the meaning of the Sixteenth Amendment** to the Constitution.
> . . .
> "(h) EFFECT ON EARNINGS AND PROFITS OF DISTRIBUTION OF STOCKS—The distribution (whether before January 1, 1939, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities of another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation . . .
> "(2) if the distribution was not subject to tax in the hands of such distributee because it **did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution** or because exempt to him under section 115(f) of the Revenue Act of 1934, 48 Stat. 712, or a corresponding provision of a prior Revenue Act."
>
> (emphasis added)

Thus, prior to 1954 the tax was imposed on "net income" and although the Code and the regulations did not disclose what income is beyond the ability of the federal government to tax, nor did they disclose what income is not included within the meaning of "income" in the 16th Amendment, at least it did disclose that some items or sources of income are exempt from taxation.

While the citizen seeking to understand what was expected of him would have to conduct a great deal of legal research to identify the limits of the federal taxing authority and to determine what income is and is not included within the meaning of the 16th Amendment, at least he was, to some extent, "on notice" to look for those exemptions.

The 1954 Code and the regulations promulgated thereunder, which was not considered to have made any significant substantive changes in the income tax law (and which, certainly, did not enlarge the Constitutional scope of federal taxation authority nor the Constitutional definition of "income"), primarily reordered and renumbered the old Code and regulations. The new Code, however, made two very significant "adjustments".

First, the tax was now imposed on "taxable" income. While the term is defined in its hybrid form, "taxable income", in § 63 (drawing our attention from the separate meanings of the words), when placed in context with the second major "adjustment", the term "*taxable*" income becomes monumentally significant.

Second, except for 26 CFR 1.312-6, each and every reference to the Constitution, to fundamental law, to limitations on the federal taxing authority and to the Sixteenth Amendment's meaning of "income" was purged, erased, banished from both the Code and the regulations.

The previous disclosures of Constitutional exemptions, exemptions under fundamental law, Constitutional limitations of federal taxing authority and the qualified scope of the word "income" within the meaning of the Sixteenth Amendment, were no longer deemed necessary. Since the imposition of the tax itself was limited by changing "net income" to "taxable" income, imposing the tax only on that income the federal government was Constitutionally entitled, *able*, to *tax*, *tax-able*, thereby, technically, excluding all Constitutionally exempt or excluded income from the effects of the tax. By excluding exempt and excluded income in the imposition itself, there was apparently no

longer any need perceived by the government to disclose that not all income is "taxable" income.

Thus, § 861 of the Code and its parallel regulations, 26 CFR 1.861-1 et seq. are vestigial disclosures, what is left of the previous § 22(b) exemptions and § 115 qualifications of the meaning of "income". There is, however, another vestigial remnant of those disclosures. Conducting a search of the regulations for "exempt", we are, not surprisingly, led back to § 861, more particularly, 26 CFR 1.861-8T(d)(2)(ii) and (iii):

> "(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**. The term exempt asset means any asset the income from which is, in whole or in part, exempt, excluded, or eliminated for federal tax purposes.
>
> [*Note the absence of reference to "fundamental law", "under the Constitution, not taxable by the federal government", or "not income within the meaning of the Sixteenth Amendment"*]
>
> "(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 (including a **foreign sales corporation** (FSC)) computing its effectively connected income, gross income (whether domestic or foreign source) which is not effectively connected to the conduct of a United States trade or business;
>
> "(B) In computing the combined taxable income of a **DISC or FSC** [*international or foreign sales corporation*] and its related supplier, the gross income of a DISC or a FSC;
>
> "(C) For all purposes under subchapter N of the Code, including the computation of combined taxable income of a **possessions corporation** and

> its affiliates under section 936(h), the gross income of a possessions corporation for which a credit is allowed under section 936(a); and
>
> "(D) **Foreign earned income** as defined in section 911 and the regulations thereunder (however, the rules of Sec. 1.911-6 do not require the allocation and apportionment of certain deductions, including home mortgage interest, to foreign earned income for purposes of determining the deductions disallowed under section 911(d)(6))."
>
> (emphasis and [*bracketed material*] added)

Although this provision defines exempt income, it, again and still, does not identify or refer us to what those exemptions are or upon what they are based. Instead, it tells us what is NOT exempt, leading to the reasonable supposition that any income other than that which is not exempt is, or at least may very well be, "exempt, excluded or eliminated" from federal income tax.

Congress and the Treasury Department have statutorily and through regulations, respectively, acknowledged that there are limitations upon Congress' power to tax and that there are items and sources of income that are Constitutionally exempt from taxation by the federal government. 1939 Code and 1940 regulations, *supra*. The present Code and regulations acknowledge that some income CANNOT be attributed to gross income; that some income is exempt from taxation; that the current Code and regulations specify those sources that CAN be included in gross income for determination of taxable income (§ 1.861-8(f)(1)) and specify those items that are not exempt (§ 1.861-8T(d)(2)(iii)).

Remembering that tax laws must be strictly construed and that any ambiguity must be resolved against imposition of the tax, it can, therefore, only be concluded that sources of income other than those enumerated cannot be included in gross income and that items

of income other than those items of income specified as *not* exempt, *are* exempt from the federal income tax. With the sole exception of those sources specifically identified as taxable and those items specifically identified as not exempt, it cannot be said that the tax has "been plainly and clearly laid" on any other sources or items of income. *Billings, Merriam, Gould, Tandy Leather, supra.*

There is no dispute, nor does the government otherwise contend, that Mr. Cryer has received no income, gains, from any of the taxable sources enumerated nor has he received any non-exempt items of income specified, and, therefore, that no tax has been clearly laid on the fees received by Mr. Cryer for legal services.

It is a virtual certainty that the government will argue that there is another interpretation of the Codal and regulatory provisions detailed hereinabove, "But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. ***If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer***." *Merriam, supra*.

If the provisions of the Internal Revenue Code, even considering those outside the Income Tax Law (Subtitle A) fail to "plainly and clearly" lay a tax upon Mr. Cryer's revenues, then they cannot be given that effect through strained interpretations, implication or inference. Nevertheless, the government claims that Mr. Cryer owes income taxes on those revenues "***though none had been clearly laid thereon by statute***. Shades of Pym and

John Hampden, of the Boston tea party, and of Patrick Henry and the Virginians! There is no warrant in law for such a holding." *Tandy Leather, supra*.

It is, therefore, respectfully submitted that the Internal Revenue Code and regulations do not plainly and clearly impose a tax on Mr. Cryer's revenues, and, therefore, there can be no federal income tax owed thereon. Without "plain and clear" imposition of taxes there can be no tax deficiency and that essential element, liability for a tax deficiency, is lacking in this case as a matter of law. Accordingly, it is respectfully submitted that both counts of the indictment should be dismissed, with prejudice.

DEFENDANT'S REVENUES ARE NOT SUBJECT TO FEDERAL TAXATION BY EXCISE

The Federal Taxing Power

The Supreme Court has on countless occasions described the taxing power of the federal government as "all encompassing", and from one standpoint it is "all encompassing". The manner and means of exercising that "all encompassing" power of taxation are not, however, limitless. A review of the Constitutional provisions specifying those means is helpful in understanding those limitations.

Article I, § 2, cl. 3:

> "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers... ."

Article I, § 8, cl. 1:

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

Article I, § 9, cl. 4:

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

To these provisions has been added:

"**Amendment XVI - Status of Income Tax Clarified.**

"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."

In these provisions are incorporated the long-standing practice and understanding that all taxes must fall into one of two classes, direct or indirect, with duties, imposts and excises being considered as indirect and taxes on property or person as direct.

The limitation on direct taxes is perfectly harmonious and parallel to the intent of the framers in restricting the powers of the new federal government, keeping it at arms length from the citizens of the "Free and Independent States."[1] The gravest concern of both the States and the People was that the federal government would seek to govern the People, whether through regulation or by taxation, a role generally regarded as the exclusive realm of the States—something neither the People nor the States were willing to tolerate or permit. Congress was permitted to tax the public, but only *indirectly*. Any tax on person or

[1] An understanding of the distinction between the nature of the individual and free-standing sovereignty of the States and the restricted and conditional sovereignty conferred by the Constitution is inherent in the fact that the Declaration of Independence did not establish the independence of the "United States", but only of the "Free and Independent States."

property had to be imposed through the States, not directly upon any citizen. The States, not Congress, would then decide through what means and from what resources the tax, more like an assessment, would be paid.

There are no Constitutional limitations upon the subject of a direct tax, and, therefore, it can honestly be said that the taxing authority of Congress is "all encompassing." For example, Congress could pass a one dollar tax on each foot of beach frontage, but that tax would not be imposed on citizens owning beach-front property. The total amount of the tax would be calculated and then apportioned among the States, each State receiving an assessment for its apportioned share of the total, and without regard to the fact that most States have no beach frontage.

Indirect taxation, however, was limited by its definition, which excludes the taxation of person or property from its class of taxation. This form of taxation differed in more than the question of means and manner, that distinction being that every indirect tax is voluntary upon and avoidable by the citizen. Any tax upon an activity can be avoided by choosing not to engage in the taxed activity. Thus, the citizen "accedes" or "consents" to the tax by engaging in the activity that is taxed. In this vein, a tax upon the activity of breathing, being unavoidable and not, at least reasonably, within the ability of the citizen to abstain, would not be an indirect tax. While at least in theory a breathing tax could be imposed, it would have to be considered direct and apportioned among the States.

The primary issue, then, in any act of taxation by Congress is whether the tax is indirect, in which case the tax must meet the requirement of uniformity, or direct, in which

case the tax must be apportioned among the states. That issue surfaced almost immediately. In *Hylton v. United States*, 3 U.S. 171 (1796), the Supreme Court was required to address a challenge that a tax on carriages "for the conveyance of persons" was a direct tax on property, carriages. The Court, however, distinguished between a tax on the ownership of property and one on the consumption (since carriages wear out) of the property, i.e., an avoidable activity, and upheld the tax as an excise, not requiring apportionment.

In 1861 the first tax on income was enacted. It imposed a tax on all income derived from property and was generally considered and implemented as, although no formal challenge was ruled upon, an indirect excise tax on the use of the property for gain. Thus the lines of demarcation between the two taxes, primarily due to *Hylton*, becomes clearer. A tax on property or person is a direct tax, requiring apportionment, and a tax on privileged and avoidable activities is an indirect tax, requiring uniformity.

