

Cracking the Code- The Fascinating Truth About Taxation In America
by Peter Eric Hendrickson
Study Guide

Surely, one of the most despised institutions in America is the Internal Revenue Service. The IRS and its agents are responsible for more human misery within the United States than any other federal agency, bar none. It enforces the ludicrously unwieldy Internal Revenue Code, which even its own employees do not understand. Certainly, the majority of taxpayers don't understand it completely, and any one of them could be harassed or have levies placed on their earnings for missing a deadline, claiming an incorrect deduction, or less. You may be one of those people who have been hounded by IRS agents and forced into bankruptcy, even through no fault of your own.

But what if everything you know about the income tax is wrong?

One man, Pete Hendrickson, decided to explore, completely, the Internal Revenue Code in order to unravel its mysteries, something that could not be done until the text of the IRC was made available in digital format, and even then, only with great effort.

What he discovered was truly revolutionary.

Pete found that not only is the Code constitutional (something which many previous researchers and “tax protesters” doubted, sometimes to their peril), the federal income tax does not apply to the vast majority of workers, businesses and investors in the United States. We have been, in a word, deceived.

But Pete also discovered that those same workers, businesses and investors can claim their improperly withheld earnings by using the instructions and forms *published by the IRS itself*. He was the first person to file a lawful return and regain all of his federal withholdings, all of his Social Security withholdings, and all of his Medicare withholdings.

Once Pete put the knowledge he gained into practice and regained his rightful property, he graciously published a book explaining it all. *Cracking the Code- The Fascinating Truth About Taxation In America* is, simply, one of the most important books written in at least the last one hundred years. It is now in its twelfth printing.

In this book, you will find:

- An explanation of how the Constitution allows the federal government to collect taxes,
- The history of the income tax, including references to applicable statutes and Supreme Court decisions,
- How the Internal Revenue Code conforms to the Constitution,
- To whom and to what property the Internal Revenue Code applies, and
- How one might go about regaining one's improperly withheld property.

However, *CtC* is a tough read. Pete has condensed a lifetime of study and reams of government regulations and case law into a book of less than 250 pages. Pete himself wisely encourages people to read it as many times as necessary and to do their own research before trying to claim their rightful property from the IRS, and while thousands of people have done just that, the many millions of

Americans who need to understand what's in *CtC* may understandably need a bit of assistance in tackling the book.

This study guide is meant to simplify some of the passages in *CtC*. It is intended as a supplement to the book and must not be used as a substitute for reading the book, especially since the legal decisions that are essential to understanding the income tax are not going to be reproduced here, for the most part. This guide is intended to summarize the findings and put the reader in the right frame of mind in order to make sense of *CtC*. It may also contain references to supplemental material on Pete's website, www.losthorizons.com, an invaluable resource for understanding the law in addition to the book. In particular, please refer to the index a reader thoughtfully provided at <http://www.losthorizons.com/tax/CtCIndex.htm>.

Part One: The Nature of the Law

Chapter 1 About Taxes – Direct v. Indirect

This chapter introduces the reader to the two main categories of taxation, direct and indirect, giving several examples of each, and describes the limits of a government's authority to tax.

“All Constitutionally valid *federal* taxes within the 50 states must be either direct or indirect.”¹

The two broadest categories of taxation are *direct* and *indirect* taxes.

A *direct* tax is a tax laid directly on a person or property, and is thus unavoidable. If the law says so, you are subject to direct taxation simply by living within the borders of the government of that state or nation where you live. A direct tax can also apply to property you own. Familiar examples include county property taxes and county ad-valorem taxes. One kind of direct tax is also known as a *capitation*. The literal translation is “head tax”; in application, a capitation is a “revenue tax”, as explained by Adam Smith in “Wealth of Nations”, the work from which the Framers took the term when drafting our current United States Constitution.

However, according to the U.S. Constitution, federal direct taxes must be *apportioned* by population among the several States. This is one of the purposes of the census, which is conducted every ten years to determine the population of each State.

Apportionment means that the federal government can present a bill to each State based on the population of that State. The State is then responsible for collecting the taxes from the citizenry, which can be more difficult than the State government would like (which was the whole point of apportionment). An early example of a properly apportioned direct tax appears on page 228 of *Cracking the Code*.

Again, the federal government cannot legally lay a direct tax on any person or property without apportionment.