The questions remaining, however, are: 1) What is the scope of taxation authority of the federal government in general? And 2) What activities may be the proper subject of an excise tax? No determination of the extent of the federal taxing authority can be made without first answering those two questions.

The answer to the first was not long in coming. The scope of taxing authority was first and thoroughly dealt with in 1819 in *McCulloch v. Maryland*, 17 U.S. 316 (1819). The Supreme Court was required to define the limits of taxing authority a State[2], Maryland,

[2] It should be noted, in passing, that the taxing authority in this instance is of a full, free-standing sovereignty, not a limited or conditional sovereignty or sovereignty by convention.

due to its attempt to tax the national bank, a body established by Congress. Justice Marshall, at p. 429:

> "It may be objected to this definition, that the power of taxation is not confined to the people and property of a state. It may be exercised upon every object brought **within its jurisdiction.** This is true, But to what source do we trace this right? It is obvious, that it is an **incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a state extends, are objects of taxation; but those over which it does not extend, are, upon the soundest principles, exempt from taxation. This proposition may almost be pronounced self-evident.**
>
> "The sovereignty of a state extends to everything which exists by its own **authority**, or is introduced by its **permission**."
>
> (emphasis added)

It should be noted that these principles are not some antiquated philosophical enunciations, but are foundational Constitutional law, in full force and effect[3] and relied upon hundreds of times by our courts, even as recently as this year (See *U.S. v. Reynard*, 02-50476 (9th Cir. 1-12-2007)).

Also noteworthy, is that in defining the extent of the taxing authority of a sovereignty as co-extensive with its jurisdiction, and, particularly, in defining all without that jurisdiction to be ***exempt*** from that authority, we are not hearing this from one who is unsympathetic to the powers of government. Marshall was a staunch Federalist. *McCulloch* is best known and remembered for its *expansion* of federal authority and his

[3] This brief description of the legislative power and sovereignty of the state is found in a variety of subsequent decisions and is thus a well established principle; see Weston v. City Council of Charlston, 2 Pet. (27 U.S.) 449, 467 (1829); The Providence Bank v. Billings, 4 Pet. (29 U.S.) 514, 564 (1830); The Piqua Branch of the State Bank of Ohio v. Knoop, 16 How. 369, 409 (1853); People of State of New York, ex rel. of the Bank of Commerce v. Commissioners of Taxes and Assessments for the City and County of New York, 67 U.S. 620, 632 (1863); Union Pacific Railroad Co. v. Peniston, 85 U.S. 5, 38 (1873); The Wheeling, Parkersburg and Cincinnati Trans. Co. v. City of Wheeling, 99 U.S. 273, 279 (1879); Society for Savings v. Coite, 73 U.S. 594, 604 (1868); Van Brocklin v. Tennessee, 117 U.S. 151, 155, 6 S.Ct. 670 (1886); United States v. Rickert, 188 U.S.

maximal views of jurisdiction are best evidenced in this ruling, where he holds that "not delegated" does not mean "not delegated" because it does not say "not *expressly* delegated" (at 406) and that "necessary" does not mean "necessary" because it does not say "*absolutely* necessary" (at 414).

It can safely be said, then, that the recognition of a State's power to tax, which would either exceed or at least equal that of a sovereignty by convention, as co-extensive with its jurisdiction, would be an ample standard to apply in surveying the authority of the federal government to tax. Therefore, if we proceed with this analysis on the basis of assigning to the federal government the full taxing authority, subject to the restrictions on manner and means of that taxation, of an original and free-standing sovereignty, such as a State, we can be assured that we will not be undercutting or minimizing that authority.

From *McCulloch*, then, we can conclude:

A. The power to tax is <u>co-extensive with the jurisdiction</u> of the taxing authority;

B. All things without that jurisdiction are <u>exempt from taxation</u> by the taxing authority; and

C. The jurisdiction of a sovereignty extends to all things that exist by its <u>authority</u> or are introduced with its <u>permission</u>.

Since the taxing authority of the federal government, then, is co-extensive with it's jurisdiction, a survey of that jurisdiction is necessary in order to define the limits of that

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432, 438, 23 S.Ct. 478 (1903); First National Bank in St. Louis v. Missouri, 263 U.S. 640, 663, 44 S.Ct. 213 (1924); Detroit v. Murray Corp. of America, 355 U.S. 489, 497, 78 S.Ct. 458 (1958);

taxing authority. Prior to doing so, there is another bookend to the extent of taxing authority. *McCulloch* not only delineated and defined the area or scope over which a sovereignty may exercise its power to tax, but also defined those areas over which a sovereignty may NOT exercise its power to tax. Marshall at 431:

> That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; **that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control**, are propositions not to be denied.
>
> (emphasis added)

That answers the question of whether a State can tax those matters that are under the jurisdiction of the federal government and where the federal government's authority over those matters is supreme, but what about the reverse of that issue? Who is the supreme authority over those matters within the State's jurisdiction? The answer to that question was also provided by the Supreme Court in *Farrington v. Tennessee*, 95 U.S. 679 (1877)[4], where the Supreme Court recognized that in the areas within State jurisdiction, State law is supreme to that of the federal government. *Farrington* at 685:

> "In cases involving Federal questions affecting a State, the State cannot be regarded as standing alone. It belongs to a union consisting of itself and all its sister States. The Constitution of that union, and "the laws made in pursuance thereof, are the supreme law of the land, . . . any thing in the Constitution or laws of any State to the contrary notwithstanding;" and that law is as much a part of the law of every State as its own local laws and Constitution. *Farmers' & Mechanics' Bank* v. *Deering*, 91 U.S. 29.

[4] Nor is *Farrington* a relic of bygone days, it is still controlling Constitutional law, having been cited and followed over one hundred thirty times and as recently as 2005, See *Loeffel Steel Products, Inc. v. Delta Brands, Inc.*, (N.D.Ill. 01 C 9389, 7/28/2005)

"**Yet every State has a sphere of action <u>where the authority of the national government may not intrude</u>. Within that domain <u>the State is as if the union were not</u>. Such are the checks and balances in our complicated but wise system of State and national polity**."

(emphasis added)

Thus, just as the State's power of taxation may not be exercised over those items within its borders where federal jurisdiction is supreme, the federal government's authority to tax may not be exercised over those items or activities over which the jurisdiction of the State government is supreme. The principle is further reinforced by the Supreme Court again, in *Bailey v. Drexel Furniture Company (Child Labor Case),* 259 U.S. 20, 42 S.Ct. 449 (1922)[5], in which case the Supreme Court struck down a federal tax on the employment of children. Chief Justice Taft, writing at p. 37:

> "It is the high duty and function of this court in cases regularly brought to its bar to decline to recognize or enforce seeming laws of Congress, dealing with subjects not entrusted to Congress but left or committed by the supreme law of the land to the control of the States. **We can not avoid the duty even though it require us to refuse to give effect to legislation designed to promote the highest good. The good sought in unconstitutional legislation is an insidious feature because it leads citizens and legislators of good purpose to promote it without thought of the serious breach it will make in the ark of our covenant or the harm which will come from breaking down recognized standards**. In the maintenance of local self government, on the one hand, and the national power, on the other, our country has been able to endure and prosper for near a century and a half.
>
> "Out of a proper respect for the acts of a coordinate branch of the Government, **this court has gone far to sustain taxing acts as such, even though there has been ground for suspecting from the weight of the tax it was intended to destroy its subject**. But, in the act before us, the presumption of validity cannot prevail, because the proof of the contrary is found on the very face of its provisions. **Grant the validity of this law, and**

[5] *Bailey v. Drexel Furniture Co.* is still controlling Constitutional law, having been cited and followed as controlling nearly 200 times and as recently as 2005, see *Simpson v. U.S.*, 877 A.2d 1045 (D.C. 2005)

> **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 so-called 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."
>
> (emphasis added)

And in *Hill v. Wallace*, 259 U.S. 44, 42 S.Ct. 453 (1922), wherein the Court struck down a federal tax on grain contracts. Chief Justice Taft, again, at p. 67:

> "Our decision, just announced, in the *Child Labor Tax Case*, *ante*, 20, involving the constitutional validity of the Child Labor Tax Law, completely covers this case. We there distinguish between cases like *Veazie Bank* v. *Fenno*, 8 Wall. 533, and *McCray* v. *United States*, 195 U.S. 27, in which it was held that **this court could not limit the discretion of Congress in the exercise of its constitutional powers to levy excise taxes because the court might deem the incidence of the tax oppressive or even destructive**. It was pointed out that in none of those cases did the law objected to show on its face, as did the Child Labor Tax Law, detailed **regulation of a concern or business wholly within the police power of the State**, with a heavy exaction to promote the efficacy of such regulation."
>
> (emphasis added)

Justice Sutherland, dissenting in *Burnes Nat'l Bank v. Duncan*, 265 U.S. 17 (1924), a case involving a national bank's right to appointment as executor of an estate, reminded us of this important principle at p. 26:

> **It is fundamental, under our dual system of government, that the Nation and the State are supreme and independent, each within its own sphere of action; and that each is exempt from the interference or control of the other in respect of its governmental powers, and the means employed in their exercise**. *Bank of Commerce* v. *New York City*, 2 Black, 620, 634; *South Carolina* v. *United States*, 199 U.S. 437, 452, *et seq.; Farrington* v. *Tennessee*, 95 U.S. 679, 685. "How their respective laws shall be enacted; how they shall be carried into execution; and in what tribunals, *or by what officers;* and how much discretion, or whether any at all shall be vested in

> their officers, are matters subject to their own control, and in the regulation of which neither can interfere with the other." *Tarble's Case*, 13 Wall. 397, 407-8. **Except as otherwise provided by the Constitution, the sovereignty of the States "can be no more invaded by the action of the general government, than the action of the state governments can arrest or obstruct the course of the national power**. *Worcester* v. *Georgia*, 6 Pet. 515, 570."
>
> (emphasis added)

Thus, the taxing authority of the federal government ends where the regulatory authority of the States begin and are, therefore, limited to those areas of activities over which the States granted the federal government authority and those lands the States granted permission to the federal government to acquire for specific purposes. Accordingly, the Constitution affords federal legislative jurisdiction over certain enumerated areas of activity and exclusive legislative jurisdiction over certain geographic areas:

> **Article I, § 8:**
>
> To lay and collect Taxes, Duties, Imposts and Excises
>
> To borrow Money
>
> To regulate commerce with foreign Nations, among the States and with Indian Tribes
>
> To establish uniform Rules of Naturalization
>
> To enact Laws on Bankruptcy
>
> To coin Money, regulate the value thereof and of foreign Coin
>
> To fix the Standard of Weights and Measures
>
> To provide for Punishment of counterfeiting

To establish Post Offices and post Roads

To make Patent and Copyright laws

To constitute Tribunals inferior to the supreme Court

To define and punish Piracies and Felonies committed on the high Seas, and Offences against the Law of Nations

To declare War, Grant Letters of Marque and Reprisal and make Rules concerning Captures on Land and Water

To raise and support and regulate Armies and a Navy and to regulate the Militia

To call out the Militia

To govern the District of Columbia [*infra*]

To make laws "necessary and proper" to enforce the Constitution

Enabling Clauses:

To enforce 13th Amendment [*abolition of slavery*]

To enforce 14th Amendment [*equal protection of the law*]

To enforce 15th Amendment [*right to vote*]

To enforce 19th Amendment [*women's suffrage*]

To enforce 23rd Amendment [*prohibition of poll tax*]

Exclusive legislative authority:

Article II, § 8, cl. 17:

"To exercise exclusive Legislation in all Cases whatsoever, over such District [*of Columbia*] (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all

> Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings."
>
> **Article III, § 2:**
>
> "The congress shall have power to dispose of and make all needful rules and regulations respecting the territory or other property belonging to the United States. . ."
>
> ([*bracketed material*] added)

That Congress may, then, tax those activities, such as interstate commerce, foreign trade and the exercise of patent rights, would seem established under the *McCulloch* definition. That it may tax any and every privileged activity within those lands over which it has exclusive legislative jurisdiction is equally apparent.

The latter, however is virtually inconsequential, since the federal jurisdiction consists solely of the District of Columbia, the territories and those scattered islands of federal lands over which the States have ceded jurisdiction to the federal government, "federal enclaves". All other territory within the country is in the States, which means they are not within the federal jurisdiction.

Most people would be surprised to learn that they do not live on United States soil and that many have been born, lived and died without ever having set foot on United States soil.

This would be a good time to review one of the regulations discussed hereinabove, more particularly, 26 CFR 1.861-8T(d)(2)(iii):

"(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 (including a **foreign sales corporation** (FSC)) computing its effectively connected income, gross income (whether domestic or foreign source) which is not effectively connected to the conduct of a United States trade or business; [*Jurisdiction to regulate foreign commerce*]

"(B) In computing the combined taxable income of a **DISC or FSC** [*international or foreign sales corporation*] and its related supplier, the gross income of a DISC or a FSC; [*Jurisdiction to regulate foreign commerce*]

"(C) For all purposes under subchapter N of the Code, including the computation of combined taxable income of a **possessions corporation** and its affiliates under section 936(h), the gross income of a possessions corporation for which a credit is allowed under section 936(a); and [*Exclusive legislative jurisdiction (all persons, property and activities) in territories or possessions*]

"(D) **Foreign earned income** as defined in section 911 and the regulations thereunder (however, the rules of Sec. 1.911-6 do not require the allocation and apportionment of certain deductions, including home mortgage interest, to foreign earned income for purposes of determining the deductions disallowed under section 911(d)(6))." [*Jurisdiction to regulate foreign commerce*]

(emphasis and [*bracketed material*] added)

There is, however, a second area of taxation granted Congress beyond those particular activities and those federal enclaves of exclusive legislative jurisdiction, and that is in the taxation clause itself. Article I, § 8, cl. 1 grants Congress the power to lay and collect duties, imposts and excises. Duties and imposts are related to foreign trade, leaving the sole remaining grant, for internal taxation, to be excises. Thus, those activities that are

included within the power to lay and collect excises would, reasonably, be implicit in the grant. The question, then, is to what extent may an excise tax be laid and collected?

The inquiry must begin with defining what, exactly, an excise tax is. Webster's Dictionary defines an excise as:

> Excise: obsolete Dutch *excijs* (now *accijus*), from Middle Dutch, probably modification of Old French *assise* session, assessment **1 :** an internal tax levied on the **manufacture, sale, or consumption of a commodity 2 :** any of various **taxes on privileges** often assessed in the form of a license or fee
>
> (emphasis added)

Black's Law Dictionary defines an excise as:

> **Excise taxes** are taxes "laid upon the **manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges**." *Flint v. Stone Tracy Co.*, 220 U.S. 107, 31 S.Ct. 342, 349 (1911); or **a tax on <u>privileges</u>, syn. "privilege tax"**.
>
> (emphasis added)

The Supreme Court, as noted by Black's, has provided a clear and definite scope of the excise taxing authority. In *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911)[6], the Supreme Court held that:

> "Duties and imposts are terms commonly applied to levies made by governments on the importation or exportation of commodities. **Excises are "taxes laid upon the manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges.**" Cooley, Const. Lim., 7th ed., 680." *Flint, supra*, at 151
>
> (emphasis added)

Now we have two basic areas of internal indirect taxation authority:

[6] Again, Flint v. Stone Tracy Co. is controlling and Constitutional law, having been cited and followed over 600 times by virtually every court as the authoritative definition of the scope of excise taxing power.

1. Taxing authority that is inherent in sovereignty, i.e., "co-extensive with jurisdiction" (*McCulloch, supra*);
2. Authority to lay and collect excises "upon the manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges (*Flint, supra*).

There is a third area of taxation authority that is not found in the Constitution, nor can any historical or traditional foundation for the taxing authority be found, but since the Supreme Court based its sanctioning of the exercise of taxation over that area as an excise, we can call it an excise of unknown ancestry. This third area of excise of unknown ancestry was established in two cases that, ironically, the Supreme Court believed would be of little significance. The fact, however, is that these cases had a profound effect on taxation in the country that accounts for many of the arcane and mysterious twists, turns and surprising dead ends in the labyrinth of past and current tax codes and regulations.

In *Railroad Co. v. Collector*, 100 U.S. 595 (1879), the Supreme Court was faced with a challenge to a tax on interest paid by corporations. In this particular case, however, the interest was payable to foreign bond holders. Fully aware of the fact that the foreign bond holders were outside the jurisdiction of the government and that the *situs* of an obligation is always that of the obligee, the Court (sort of) upheld the tax:

> "That the tax was actually collected without resistance, and the present suit is brought to recover it back, is sufficient answer to the assertion that it could not be enforced.
>
> "**Whether Congress, having the power to enforce the law, has the authority to levy such a tax on the interest due by a citizen of the United States to one who is not domiciled within our limits, and who owes the**

> **government no allegiance, is a question which we do not think necessary to the decision of this case.**
>
> "The tax, in our opinion, is essentially an excise on the business of the class of corporations mentioned in the statute.
>
> ". . .**The tax is laid by Congress on the net earnings, which are the results of the business of the corporation, on which Congress had clearly a right to lay it; and being lawfully assessed and paid, it cannot be recovered back by reason of any inefficiency or ethical objection to the remedy over against the bondholder.**" *Railroad Co., supra*, at 597-9 (emphasis added)

See also, *United States v. Erie Railway Co.*, 106 U.S. 327 (1882).

So, now we have three areas of indirect taxation authority that the federal government can exercise, those activities within its regulatory authority and all privileged activities within those territories and federal enclaves over which it has exclusive legislative authority (*McCulloch*); excise taxes on the manufacture, sale or consumption of commodities, licensing of certain occupations and corporate privileges (*Flint, supra*), and, finally, the excise of unknown ancestry authority on monies payable to nonresident aliens and foreign corporations (*Railroad Co., supra*).

We also have prohibited areas, those being any activities that are within the scope of the regulatory authority of the States (*McCulloch, Farrington, Bailey* and *Hill, supra*) and those activities to which the jurisdiction of the federal government may not apply, i.e., those subjects of taxation that do not exist by the federal government's authority and are not introduced by its permission (*McCulloch, supra*) (with the exception, of course of monies owed nonresident aliens and foreign corporations). In other words every activity outside of those three areas of taxation authority are, in Marshall's words, ***exempt*** from federal taxation.

The income tax is an excise

The next issue is whether the income tax is a direct tax, which can be levied on virtually anything, or an indirect tax, which can only be laid on those activities listed in *Flint*. In 1861 the federal government imposed a tax on income derived from property. The tax was never challenged, but was referred to by Chief Justice White in *Brushaber* as an excise tax. *Brushaber, supra*, p. 15. Prior to *Brushaber*, however, the nature of the income tax had come into question.

In *Pollock v. Farmers' Loan and T. Co.*, 157 U.S. 429 (1894), the Supreme Court held that the Income Tax Act of 1894 imposing a tax on income from real estate and investments was a direct tax, and, therefore invalid for want of apportionment. The basis of the ruling was that the tax on the revenues from real estate was a burden on the ownership of the real estate, and, hence, a tax on the property itself. The decision that the tax was direct turned on the source of the income, rather than the income itself and was not in agreement with prior Supreme Court reasoning, such as in *Hylton, supra*.

In response to the ruling the federal government sought an amendment to overrule the *Pollock* decision. Ultimately, in 1913, the Sixteenth Amendment to the Constitution was certified as adopted. It read:

> "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."

Congress immediately passed the Income Tax of 1913, imposing a tax on net income, "from whatever source derived." The law was challenged in *Brushaber v. Union*

Pac. R.R. Co., 240 U.S. 1, 36 S.Ct. 236 (1916), requiring the Court to determine the impact of the Sixteenth Amendment on tax authority. Chief Justice White, who had dissented in Pollock, wrote for the Court, holding that the Sixteenth Amendment did not confer any additional authority to tax and that its sole purpose and effect was to preclude the consideration of the source of income in order to reclassify the tax as a direct tax, requiring apportionment.