Although the author does not refer directly to the sections in the Constitution that refer to direct taxation, here are the sections:

Article 1, Section 2:

Representatives and **direct Taxes shall be apportioned among the several States** which may be included within this Union, **according to their respective Numbers**, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years², and excluding Indians not taxed, three fifths of all other Persons³.

(The 14th Amendment added some clauses about denying representation in Congress in proportion to

1 *CtC*, p. 2, emphasis added.

2 e.g., prisoners.

3 e.g., slaves.

the number of male citizens denied the right to vote for electors in a State⁴, but it did not change the requirement for apportionment of direct taxes.)

Article 1, Section 9:

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

The authors of the Constitution said it again. Must be important.

The second category of taxes is *indirect*. In general, an indirect federal tax involves a special privilege granted by the federal government. Understanding this point is key to understanding *Cracking the Code* and what it says about the tax code.

The Constitution describes lawful indirect taxes in Article 1, Section 8:

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**[.]

A closer look at the categories of indirect taxes is in order, although the author does not go into great detail, except for excise taxes. This will help the reader to decide what is and what is not the proper subject of an indirect tax.

Although both are technically generic terms, a *duty* or *impost* is generally meant as a tax on imports. If you trade across the border of the United States, you may have to pay a tax on imported goods.

An *excise* is a tax arising in connection with the wholly optional purchase of a specific kind of good, where the seller can transfer the cost of the tax to the consumer. A federal tax can be laid on the purchase of gasoline⁵, or a yacht. An excise can also be laid on the exercise of a specific privilege granted by the taxing entity, such as a job with the federal government. This is actually the crux of understanding how the income tax is laid; much of the rest of *Cracking the Code* is devoted to how, exactly, the federal government misleads you into claiming that much of your private-sector income derives from federal privilege when it most likely does not.

It is the nature of the activity, not the income derived, that makes the income taxable. In other words, it's not the income that's taxable, *it's what you did to earn the income that determines whether the income is taxable*, as it is the nature of the activity that determines whether it was an activity that was dependent on a privilege granted by the federal government. “[T]he (income) tax is not on the property itself, but rather is a fee for the privilege of receiving gain from the property. The tax is based on the *amount of the gain*, not the value of the property.”⁶ Earnings that did not derive from the exercise of federal privilege are therefore *not indirectly taxable*.

4 This describes people barred from participating in elections following the Civil War, usually freed slaves.

5 This kind of excise tax is laid on the privilege of selling the taxed item within the taxing entity's jurisdiction.

6 “Frequently Asked Questions Concerning the Federal Income Tax”, C.R.S. Report for Congress 92-303A, quoted in *CtC*, p. 5, emphasis added.

The author also describes *jurisdictional* limitations on taxation. “A government cannot tax directly or indirectly any thing or any activity outside either its legal or its geographical jurisdiction.”⁷ The power of a government to go outside its own borders to impose taxes would be absurd. However, when the government allows you to benefit from the exercise of federal power, such as being employed by the federal government or profiting from investment in, or operation of, a federal instrumentality or federally-connected industry (such as railroads or national banks), it may impose indirect taxes on such activities.

The Constitution describes the boundaries, and therefore the jurisdiction, of the federal government as what is now known as the District of Columbia, plus all the land purchased in a State, by the consent of the legislature of the State in question, by the federal government for forts, magazines, and other “needful buildings”, and the territories and possessions.

However, except for those areas thus ceded to the federal government, the jurisdiction of a State is coincident with the borders of that State. The federal government has no geographical jurisdiction there.

Also, living in the District of Columbia or other federal enclave does not necessarily mean that your earnings are indirectly taxable, that is, subject to the federal income tax. In fact, you are probably even more protected, as there cannot be a direct federal tax laid, since there cannot be an apportionment! (The several states, of course, can and do levy direct taxes.) But *working* for the local government in a federal enclave would establish the fact that that one's income does indeed derive from a federal privilege.

To review:

- Only two categories of taxation exist: direct and indirect.
- The Constitution does not permit direct taxation except by apportionment among the States.
- Indirect taxes, including duties, imposts, and excises, can only be laid on gain, profit or incomes deriving from federal privilege.
- The power of the federal government to tax is limited to its jurisdiction.

“[We] can perceive that unprivileged, outside-of-federal-geographical-jurisdiction work cannot be taxed indirectly by the federal government.”⁸ “The proceeds of such work can only be taxed, of course, with an apportioned direct tax. [No] attempt to violate these principles is found within the Internal Revenue Code, as will soon be made clear.”⁹

This last point bears repeating. *No attempt to violate the principles of the Constitution, from its definition of direct and indirect taxation to its definition of the federal government's jurisdiction, is found within the Internal Revenue Code.* The Internal Revenue Code is constitutional.