There has been some confusion regarding the actual import of the *Brushaber* ruling, one court actually holding that the effect of *Brushaber* was to uphold the constitutionality of the Sixteenth Amendment[7](?), and another has held that Congress was given the power to tax incomes by the Sixteenth Amendment[8]. One court, incredibly, cited *Brushaber* as holding that the Sixteenth Amendment "provided the needed constitutional basis for the imposition of a *direct non-apportioned income tax*,"[9] a proposition that the Supreme Court in *Brushaber* categorically rejected! The clear and unequivocal ruling of the Court in *Brushaber* is that the Sixteenth Amendment granted no new powers to Congress:

> "It is clear on the face of this text that **it does not purport to confer power to levy income taxes in a generic sense — an authority already possessed and never questioned** — or to limit and distinguish between one kind of income taxes and another, but that **the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived.**" *Brushaber, supra,* at 17-8
>
> (emphasis added)

[7] See *Funk v. C. I. R.*, 687 F.2d 264 (8th Cir. 1982) and *Miller v. U.S.*, 868 F.2d 236 (7th Cir. 1989)
[8] See Lonsdale v. C. I. R., 661 F.2d 71, 5th Cir. 1981); but, "[I]ts enactment was not authorized by the Sixteenth Amendment." *Brushaber, supra,* at 20.
[9] See *Parker v. Commissioner*, 724 F.2d 469, 471 (5th Cir. 1984); as opposed to *Brushaber, supra,* at 19.

nor did the Court recognize a third class of taxes, a direct tax not requiring apportionment:

> "The various propositions are so intermingled as to cause it to be difficult to classify them. **We are of opinion, however, that the confusion is not inherent, but rather arises from the conclusion that the Sixteenth Amendment provides for a hitherto unknown power of taxation, that is, a power to levy an income tax which although direct should not be subject to the regulation of apportionment** applicable to all other direct taxes. And **the far-reaching effect <u>of this erroneous assumption</u> will be made clear by generalizing the many contentions advanced in argument to support it**, . . ." *Brushaber, supra,* at 10-11
>
> (emphasis added)

The effect of the Sixteenth Amendment was not to permit a direct income tax, nor to grant Congress any additional power of taxation. If that conclusion can be in any doubt from the difficulties experienced by some in understanding the *Brushaber* opinion, the point is reiterated in *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916), the Supreme Court held:

> ". . . **The provisions of the Sixteenth Amendment <u>conferred no new power of taxation</u> but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning <u>from being taken out of the category of indirect taxation to which it inherently belonged</u>** and being placed in the category of direct taxation subject to apportionment by a consideration of the sources from which the income was derived, . . ."
> *Stanton, supra,* at 112-3
>
> (emphasis added)

and by the Supreme Court, again, in *Peck & Co. v. Lowe*, 247 U.S. 165 (1918), at p. 172-3:

> "**The Sixteenth Amendment**, although referred to in argument, has no real bearing and may be put out of view. As pointed out in recent decisions, it **does not extend the taxing power to new or excepted subjects, but merely removes all occasion, which otherwise might exist, for an apportionment among the States of taxes laid on income, whether it be derived from one source or another**. *Brushaber* v. *Union Pacific R.R. Co.*, 240 U.S. 1, 17-19; *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 112-113."

(emphasis added)

and by the Supreme Court, again, in *Eisner v. Macomber*, 252 U.S. 189 (1920), at p. 206:

> **<u>As repeatedly held</u>**, this [*the 16th Amendment*] **did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income**. *Brushaber* v. *Union Pacific R.R. Co.*, 240 U.S. 1, 17-19; *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 112 *et seq.; Peck & Co*. v. *Lowe*, 247 U.S. 165, 172-173.
>
> (emphasis and [*bracketed material*] added)

In a memorandum from the Congressional Research Service, Library of Congress, it was stated, citing both *Brushaber* and *Stanton*, supra, "Therefore, it is clear that the income tax is an 'indirect' tax."[10]

There can be no doubt, the income tax is an indirect tax, not a property tax that is immune from direct tax apportionment, and there can be no doubt that the Sixteenth Amendment did not in any way, shape or form enlarge or enhance the taxation power of Congress. *Brushaber, Stanton, Peck* and *Eisner, supra*. It is, therefore, subject to the same limitations on taxing authority that are established hereinabove, and that is that it cannot tax person or property without apportionment (Article I, § 9, cl. 4), nor any activity that is without either the scope of federal legislative authority (*McCulloch* and *Farrington, supra*), outside the scope of excise (*Flint, supra*) or monies owed to nonresident aliens and foreign corporations (*Railroad Co*. and *Erie R.R.*, supra). Nor does the power to tax by excise permit the federal government to tax activities that are solely within the realm of the State jurisdiction (*Bailey* and *Hill*, supra).

All of these cases, *McCulloch, Farrington, Flint, Railroad Co, Bailey* and *Hill*, are still controlling and the last word of the Supreme Court on the power of the federal government to tax. While there have been other Supreme Court cases upholding the imposition of the income tax, every one of them has been upheld against challenges by corporations and others whose activities are by definition of the excise within the taxing authority. Notwithstanding continuous taxation of income for the last 94 years, there are only two instances where the Supreme Court has ruled on the validity of the income tax with respect to anyone who is either not a corporation or otherwise within the jurisdictional and jurisprudential limitations of the federal taxing authority and in both instances it held the income tax exceeded its Constitutional scope. See *Towne v. Eisner*, 245 U.S. 418, 38 S.Ct. 158 (1918) and *Eisner v. Macomber*, 252 U.S. 189, 40 S.Ct. 189 (1920) That question, then, remains unsettled and unanswered. The principles set forth in those cases, however, do provide the answer by defining the limits of the federal taxing authority with enough certainty to establish that defendant and the revenue he received for services personally rendered in the practice of law are not subject to that taxing authority.

[10] See "Some Constitutional Questions Regarding the Federal Income Tax Laws", by Howard Zaritsky, Congressional Research Service, Library of Congress, May 25, 1979, p. 3.

Defendant's activities and revenues are exempt from federal excise taxation[11] as being outside the taxing authority of the federal government

Justice Marshall, in *McCulloch v. Maryland, supra*, stated without qualification or reservation, that:

> It is obvious, that it [the power to tax] is an **incident of sovereignty, and is co-extensive with that to which it is an incident.** All subjects over which the sovereign power of a state extends, are objects of taxation; **but those over which it does not extend, are,** upon the soundest principles, **exempt from taxation. This proposition may almost be pronounced self-evident.**
>
> "The sovereignty of a state extends to everything which exists by its own **authority**, or is introduced by its **permission**."
>
> (emphasis and [*bracketed material*] added)

That principle is still the law of the land. It has never been questioned, challenged nor distinguished into an insignificant corner, much less overruled, probably due to the fact that, as Justice Marshall indicates, the principle is "*obvious*" and "*self evident*." He also gives us a test by which to determine whether a proposed subject of taxation is within that authority, "the sovereignty of a state (not a political subdivision, but a "state", whether it be the State of Louisiana or the State of Israel or any other sovereign) extends to everything that exists **by its own authority** or is **introduced by its permission**."

Does defendant exist by authority of the federal government? Does he work, live, practice law by permission of the federal government? The answer to both of those questions is, undoubtedly, no. He is, therefore, not within the sovereign power of the

[11] See § 19.22(b), 1940 Code of Federal Regulations

federal government and, therefore, both he and his revenues "are, upon the soundest principles, exempt from taxation" by the federal government.

Defendant, Mr. Cryer, is, and was during the two subject years, 2000 and 2001, engaged solely in the practice of law, under license from the State of Louisiana. He is not engaging in interstate commerce, he is not exercising any corporate privileges, he does not work or reside within the federal jurisdiction, residing and working in the State, within State jurisdiction only. Nor is he engaged in the manufacture or sale of commodities and his occupation requires no license from the federal government. And, obviously, he is not a nonresident alien or foreign corporation to whom a person in the United States owes money.

Accordingly, both Mr. Cryer and his revenues are outside the indirect taxing authority of the United States. The federal government is without authority to tax defendant's revenues because he and his revenue are not either within the jurisdiction of the federal government nor the scope of the excise taxing authority. Therefore, Where there can be no tax, there can be no tax deficiency, an essential element of the charges against Mr. Cryer, and, therefore, it is respectfully submitted that both counts of the indictment should be dismissed, with prejudice.

Defendant and his revenues are exempt from federal excise taxation because they are within the sole and exclusive jurisdiction of the State

In *Bailey v. Drexel Furniture Co.*, 259 U.S. 20 (1922), the Supreme Court held that the federal government could not tax those activities that were under the sole and exclusive

realm of the States. This is still sound, controlling Constitutional law, and is cited as such on a regular basis, and only recently in nullifying a federal tax law that required an organization to disclose the names of its contributors of money for use by or for the benefit of candidates in state and local elections.[12] Reiterating what Justice Taft wrote in *Bailey* at p. 37:

> 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 so-called 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."**
>
> (emphasis added)

Hill v. Wallace, *supra*, followed, reiterating the principle that the State sovereignty cannot be invaded through a so-called exercise of taxing authority. These principles are sound and valid, being in total agreement with the concepts of mutually exclusive sovereignty expressed by Justice Marshall in *McCulloch*. Where one government is sovereign, another cannot be, thus Maryland's attempt to tax the United States Bank, a creation and agency created by and within the sole jurisdiction of the federal government, could not be sustained.

Farrington, supra, in 1877, made it clear that the mutually exclusive nature of sovereignty, and, via *McCulloch*, power to tax, was reciprocal, holding that where the State governs, it is *as though the federal government does not exist*. The cases holding state

[12] See National Federation of Republican Assemblies v. U.S., 218 F. Supp.2d 1300 (S.D.Ala. 2002)

taxes unconstitutional insofar as they tax any interstate transaction are too numerous to list, but the same principle upon which those cases were based applies to federal attempts to tax activities that are purely within the power of the States to govern.

As Justice Marshall properly, and wisely, observes in *McCulloch*, at p. 431:

> "That **the power to tax involves the power to destroy**; that the power to destroy may defeat and render useless the power to create; that **there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control, are propositions not to be denied**."
>
> (emphasis added)

The courts have repeatedly held, as Chief Justice Taft pointed out in *Bailey*, that where there is authority to tax, the tax must be upheld, even if the tax is intended to and does destroy its subject. However, where the subject of the tax is within the realm of another sovereignty which, within that sphere of activities, is supreme, then the tax cannot be sustained.