Therefore, We the People must be missing something.

⁷ *CtC*, p. 5.

⁸ *CtC*, p. 10.

⁹ *CtC*, p. 11.

Questions:

1. According to the definition of an indirect tax in Black's Law Dictionary, who pays the tax?
2. Name two Supreme Court decisions that define the income tax as an excise.
3. Name two Supreme Court decisions that clarified the jurisdiction of the federal government.
4. "Since the right to receive income or earnings is a right belonging to every person, this right cannot be taxed as privilege." From what decision is that statement?

Chapter 2 The Origin of the “Income” Tax

This chapter discusses two of the earliest federal revenue acts that established taxes on incomes, and the scope of those taxes.

In the heat of the Civil War, the U.S. Congress passed the Revenue Act of 1862. Three sections of the Act are quoted.

Section 86 established that a three-percent duty, to be collected by withholding, was to be laid on the salaries of essentially all federal employees, including senators and representatives in Congress, who were paid more than six hundred dollars a year. The amount withheld, plus a certificate with the name of the employee, was to be sent to the office of the Commissioner of *Internal Revenue*, and entered as part of the *internal duties*. (The name alone implies the proper jurisdiction.) The taxes laid on those salaries were lawful indirect taxes deriving from federal privilege; they were a duty on federal outlays. The federal government, in these cases, got their money up front before they paid the salaries.

Section 90 established a duty of three percent on any amount exceeding six hundred dollars (up to ten thousand dollars, after which it went to five percent), upon the annual *gains, profits, and income* of every person residing in the United States, *however derived*. The jurisdiction is once again that of the United States.

It is important to understand what the Act meant by “gains, profits, and income...*derived from*” certain activities, since the current Internal Revenue Code still maintains this distinction. Clearly, if the government meant to say that the tax applied to everything that came in, such as it applied to the salaries of government workers, it would have done so.

Recall, it is the *activity* that determines whether the “gains, profits, and income” derived from it are taxable. Private sector earnings were not gains, profit or income, but investing a portion of those earnings in taxable entities (such as railroads) might have resulted in taxable gains.

Lastly, Section 93 established the manner by which any person could declare his or her income that was liable to be assessed for taxes, or to correct any mistakes the federal government or others may have made in determining that income. The federal government largely left it up to the taxpayer to determine his or her own liability. Crucially, the government had to accept the person's declaration as fact unless it had evidence to the contrary (that is, unless it was the source of the income, as it would have been if it had simply paid the person a salary).

In 1880, a lawyer named Springer sued in federal court, claiming that the Revenue Act established an unapportioned (and therefore unconstitutional) direct tax on his professional earnings. The Supreme Court eventually ruled against him, partly because he had mischaracterized all of his earnings as “income” for the purposes of the litigation. (Some was, some wasn't, as a later Supreme Court ruling noted.) But the Court said even an *apportioned tax on incomes* would be inequitable, since there may be few people in a populous state that might be earning income.

The ruling makes sense if one considers “income” to be receipts connected with a federal privilege. At the time, there was likely only a small minority of the population of any given State investing in

taxable entities or earning a salary from the federal government. To saddle them with the tax, as apportioned to the entire population of the State, would be ruinous. Clearly, the Court did not have that in mind.

In *Pollock v. Farmers Loan & Trust*, the Supreme Court again ruled on what could and could not be considered income. It said that even otherwise taxable income is untaxable if connected with personally owned property, which, as we know, can only be federally taxed by an apportionment among the States. The Court also said that “taxation on income was in its nature an *excise* entitled to be enforced as such,” that is, indirectly, upon an optional exercise of privilege.¹⁰

¹⁰ *CtC*, p. 17.

Chapter 3 The Supreme Court and the Meaning of “Income”

In 1913, the Sixteenth Amendment was declared to be ratified and was promptly followed up with a new revenue act.¹¹ The text of the Sixteenth Amendment is as follows:

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.¹²

Shortly thereafter, a man named Frank Brushaber filed suit¹³ to fight the taxation of his dividends from his railroad investments. His argument was that the Sixteenth Amendment and the subsequent revenue act had established a direct, yet unapportioned, tax on personal property. The Supreme Court disagreed, noting that Article 1, Section 9 of the Constitution was *not repealed* by the Sixteenth Amendment. The meaning of “income” was still the same as before (and had in fact become fixed in case law), and income taxes were still excises dependent on the exercise of a federal privilege. One could only argue whether the activity engaged in was such an exercise of privilege.

In other words, the Sixteenth Amendment can be seen as saying, "If a constitutional indirect tax is passed, it can be assessed from whatever source derived (i.e., no matter what one did to earn that income)". Naturally!

Revenue acts from this point onward, even today's Internal Revenue Code, have included language excluding “income exempt from taxation by (the fundamental) law”; that is, the Constitution. This language helps to protect the revenue acts from being struck down from overreach, although it is probably not necessary, based on what we learned from *Brushaber*.

The Supreme Court went even further, and pointed out that even after the Sixteenth Amendment, if a tax act sought to expand the term “income” to encompass private-sector earnings or other personal property, the Constitution still demanded the apportionment of such taxes among the States as discussed in Chapter 1. The Court would have then required that such taxes be apportioned, regardless of what they were called. Otherwise, the Court said in so many words, what would have been the point of such a restriction?¹⁴

The author goes on to discuss additional Supreme Court rulings which drive home the point that income is properly the subject of indirect taxes. Additionally, the Court further clarified the necessary elements of what could be classified as “gains, profits and income”:

...“income”, as used in the statute should be given a meaning **so as to not include everything that comes in**. The true function of the words “gains” and “profits” is to limit the meaning of the word “income”.¹⁵

11 Whether it actually was properly ratified is the subject of much scholarly debate. Nevertheless, the author treats the Sixteenth as properly ratified and will explain why this is a good thing.

12 Emphasis added.

13 *Brushaber v. Union Pacific R. Co.*, 240 U.S. 1 (1916).

14 *Ibid.*

15 *So. Pacific v. Lowe*, from the ruling in the District Court, affirmed in 247 U.S. 330 (1918), as quoted in *CtC*, p. 24 and

Income which can be lawfully taxed must therefore not only be a consequence of the exercise of a privilege, it must also involve a meaningful gain.

The remainder of the chapter is a discussion of the nature of trade, money, and property that does not require additional explanation. The author describes money as representing useful labor. While this is valid in a metaphorical sense, in truth, economists have firmly established that money is simply the commodity that is used most commonly as the means of exchange amongst the members of a society engaging in trade, whether that commodity naturally evolves to become the unit of exchange in the marketplace, such as gold and silver, or whether it is imposed by government fiat, such as Federal Reserve Notes.¹⁶

Nevertheless, no matter how one describes money and its function in society, money is property and remuneration for private-sector work can in no way be considered in the category of “gains, profits, or income” that would be subject to indirect taxation. Payment for work performed is simply an exchange and does not involve a meaningful gain, let alone the exercise of a privilege.

But if someone works for the federal government, such activity *does* involve the exercise of a privilege and the income derived can be taxed accordingly. It is incumbent upon everyone to determine which of his or her activities involve such exercises of privilege and which activities do not.

also see page *CtC* p. *i*, emphasis added.

16 For additional information, the reader is encouraged to read the works of the Austrian School economists. A superb beginning point is Murray N. Rothbard's “What Has Government Done to Our Money?” at <http://mises.org/money.asp>.

Chapter 4 Regarding the Law and Its Virtues

The author here gives a thumbnail sketch of legal jurisprudence. For the most part, this chapter is straightforward and does not need much explanation.

He explores the origins of law in a society and describes the necessary elements of a just law:

1. Legitimacy of authority
2. Clarity of command
3. Conformity with established procedures of notice

Legitimacy of authority: “A law can only issue from an agency to which those upon whom the law will act have designated appropriate authority.”¹⁷ In other words, such agencies have no legitimate authority in and of themselves. Such authority must be delegated to them.

Clarity of command: “The law must mean what it says, and say what it means, or there is no purpose to it whatsoever.”¹⁸

Conformity with established procedures of notice: “No one can be held to account for a law the existence, meaning, or authority of which is kept from them, or is otherwise unavailable. Thus it is an essential principle that a consistent and effective means of notice be established and deployed.”¹⁹

The revenue statutes of the federal government, like all laws, must possess these attributes to be lawful. Again, the author has determined this to be true, and that any appearances to the contrary are resolved as one digs deeper. Otherwise, the statutes would be inherently void.

¹⁷ *CtC*, p. 35.

¹⁸ *CtC*, p. 39.

¹⁹ *CtC*, p. 41.