The practice of law is solely and exclusively within the jurisdiction of the State, and, therefore, is outside both the jurisdiction and the taxing authority of the federal government.

The Supreme Court has acknowledged the States' jurisdiction over the practice of law. *Railroad Trainmen v. Virginia Bar*, 377 U.S. 1 (1964); *Mine Workers v. Illinois Bar Association*, 389 U.S. 217 (1967).

A review of the enumerated powers of Congress, *supra*, readily reveals that the regulation of the practice of law is not among those powers. Accordingly, the regulation of the practice of law is "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." *Bailey*, *supra*. It is within that "sphere of action where the authority of the national government may not intrude. Within that domain the State is as if the union were not." *Farrington, supra*.

Therefore, it is respectfully submitted that the activities and revenues derived from defendant's law practice are exempt from federal taxation, which cannot intrude into or upon that activity. Accordingly, those revenues being exempt, there is no tax deficiency, an essential element of the charges against Mr. Cryer, and, therefore, it is respectfully submitted that both counts of the indictment should be dismissed, with prejudice.

Defendant's revenues are exempt from federal excise taxation[13] because the activity is the exercise of a fundamental, constitutionally protected right, and, therefore, outside the taxing authority of the federal government

Fundamental rights are those described in general terms by Thomas Jefferson in the Declaration of Independence. They are derived from Natural Law, "the Laws of Nature and of Nature's God", not from the Constitution, not from the government. Such rights are inalienable and inviolable, and are not privileges that can be the subject of a tax on privileges.

Therefore, under Marshall's definition of the scope of sovereignty, being those things that exist by its authority or are introduced by its permission, the scope of the federal government's sovereignty cannot extend to the exercise of such rights. The right to work and engage in one's chosen occupation is one of those fundamental rights.

A person's freedom and ability to work is his own property, and that right cannot be taken, bought, sold or bartered away, at least not since the 13th Amendment was adopted. The Supreme Court has recognized this right as a fundamental right and part of the freedom to pursue happiness. In *Butchers' Union Co. v. Crescent City Co.*, 111 U.S. 746, 4 S.Ct. 652 (1884), the Supreme Court was presented with a case involving a Louisiana statute granting exclusive and irrevocable right to operate stock-receiving and slaughter house operation to Crescent City Company. Crescent City Company had sued Butchers' Union Co. for a restraining order in an effort to enforce its exclusive franchise. The Supreme

[13] See § 19.22(b), 1940 Code of Federal Regulations

Court held that the grant was unconstitutional because it purported to be irrevocable, ceding authority of subsequent legislative action rescinding the monopoly grant.

The case has been cited, however, more often for the premises set out in Justice Field's Concurrence, in which he stated at p. 756:

> "As in our intercourse with our fellow-men certain principles of morality are assumed to exist, without which society would be impossible, so certain inherent rights lie at the foundation of all action, and upon a recognition of them alone can free institutions be maintained. These inherent rights have never been more happily expressed than in the Declaration of Independence, that new evangel of liberty to the people: '**We hold these truths to be self-evident' — that is so plain that their truth is recognized upon their mere statement — 'that all men are endowed' — not by edicts of Emperors, or decrees of Parliament, or acts of Congress, but 'by their Creator with certain inalienable rights**' — that is, rights which cannot be bartered away, or given away, or taken away except in punishment of crime — 'and **that among these are life, liberty, and the pursuit of happiness, and to secure these' — not grant them but secure them — 'governments are instituted** among men, deriving their just powers from the consent of the governed.'
>
> "**Among these inalienable rights, as proclaimed in that great document, is the right of men to pursue their happiness, by which is meant the right to pursue any lawful business or vocation,** . . .
>
> "It has been well said that, **"The property which every man has in his own labor, as it is the original foundation of all other property, so it is the most sacred and inviolable.** . . ." Adam Smith's Wealth of Nations, Bk. I. Chap. 10."
>
> (emphasis added)

Although this opinion was a concurring opinion, Justice Field was not alone in his assessment. He was joined in his concurrence by Justice Bradley, who, joined by JJ. Harlan and Woods, also concurred, but on the basis of Field's reasoning, stating at p. 762:

> **"The right to follow any of the common occupations of life is an inalienable right**; it was formulated as such under the phrase "pursuit of

> happiness" in the Declaration of Independence, which commenced with the fundamental proposition that "all men are created equal, that they are endowed by their Creator with certain inalienable rights; that among these are life, liberty, and *the pursuit of happiness*." **This right is a large ingredient in the civil liberty of the citizen**."
>
> (*italics*, the Court's; **bold** emphasis added)

In *Yick Wo v. Hopkins*, 118 U.S. 356 (1886), the Supreme Court, again, recognized this fundamental right in declaring unconstitutional a statute that would force a Chinese laundry businessman out of business, holding at 370:

> "But **the fundamental rights to life, liberty, and the pursuit of happiness, considered as individual possessions**, are secured by those maxims of constitutional law which are the monuments showing the victorious progress of the race in securing to men the blessings of civilization under the reign of just and equal laws, so that, in the famous language of the Massachusetts Bill of Rights, **the government of the commonwealth 'may be a government of laws and not of men.' For, the very idea that one man may be compelled to hold his life, or the means of living, or any material right essential to the enjoyment of life, at the mere will of another, seems to be intolerable in any country where freedom prevails, as being the essence of slavery itself."**
>
> (emphasis added)

In *Allgeyer* v. *Louisiana*, 165 U.S. 578 (1897), the Supreme Court held invalid a Louisiana statute prohibiting a citizen from contracting outside the State for insurance on his property lying therein because it violated the liberty guaranteed to him by the Fourteenth Amendment.

In *Truax v. Raich*, 239 U.S. 33 (1915), an Arizona statute requiring a minimum quota of citizens was declared unconstitutional. The Supreme Court held at p. 41:

> "It requires no argument to show that **the right to work for a living in the common occupations of the community is of the very essence of the personal freedom and opportunity that it was the purpose of the [14th]**

Amendment to secure. *Butchers' Union Co*. v. *Crescent City Co.*, 111 U.S. 746, 762; *Barbier* v. *Connolly*, 113 U.S.

27, 31; *Yick Wo* v. *Hopkins, supra; Allgeyer* v. *Louisiana*, 165 U.S. 578, 589, 590; *Coppage* v. *Kansas*, 236 U.S. 1, 14."

(emphasis and [*bracketed material*] added)

Again, in *Adams v. Tanner*, 244 U.S. 590, 37 S.Ct. 662 (1917), the Supreme Court considered a statute prohibiting employment agencies from charging fees for obtaining employment. The Supreme Court, citing and quoting *Allgeyer*, held:

> **"The liberty mentioned in that amendment means not only the right of the citizen to be free from the mere physical restraint of his person, as by incarceration, but the term is deemed to embrace the right of the citizen to be free in the enjoyment of all his faculties; to be free to use them in all lawful ways; to live and work where he will; to earn his livelihood by any lawful calling; to pursue any livelihood or avocation."** *Adams, supra*, at 595

(emphasis added)

The Supreme Court was presented with a challenge by a German teacher of a Nebraska law which prohibited teaching lessons in any language other than English in *Meyer v. Nebraska*, 262 U.S. 390, 43 S.Ct. 625 (1923). The Supreme Court held the law was an unconstitutional infringement on a fundamental right protected by the 14th Amendment. At p. 399 the Supreme Court stated:

> "While this Court has not attempted to define with exactness the liberty thus guaranteed, the term has received much consideration and some of the included things have been definitely stated. **Without doubt, it denotes not merely freedom from bodily restraint but also the right of the individual to contract, to engage in any of the common occupations of life, to acquire useful knowledge, to marry, establish a home and bring up children, to worship God according to the dictates of his own conscience, and generally to enjoy those privileges long recognized at common law as essential to the orderly pursuit of happiness by free men.** *Slaughter-House Cases*, 16 Wall. 36; *Butchers' Union Co.* v. *Crescent City Co.*, 111 U.S. 746; *Yick Wo* v. *Hopkins*, 118 U.S. 356; *Minnesota* v. *Barber*, 136 U.S. 313;

Allgeyer v. *Louisiana*, 165 U.S. 578; *Lochner* v. *New York*, 198 U.S. 45; *Twining* v. *New Jersey*, 211 U.S. 78; *Chicago, Burlington & Quincy R.R. Co.* v. *McGuire*, 219 U.S. 549; *Truax* v. *Raich*, 239 U.S. 33; *Adams* v. *Tanner*, 244 U.S. 590; *New York Life Ins. Co.* v. *Dodge*, 246 U.S. 357; *Truax* v. *Corrigan*, 257 U.S. 312; *Adkins* v. *Children's Hospital*, 261 U.S. 525; *Wyeth* v. *Cambridge Board of Health*, 200 Mass. 474."

(emphasis added)

In *Massachusetts Bd. Of Retirement v. Murgia*, 427 U.S. 307, 96 S.Ct. 2562 (1976), at issue was a Massachusetts law regarding an age limit for police officers. There was no question regarding the right to pursue one's occupation as being protected under the Constitution, but only with respect to the standard of review of the law. In objecting to the court's application of a rational basis standard rather than a strict scrutiny test, Justice Marshall writing at 322:

"Whether "fundamental" or not, "`the right of the individual . . . to engage in any of the common occupations of life'" has been repeatedly recognized by this Court as falling within the concept of liberty guaranteed by the Fourteenth Amendment. *Board of Regents* v. *Roth*, 408 U.S. 564, 572 (1972), quoting *Meyer* v. *Nebraska*, 262 U.S. 390, 399 (1923). As long ago as *Butchers' Union Co.* v. *Crescent City Co.*, 111 U.S. 746 (1884), Mr. Justice Bradley wrote that this right 'is an inalienable right; it was formulated as such under the phrase `pursuit of happiness' in the Declaration of Independence . . . . This right is a large ingredient in the civil liberty of the citizen.' *Id.*, at 762 (concurring opinion). And in *Smith* v. *Texas***,** 233 U.S. 630 (1914), in invalidating a law that criminally penalized anyone who served as a freight train conductor without having previously served as a brakeman, and that thereby excluded numerous equally qualified employees from that position, **the Court recognized that 'all men are entitled to the equal protection of the law in their right to work for the support of themselves and families.'** *Id.*, at 641."