Chapter 5 The Plot Thickens

In 1921, the Supreme Court ruled in *Eisner v. Macomber*²⁰ that, in regards to the definition of “income”, Congress was not free to alter the Constitution through legislation, since the power to legislate was derived solely from the Constitution itself.

Congress, however, was starting to get crafty. In the new Revenue Act of 1921, it said that the *term gross income* “includes gains, profits, and income derived from salaries, wages and compensation for personal service (including in the case of the President of the United States [and other federal employees]...*the compensation received as such*)...or all gains, profits and income derived from any source whatever.”²¹

The author is getting a little ahead of himself here, so the importance of the words “term” and “includes” might not be obvious to the reader just yet. He will explore the meanings of both later on in the book.

What the definition of the term “gross income” accomplishes is to clarify that the compensation to federal workers is to be included *in its entirety*, and not just whatever gains that might be realized by investing part of that salary, which is covered in the last part of the definition and is still dependent on the exercise of a federal privilege.

In 1928, Congress passed another Revenue Act. The definition of “gross income”²² was heavily altered and terribly misleading, but by that time, many of the terms that appeared in the Revenue Act were defined *elsewhere*, such as in the Classification Act of 1923.²³ The practical meaning of “gross income” was unchanged, however, as it still referred to “gains, profits and income derived from any source whatever.”

In 1936, only 3.9% of the population filed income tax returns. At that time, as the Treasury Department noted, the largest portion of consumer incomes was not subject to income taxation.²⁴ Clearly, if Congress had meant, or was able, to tax all of those consumer incomes, would it not have done so?

20 *Eisner v. Macomber*, 252 US 189 (1920), as referenced in *CtC*, p. 46.

21 *CtC*, pp. 46-47.

22 *CtC*, p. 50.

23 *CtC*, pp. 51-52.

24 “Collection at Source of the Individual Normal Income Tax”, Division of Tax Research, U.S. Department of the Treasury, 1941.

Chapter 6 The Law Means What It Says

*“Inclusio unius est exclusio alterius. The inclusion of one is the exclusion of another.”*²⁵ This legal principle will go a long way to helping people unravel the Internal Revenue Code. In fact, most of Chapter 6 is devoted to explaining the usage of the word “includes” in law.

For instance, a legal term might be defined as follows: “For purposes of this paragraph, the term “Fruit” includes apples, pears, and oranges.”²⁶ That means, that for the length of this paragraph, cherries are not included in the definition of fruit, nor are bananas, nor anything other than what is **included** in the definition of the term. The term “Fruit” does not retain its common definition in such a legal construct. When the *word* “fruit” is given a legal definition, it becomes a legal *term* and the common meaning is stripped away.

Here's another one: “For purposes of this chapter, the term ‘employee’ includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term ‘employee’ also includes an officer of a corporation.”

That definition is from the United States Code, Title 26, Subtitle C, Chapter 24, Section 3401. Now, does that definition retain the common meaning of the word “employee”? Absolutely not. If Congress had meant it to, it would have said something like, “The term ‘employee’ includes all persons working for wages in the private sector or the public sector.” But, for the purposes of Chapter 24 (Collection of Income Tax at Source on Wages), Congress did not so define the term, *because it could not*. These definitions will be examined in detail later.

There is a rather tricky definition in the tax statutes of the terms “include” and “including” that may make one think that the use of the terms is expansive, and brings in other definitions in addition to the common usage of the word. Not true. The definition is this: “The terms ‘includes’ and ‘including’ when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.”²⁷

The author explains this in great detail, but our example above will help to illustrate it simply. “For purposes of this paragraph, the term “Fruit” includes apples, pears, and oranges.” So, we know cherries and pineapples are not included in the term. But does it include all varieties of apples? Yes, it does. One need not list Granny Smith, Braeburn, Fuji, Red Delicious, or Gala apples separately, since they are otherwise within the meaning of the term defined. Get it?

And so, the craft is revealed, and will be made plain in later chapters. The Internal Revenue Code is dependent on terms that have stripped the common meanings from such words as “income”, “wages”, “employees”, “employers”, and “trade or business”. Not one person in a million can read the Internal Revenue Code and figure out what the regulations really mean, and to whom they really apply. This was deliberate. But the truth is, again, that the law means what it says.

25 Black's Law Dictionary, 6th Edition.

26 *CtC*, p. 57.