"'In so far as a man is deprived of the right to labor his liberty is restricted, his capacity to earn wages and acquire property is lessened, and he is denied the protection which the law affords those who are permitted to work. Liberty means more than freedom from servitude, and the constitutional guarantee is an assurance that the citizen shall be

protected in the right to use his powers of mind and body in any lawful calling.' *Id.*, at 636."

(emphasis added)

See also *In re Slaughter-House Cases*, 16 Wall. 36, 21 L.Ed. 394; *Minnesota v. Barber*, 136 U.S. 313, 10 S.Ct. 862, 34 L. Ed. 455; *Lochner v. New York*, 198 U.S. 45, 25 S.Ct. 539, 49 L.Ed. 937, 3 Ann.Cas. 1133; *Twining v. New Jersey*, 211 U.S. 78, 29 S.Ct. 14, 53 L.Ed. 97; *Chicago, Burlington & Quincy R.R. Co. v. McGuire*, 219 U.S. 549, 31 S.Ct. 259, 55 L.Ed. 328; *New York Life Ins. Co. v. Dodge*, 246 U.S. 357, 38 S.Ct. 337, 62 L.Ed. 772, Ann.Cas. 1918E, 593; *Truax v. Corrigan*, 257 U.S. 312, 42 S.Ct. 124, 66 L.Ed. 254, 27 A.L.R. 375; *Adkins v. Children's Hospital*, 261 U.S. 525, 43 S.Ct. 394, 67 L.Ed. 785, 24 A.L.R. 1238; *Wyeth v. Cambridge Board of Health*, 200 Mass. 474, 86 N.E. 925, 23 L.R.A., N.S., 147, 128 Am.St.Rep. 439; *Farrington v. Tokushige*, 273 U.S. 284, 47 S.Ct. 406, 71 L.Ed. 646; *Pierce v. Society of Sisters*, 268 U.S. 510, 535, 45 S.Ct. 571, 69 L.Ed. 1070, 39 A.L.R. 468; and *Wysinger v. Crookshank*, 82 Cal. 588, 23 P. 54.

There is no doubt that the right to work and to pursue one's chosen occupation is a basic and fundamental right that the federal government, and, through the 14th Amendment, the States, may not abridge. This is a right that is not owed to the federal government or the Constitution and one the federal government does not grant or permit, thus it neither exists by its authority nor is it introduced by its permission.

The taxing of fundamental rights is so repugnant to the mind, spirit and conscience of any man that even Congress has, with this exception, not undertaken to impose a tax on the exercise of those rights. Therefore there is little case law on the issue. There is,

however, some illumination to be gleaned from some home-grown law. In 1934, Louisiana passed an excise tax on publishers of newspapers, magazines and other printed publications. The Supreme Court, in *Grosjean v. American Press Co.*, 297 U.S. 233 (1936), struck the law down as an abridgement on the fundamental freedom of speech, stating:

> "That freedom of speech and of the press are rights of the same fundamental character, safeguarded by the due process of law clause of the Fourteenth Amendment against abridgment by state legislation, has likewise been settled by a series of decisions of this Court beginning with *Gitlow* v. *New York*, 268 U.S. 652,666, and ending with *Near* v. *Minnesota*, 283 U.S. 697, 707. **The word "liberty" contained in that amendment embraces not only the right of a person to be free from physical restraint, but the right to be free in the enjoyment of all his faculties as well.** *Allgeyer* v. *Louisiana*, 165 U.S. 578, 589." *Grosjean, supra*, at 244.
>
> (emphasis added)

The Court in *Grosjean* pointed out, as it did in *Murdock* and *Follett, infra*, that a publishing company was not immune from all taxation, in that it could be taxed on its profits as a corporation or on its property, but this tax was an excise on "the privilege of engaging in such business" (publishing a newspaper), not on the exercise of corporate privilege nor on its property.

A license fee for distributing religious material door to door was struck down by the Supreme Court in *Murdock v. Pennsylvania*, 319 U.S. 105 63 S.Ct. 870 (1943) as abridging freedom of speech, press and religion. The Court stated at p. 108:

> "The First Amendment, which the Fourteenth makes applicable to the states, declares that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press . . ." **It could hardly be denied that a tax laid**

> **specifically on the exercise of those freedoms would be unconstitutional.** Yet the license tax imposed by this ordinance is, in substance, just that."
>
> And at 112:
>
> "**the power to tax the exercise of a privilege is the power to control or suppress its enjoyment**."
>
> (emphasis added)

See also *Jones* v. *Opelika*, 316 U.S. 584, 56 S.Ct. 444 (1943); *Follett v. McCormick*, 321 U.S. 573 64 S.Ct. 717 (1944)

Striking down a Virginia poll tax in 1966, the Supreme Court in *Harper v. Virginia Bd. Of Elections, 383 U.S. 663, 86 S.Ct. 1079* (1966), quoted and cited *United States v. State of Texas*, 252 F. Supp. 234 (1966), a three-judge panel case, that said at p. 254:

> "If the State of Texas placed a tax on the right to speak at the rate of one dollar and seventy-five cents per year, no court would hesitate to strike it down as a blatant infringement of the freedom of speech. Yet the poll tax as enforced in Texas is a tax on the equally important right to vote."

There is, in addition to the repugnancy of imposing a tax on an activity that is the exercising of what is clearly a fundamental right, protected under the Fifth and Fourteenth Amendments, and in addition to the fact that the exercise of that fundamental right and freedom is beyond the reach of the jurisdictional arm as defined by Justice Marshall in *McCulloch*, still another conflict, and that is that one of the characteristics of an indirect tax is that it is voluntary in the sense that one can avoid payment of the tax by abstaining from the activity taxed. A tax that cannot be avoided by abstention from the activity is a tax on the person or property, not on the activity described. For example, if an excise on tobacco

products is imposed, one can simply abstain from consuming tobacco products, avoiding the tax.

However, as was mentioned previously, if a tax were imposed on breathing, a tax that could not be avoided by abstention, or at least not without dire consequences, then such a tax would be a mandatory tax on being (remaining) alive, on one's existence, and would, therefore, be direct, subject to apportionment.

Working, practicing one's craft in one's chosen occupation is, like breathing, not an avoidable activity. While one could resign himself to the life of a hobo, scraping, foraging and begging for his daily bread and living under whatever he can find resembling shelter, that option is only slightly better than abstaining from breathing.

The Supreme Court, in *Brushaber*, did not uphold the constitutionality of the income tax in all respects, but only in that presented to the Court. The Court left the door open for challenges in other situations where the tax would operate to tax a property (as is a fundamental right) or fall into the class of direct taxes:

> "Moreover in addition the conclusion reached in the *Pollock Case* did not in any degree involve 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 its 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 taxation 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.**" *Brushaber*, *supra*, at 16-17.
>
> (emphasis added)

Chief Justice White, obviously, could see that not all income was taxable by the federal government and anticipated that if the income tax were applied to such income that is outside the taxing authority or would in effect require the taxing of person, property or possession, the effect, or substance, not the name, or form, of the tax would be considered and that apportionment would be required, the Sixteenth Amendment notwithstanding.

Recalling the reasoning of Justice Marshall in *McCulloch*, that "the power to tax involves the power to destroy", and that "there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control, are propositions not to be denied." at 431.

Applied to and paraphrased for the instant case: ***That the power to tax a fundamental right involves the power to destroy that right, and that there is a plain repugnance in the conferring on any government a power to control the freedoms and rights granted by another, which other, with respect to those very measures, is the most supreme sovereignty, the sovereignty and supremacy of the "Laws of Nature and of Nature's God", are propositions not to be denied.***

It is, therefore, strenuously submitted that where that "privilege tax"[14] is imposed upon the exercise of a fundamental, natural right, as opposed to a privilege, to an unavoidable activity, as opposed to an optional activity, that it must be "concluded that to enforce it" against the wages and fees personally earned in the exercise of that fundamental

[14] Black's Law Dictionary identifies "privilege tax" as a synonym for "excise tax"

right "would amount to accomplishing the result which the requirement as to apportionment of direct taxation was adopted to prevent."

Thus, given that the Supreme Court has made it clear that fundamental rights are not to be abridged by taxation (*Grosjean, Murdock, Follett* and *Harper*, supra), that a fundamental right is not a privilege by authority or permission of the federal government, and, therefore cannot be the proper subject of an *excise (Flint, McCulloch, supra*), that the right to work and engage in one's chosen occupation is his property (*Butchers' Union*, supra) and, therefore ***exempt*** from indirect taxation by the federal government (Article I, § 9, cl. 4 and *McCulloch*), it is respectfully submitted that the income tax, as applied (or claimed to be applied), to wages and fees personally earned, without exercise of corporate privileges, without manufacture or sale of commodities and without the lawful jurisdiction of the federal government, is clearly in violation of the Fifth Amendment in that it deprives and abridges an inviolable, fundamental right, and a violation of Article I, § 9, cl. 4, of the Constitution in that it is in substance a direct tax on property, requiring apportionment.

It is, therefore, respectfully submitted that defendant's revenues, deriving solely from his own labor and effort in the pursuit of his chosen occupation, is exempt from taxation by the federal government and certainly exempt from indirect taxation by the federal government, and, accordingly, those revenues being exempt, there is no tax deficiency, an essential element of the charges against Mr. Cryer, and, therefore, it is respectfully submitted that both counts of the indictment should be dismissed, with prejudice.

Defendant's revenues do "not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution"[15]

In order to avoid repetition of materials already included hereinabove, a brief review of premises already established is in order:

1. The Internal Revenue Code does not define "income";
2. Webster defines income as a **gain** or recurrent benefit usually measured in money that derives from capital or labor;
3. Black's Law Dictionary defines income as The **return** in money from one's business, labor or capital invested; **gains, profits** or private revenue.
4. Louisiana law defines income, "fruits", as things that are produced by or derived from another thing **without diminution of its substance**.
5. From 1913 through 1954, the Congress, by statute, acknowledged that some revenues are not income within the meaning of the Sixteenth Amendment (e.g., 1939 Code, § 115);
6. From 1913 through 1954 the Treasury Department in regulations acknowledged that some items are exempt from federal taxation due to either the Constitution or fundamental law and need not be included in gross income (e.g. 1940 Regulations, § 22(b));
7. Following 1954, vestigial remnants of those acknowledgements remain (26 CFR § 1.861-8(f)(1) and 1.861-8T(d)(2)(ii) and (iii));

8. The Supreme Court, in *Brushaber*, kept the door open on any application of the income tax law that would impose a tax on property or person in which case the Supreme Court would look to substance rather than form and require apportionment (*Brushaber*, at 16-17).

We have already discussed two examples of Constitutional exemption acknowledged by the Treasury Department, those activities that are beyond the federal government's jurisdiction and those fundamental rights that are endowed by a superior sovereignty, but what about the regulations acknowledging that some revenues "do not constitute income within the meaning of the Sixteenth Amendment to the Constitution"?

If Johnny Public were to choose the door marked "wages, salaries and fees *personally earned*", he would win the prize, the exemption, not only because the right to earn a living is exempt as a fundamental right, but because "'The ***property which every man has in his own labor***, as it is the original foundation of all other property, so it is the most sacred and inviolable. . . .' Adam Smith's Wealth of Nations, Bk. I. Chap. 10." *Butchers' Union, supra*.

In addition to Webster and Black's above, the Supreme Court weighed in on the definition of "income", the same year the word was used in both the Sixteenth Amendment and the first version of the current imposition of a tax on income. In *Stratton's Independence v. Howbert*, 231 U.S. 399, 400; 34 S.Ct. 136 (1913) the Supreme Court stated:

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[15] See § 115, 1939 Revenue Code

"Income may be defined as the **gain** derived from capital, from labor, or from both combined."

and

" . . . And, **however the operation shall be described, the transaction is indubitably 'business'** within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly the income from that **business**; for **"income" may be defined as the gains derived from capital, from labor, or from both combined**, combined operations and here we have of capital and labor." *Id* at p. 415

(emphasis added)

Five years later, the Supreme Court in *Doyle v. Mitchell Brothers Co.,* 247 U.S. 179, 38 S.Ct. 467 (1918), states:

"Yet it is plain, we think, that by the true intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income. **Whatever difficulty there may be about a precise and scientific definition of "income," it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities**. As was said in *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415: **'Income may be defined as the gain derived from capital, from labor, or from both combined.'**" Id at 184-5

(emphasis added)

As was pointed out, *supra*, the Court in *Brushaber* indicated that in the event that receipts that, if taxed, would have the effect of taxing person or property, the Sixteenth Amendment would not prevent it from applying the rule of apportionment, and one such occasion was presented in *Towne v. Eisner*, 245 U.S. 418, 38 S.Ct. 158 (1918). The district court had ruled that the stock dividend was included in the government's definition of income subjected to the tax. Justice Holmes, writing for the Court:

"But it is not necessarily true that income means the same thing in the Constitution and the act. **A word is not a crystal, transparent and**

> **unchanged, it is the skin of a living thought and may vary greatly in color and content** according to the circumstances and the time in which it is used. . . .**The plaintiff says that the statute as it is construed and administered is unconstitutional. He is not to be defeated by the reply that the Government does not adhere to the construction by virtue of which alone it has taken and keeps the plaintiff's money, <u>if this court should think that the construction would make the act unconstitutional</u>**. *Id* at 425
>
> (emphasis added)

The Supreme Court did think that construction would make the act unconstitutional. The Court went on to hold that the stock dividend was a conversion of capital from one form to another, and, therefore, was not income, regardless of whether the Government's definition included such conversions in its definition.

In another stock dividend case, *Eisner v. Macomber*, 252 U.S. 189, 40 S.Ct. 189 (1920), the Supreme Court ruled the Revenue Act of 1916 (successor of the 1913 income tax) unconstitutional insofar as it applied to stock dividends. The Court held that:

> ". . . Income may be defined as the **<u>gain</u>** 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**, to which it was applied in the *Doyle Case* (pp. 183, 185)."
>
> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word "gain," which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. "*Derived — from — capital;*" — "the *gain — derived — from — capital*," etc. Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but **a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being *"derived,"* that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate***
> **use, benefit and disposal**; — *that* is income derived from property. Nothing else answers the description." *Id* at 207
>
> (*italics* the Court's, **bold** emphasis added)

The only addition or supplement to the Supreme Court's definition of "income" "within the meaning of the Sixteenth Amendment" is in *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 75 S.Ct. 473 (1955).[16] In that case, the Court determined that where treble damages had been awarded in a fraud claim and was paid and received, the exemplary damages, those in excess of the compensatory damages, were income and subject to taxation.

The Court in *Glenshaw Glass* distinguished *Eisner v. Macomber*, stating that the additional damages were "accessions to wealth." In fact, however, the reasoning behind *Eisner v. Macomber* was actually no different from that in *Glenshaw*, in that the reason stock dividends were found not to be income is that they were not accessions to wealth, i.e., that the corporation was no worse off for the dividend nor was the stockholder any better off for the dividend.

The applicability of the *Eisner* definition of income to Glenshaw's exemplary damages was apparently misunderstood because the compensatory damages were never at issue and were not regarded in the analysis. Had the Court done so, it would have realized that in order to recover three hundred percent, the plaintiff must have first incurred one hundred percent. In other words, the income was three hundred less one hundred, the one hundred being the basis, the capital, that produced a gain, profit or "accession to wealth" of two hundred. Glenshaw Glass received three hundred, but its wealth was only enhanced by two hundred. Macomber received additional shares, but his wealth was not enhanced.

Whether *Eisner v. Macomber* or *Glenshaw Glass*, the measure of income is in the GAIN realized.

There is no doubt that had the government contended that all of the treble damage award in *Glenshaw* was income, the Court would have rejected such a position. Likewise, if the government were to contend that a widget shop owner could only deduct his shop expenses, but not his cost of goods, from his gross revenue, the Court would not stand for that, either, because that would not only be a tax on the income (gain or profit), but on the capital, as well.

Gain or profit is, without question, that portion of monies received that is above and beyond what was given up, either in property or expense, in order to receive those funds. Gross revenue less cost and overhead equals profit or gain—income. Neither the Court nor the government gave a thought to whether the compensatory damages were income, having backed those compensated damages out of the equation to begin with.

Given the understanding, then, that in order to be income there must first be a gain, or profit, we are prepared to examine whether wages, salaries and fees personally earned (hereinafter referred to collectively as "wages" in the interest of brevity), are income within the meaning of the Constitution.

The Code defines gross income as "income from . . . compensation for services". Since income is gain, profit, then that definition is actually "that portion of compensation for services that is gain or profit." The government's contention is that the gain or profit is everything received for compensation for services, thus with respect to wages the

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[16] Cited and followed in *Murphy v. I.R.S.*, 460 F.3d 79 (D.C. Cir. 2006)

government contends that gross revenue and gross income are the same. Wages are the only revenue that the government treats as equivalent to income.

A tax on gross revenue as opposed to net gain is not an income tax, but a tax on both capital and income. *State Tax on R. Gross Receipts*, 15 Wall. 284, 21 L. Ed. 164; *Philadelphia & S. Mail S. S. Co. v. Pennsylvania*, 122 U.S. 326, 30 L. Ed. 1200; *Maine v. Grand Trunk R. Co.*, 142 U.S. 217, 35 L. Ed. 994; and since a tax on gross revenue is taxing both income and capital, insofar as the tax on capital is concerned it is not indirect nor is it 'exempt' from the requirement of apportionment.

The problem with wages is that, unlike every other form of "income" described in the code, the government does not permit the wage-earner to back out what he has given up in order to receive those wages. It has been established that a man's labor is his property, the capital. Thus wages are the purchase price for that property. Any other exchange of property for money must generate a profit before it is considered income, so on what basis does the government contend that all of the money exchanged for his property must be and is profit or gain?

While many have contended that wages are not income because they are a fair and equal exchange of value for money and, therefore, a break-even transaction, that position would be difficult to maintain. The sale of a widget is, presumably, an equal exchange of value for money but such a transaction could generate income (or loss) to the seller.

To contend, however, that there is no value contributed by the seller of labor for wages, and that, therefore 100% of all wages are profit, i.e., income, is not only equally untenable, but is offensive to the senses of reason and justice.

Some may be paid far more than the true value of their effort, exertion and proficiency. Others may be paid only a fraction of the value of their labor and skill. It is impossible to determine what portion of wages is basis and what part is gain.

It is equally impossible, however, to seriously contend that all wages are received in exchange for nothing. As absurd as such a proposition sounds, that is what the government is saying when it states that the cost basis for wages is zero. If, however, the wage-earner must give up something in order to receive his wages, then the wages he receives are not free. If the wages are not free, then they are not 100% profit. Employing a *Glenshaw* approach, if he must first sacrifice a loss to another in order to receive the wages, then only the "exemplary" portion of his wages is income.

The remainder is capital. What the court termed “human capital” in *Murphy v. I.R.S.*, 460 F.3d 79 (D.C. Cir. 2006).

Assuming that any of the wage is above and beyond the amount of expenditure on the wage-earner's part, a tax on the entire wage would have to be considered a tax on both the capital, the expenditure, and the profit, and would, therefore be a tax on the capital, or property, portion of the wage. This is exactly what Chief Justice White was describing when he stated that should the application of the income tax have the effect of taxing property or person, rather than profits and gains, alone, then "duty would arise to disregard

form and consider substance alone and hence subject the tax to the regulation as to apportionment." *Brushaber, supra*.

If any portion of wages represents what the wage-earner had to give in exchange for the wages, then that portion, however minute or great, is not income, is not a gain or an accession to wealth, and, therefore, that portion is not "income within the meaning of the Sixteenth Amendment" and would be in conflict with the Constitution to the same and identical extent as in *Towne* and *Eisner, supra*. It is a tax on gross receipts, which includes the basis or capital, and, therefore, not an income tax. *Gross Receipts, Philadelphia Steamship, Grand Trunk* and *Brushaber*, supra.

The distinction here is not one of mere form or technicality. It is a distinction of substance.

So, what does a wage-earner give up in order to receive his wages? It has been said that "When man is born his days are numbered and filled with trouble." So, too are his work days numbered and filled with toil and exertion. The term "expending" energy is no different than "expend"iture of money or goods. The wage-earner has made an expenditure and received a wage in return.

This and every other court has on innumerable occasions suffered through the monotony of an expert witness recounting statistical and actuarial data in evaluating the remainder of a disabled plaintiff's work life. While those witnesses usually disagree, having used different assumptions and/or data pools, the one thing upon which every one of them does agree is that the work life of any person is not infinite. We are all mortal.

These experts will also agree that work life and life expectancy are rarely the same, but in both instances they are not infinite.

When a wage-earner finishes his year of labor and receives his W-2, it reflects his gross *revenue,* what he received, not his gross *income*, what he gained. It does not reflect what he gave up in exchange. He has over the year received the total shown on the W-2, and during the same year he had expended a great deal of energy and labor, he has given a year out of his work life a year out of his life expectancy to another in exchange for his wages. And, yet, the government contends that those wages were all profit, all gain, and that the basis for his earnings was $0.00. He contributed nothing to the exchange and was paid for nothing.

The obvious conflict in the government's assessment of wages as having been paid for nothing is that if that is the case, then the wages are gratuities, gifts, not "income". The government cannot have it both ways, to state that the wage-earner on the one hand realized earnings, or income, but on the other hand received a gift, purely gratuitous.

If we attempt to imagine the most "worthless" employment possible, one that required the absolute least amount of expenditure of effort and no knowledge or skill, we would still have to admit that no matter how much or how little such an employment paid, the employee is not paid for nothing. A night watchman, whose only requirement is that he remain in the premises overnight, is still giving up something for his wages. He is not being paid for nothing in exchange.

In *Bailey v. Drexel Furniture Co., supra*, Chief Justice Taft stated "All others can see and understand this. How can we properly shut our minds to it?" *Id* at 37.

A few examples should demonstrate that this distinction between wages, salaries and fees personally earned is one of substance:

Example 1: Gains on Capital

Joe places $100,000 in a certificate of deposit earning 6% per annum. Joe gave up his $100,000 for a year and at the end of the year he received $106,000 of which only $6,000 would be income as defined by the act. **Joe still has his original $100,000** and can 'rent' it out again for another year, but he pays taxes only on the $6,000 gain.

Example 2: Gains on Sales

Tom buys a widget for $1 and sells it for $2. Tom gave up $1 in order to receive $2, but only the additional $1 is considered income. **Tom still has his dollar** back and can purchase another widget to sell, but he pays taxes only on the $1 gain.

Example 3: Gains on Labor

Bob pays Bill $50 to unplug Mrs. Haversham's drain for which Bob charges Mrs. Haversham $75. Bob gave up $50 in order to receive $75, but only $25 is considered income, his realized gain of $25 on Bill's labor. **Bob still has his original $50** that he can use to purchase more labor that he can sell for profit, but he pays taxes only on the $25 gain.

But what about Bill's $50? What has Bill given up? Nothing? Bill gave up a day out of his life, he expended his effort and skill, employed the use of his working tools. **Bill no**

longer has his day or his labor, both are spent. He cannot, even with every penny of his $50, buy another day or recover the effort he expended, yet according to the government, his $50, every bit of it, is profit, gain, accession to wealth and was received in exchange for nothing. What Bill gave up to receive his $50 was not "nothing", it was '"The ***property which every man has in his own labor***, [and] as it is the original foundation of all other property, so it is the most sacred and inviolable. . . .' Adam Smith's Wealth of Nations, Bk. I. Chap. 10." *Butchers' Union, supra*.

Joe recovered his $100,000, and paid no tax on it; Tom recovered his $1 and paid no tax on it; Bob recovered his $50 and paid no tax on it; but Bill can never recover his day, energy or labor, but pays tax on his gross revenue, including the value of his day, energy and labor and even if the value of that day, energy and labor exceeds the gross revenue!

We can all agree that a person's labor is not only his property, his capital, but that it is depleted in its employment and, eventually, is exhausted and totally spent. We have two major, landmark Supreme Court decisions, still controlling law, dealing specifically with that issue, and the decisions of the Supreme Court in those two cases makes a conclusion that an income tax on wages is not an income tax, but a tax on gross receipts, taxing both income and capital, and, therefore, unconstitutional.

Stratton's Independence v. Howbert, 231 U.S. 399, 400; 34 S.Ct. 136 (1913) and *Stanton v. Baltic Mining Co.,* 240 U.S. 103, 36 S.Ct. 278 (1916) both dealt with challenges to a tax on profits of mining companies. The first dealt with the Corporation Tax Law of 1909 and the latter with the Income Tax Law of 1913.

The mining companies were contending with an identical issue as we have here with wages, salaries and fees personally earned. They were engaged in a business that required them to deplete their ore deposits in order to conduct that business. They not only incurred costs of operations, overhead and cost of sales, etc., they incurred the depletion of a finite, albeit of unknown quantity, capital asset. At the end of the mine's life, all of the ore would be gone, just as at the end of our work lives, our ability to earn will be gone. Our human capital will have been exhausted, “sold out”.

The wage issue is exactly the same. Not only does one personally earning a wage, salary or fees incurring costs for tools, work clothes and other expenses, he is depleting his working life along with a goodly portion of his life itself, a finite, albeit of unknown duration, capital asset, his "most sacred and inviolable" asset.

The Supreme Court in both mining cases resolved the problem by determining that the tax, insofar as Baltic was concerned, was not an income tax at all, but a tax on the exercise of corporate privileges and the privilege of conducting mining operations that was "measured in income."

In *Stratton's Independence*, that was the case. The law in question was not an income tax, *per se*, but an excise on the exercise of corporate privileges, the Corporation Tax Law of 1909. The Court in *Stratton's Independence* pointed out that Stratton's was a corporation and that it was engaging in business activities that generated mining products, two of the proper objects of an excise. On that basis the Court held that the tax was not on

the income of the mining operation, but rather an excise on the conducting of the business of a mining operation that was measured in income.

But in *Baltic Mining*, the Court *was* dealing with the Income Tax Law of 1913, the same law it dealt with in *Brushaber* and the direct statutory ancestor of our present income tax law. The tax was not a corporation or mining operations tax, it was an *income* tax and identified itself as such.

The Court had only two options: 1) Find that the income tax was taxing both the income and the capital and, therefore, unconstitutional, or 2) find that the income tax was taxing something else. It went with the something else. After stating the case and respective positions, the Court briefly and simply stated:

> ". . . independently of the effect of the operation of the Sixteenth Amendment it was settled in *Stratton's Independence* v. *Howbert*, 231 U.S. 399, **that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations**." Id at 114
>
> (emphasis added)

The clear and unmistakable message here is that the only tax that could tax more than income, gross receipts without allowance of deduction for the depletion of the ore body, was a corporate or manufacture of commodities based excise tax. If the income tax could constitutionally tax income of a mining operation, which would include taxing the depletion of its ore body, then the Court would have simply said so. It did not because it could not.

In the case of wages, salaries and fees personally earned, there are no corporate privileges being exercised. The wage-earner is not (at least not for himself, See *Calamaro, supra*) manufacturing a commodity or conducting mining operations. All he is exercising, and exhausting in the process, is his body, mind and his God-given right to earn a living with both, all at the expense of the loss, or cession, of a good portion of his lifetime here to another in exchange for a wage.

There is no alternate subject of excise. No "something else", as in *Baltic Mining*, and the only conclusion we can reach, based upon the sound, ample and still controlling principles set out in all of the Supreme Court cases referred to herein, is that any tax that taxes 100% of wages personally earned has to be taxing not only the gain the wage-earner realized, if any, but also the asset that the wage-earner gives up in exchange for those wages, salaries and fees.

It is, therefore, respectfully submitted that insofar as the government purports to apply the income tax law as imposing a tax on wages, salaries and fees personally earned, it is in conflict with Article I, § 9, cl. 4, of the Constitution, and is, as so applied, unconstitutional and not entitled to enforcement.

Based upon recent cases involving claims that wages are not income there is an apparently common misconception, an erroneous understanding or belief, that the issue of whether wages, salaries and fees personally earned are "income" within the meaning of the income tax law and, particularly, "within the meaning of the Sixteenth Amendment", has been settled. It has not.

One government official contends that wages are constitutionally taxable income because the Supreme Court has not found them to be otherwise.[17] The same reasoning could be employed to conclude that since the Supreme Court has not found wages, salaries and fees personally earned to be lawfully and constitutionally taxable by the federal government, they are not.

Although numerous cases have been cited as supporting that misconception, a review of the cases commonly cited as such reveals that they fail to support that conclusion. The Supreme Court has never considered the issues here presented, and until it does the latest enunciations from that Court are the law of the land. The position here advanced is not only supported, but mandated, by the current and controlling pronouncements of the principles involved by that body, and no District or Circuit Court can override or negate, much less overturn those Supreme Court pronouncements.

The Court is urged to scrutinize any cases cited to the contrary, and it is suggested that a careful review of those cases mistakenly cited will, it is hoped, clarify that the issue is still in urgent need of resolution and that in the cases generally relied upon to the contrary either the court involved has not actually dealt with the issues here presented, did not have the issue before it, stated no reasoning on any dictum to that effect or is totally without weight.

It is, therefore, respectfully submitted that defendant's revenues, deriving solely from his own labor and effort in the pursuit of his chosen occupation, without involvement

[17] See "Some Constitutional Questions Regarding the Federal Income Tax Laws", by Howard Zaritsky, Legislative Attorney, updated by John R. Luckey, research assistant, Congressional Research Service, Library of Congress, May 25, 1979, updated

of corporate privilege or conduct of manufacturing or sale of commodities, is in conflict with the Constitution and, therefore, invalid as so applied, and, accordingly, those revenues being exluded from taxation as such, "not constituting income within the meaning of the Sixteenth Amendment" or of the Constitution, there is no tax deficiency, an essential element of the charges against Mr. Cryer, and, therefore, it is respectfully submitted that both counts of the indictment must be dismissed, with prejudice.

CONCLUSION

For the reasons hereinabove given and upon the authorities hereinabove cited it is respectfully submitted that there is and can be no tax deficiency, an essential element of the charges against defendant, and, therefore, it is respectfully submitted that both counts of the indictment should be dismissed, with prejudice.