27 U.S. Code, Title 26, Subtitle F, Chapter 79, § 7701.

Chapter 7 The Code Is Born

The Internal Revenue Code came into existence in 1939. The Code was a compilation of all revenue acts that were in effect at the time and incorporates new revenue acts as they are enacted. The Code has evolved over the years to be less and less communicative of the letter and intent of the revenue acts, perhaps deliberately so, but it is still reliant on them.

The Code itself, in its first iteration, stated this clearly: “The title contains no provision, except for effective date, not derived from a law approved prior to January 3, 1939...” Compiling the statutes into the Code and rearranging the statutory requirements within the Code does not change the underlying statutes, which we have explored quite sufficiently in the book so far. Notably, the 1939 Code acknowledges that its active source statutes go back to 1862. That is, the foundation of current tax law-- indeed, a very large fraction of present-day Title 26-- was enacted long before the advent of the 16th Amendment.

This is important to note: the current location in the Code of crucial definitions and language that reflect the underlying statutes has changed over the years, and can change again in the future. Any references to various sections of the Code may change. New revenue acts may be enacted as well, and they may change some of the language of the Code, but the federal government already taxes the gains, profits and incomes of pretty much everyone it can now (and hundreds of millions more besides, due to widespread ignorance of the tax’s limitations), so new revenue acts are unlikely to bring in anyone else as taxpayers.

The author provides an example in this chapter. Following the release of the Code, the Public Salary Tax Act of 1939 was enacted. This act changed the definition of “gross income” to mean “compensation for personal service including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of the foregoing.” Isn't this outside the federal government's jurisdiction? Not at all! The same act defined the term “State” as follows: “The term “State” shall be construed to include the Territories and the District of Columbia, where such construction is necessary to carry out the provisions of this title.”²⁸ (Now you see why the author spent so much time on the word “includes”: it's the key to unraveling much deception.) So, the officers and employees of the governments of the several States are not subject to federal excise taxes, just those local government workers in D.C. (whose remuneration has been subject to the income tax since 1921) and United States territories²⁹ (whose remuneration was added by this act).

In addition, the act said nothing about taxing officers or employees in the private sector, but now you know why that is. If the provisions of the revenue laws and the Code had applied to all workers, there would have been no point to the Public Salary Tax Act of 1939.

Having now been brought into the fold of taxpayers by the act, the Code no longer needs to mention these workers explicitly. Their earnings while performing in their federally-connected capacities now fall under the umbrella of the term “gains, profits, and income” without distinction, and they therefore needn’t be distinguished (and besides, leaving theirs and other activities subject to the tax unspecified

28 Public Salary Tax Act § 206; 1939 IRC § 3797; U.S. Code, Title 26, Subtitle F, Chapter 79, § 7701 (10).

29 U.S. Code, Title 26, Subtitle F, Chapter 79, § 7651.

helps contribute to a general misunderstanding of the true nature of the tax).

Chapter 8 Withholding the Truth

In this chapter, the author provides several key examples of the craft that legislators and bureaucrats use to hide the legal definitions, which are entirely in keeping with the law, in terms that are ambiguous if the definitions are found elsewhere, as they frequently are. Indeed, as the author notes, we are lucky that they did not make the search for the truth more difficult!

For instance, consider the following:

“Except as otherwise provided in this section, every **employer** making payment of **wages** shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary.”³⁰

That sounds pretty all-encompassing. It also contradicts what we've learned about lawful indirect taxation. Ah, but here's the catch:

“For purposes of *this chapter*, the term "**wages**" means all remuneration (other than fees paid to a public official) for services performed by an **employee** for his **employer**,...”³¹

“...the term "**employer**" means the person for whom an individual performs or performed any service, of whatever nature, as the **employee** of such person,...”³²

And, the *coup de grace*:

“the term "**employee**" *includes* an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "**employee**" also includes an officer of a corporation.”³³

The term is limited to what is included in the definition. Therefore, a person who is not “an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing” is not an “employee” per the Internal Revenue Code, and the withholding tax does not apply.

We will leave alone for the moment the fact that your so-called employer (ha!) deducts and withholds a portion of your pay anyway. We'll deal with that later.

A similar exercise is applied in this chapter to the FICA taxes, Social Security and Medicare, as well as Federal Unemployment Taxes (FUTA taxes). Both taxes are nothing but “income” taxes like any other, and have been defined as such in Supreme Court decisions.

30 U.S. Code, Title 26, Subtitle C, Chapter 24, § 3402, emphasis added.

31 *Ibid*, § 3401(a), emphasis added. Note that the definitions in Section 3401 apply to Section 3402 as well as every other section in Chapter 24.

32 *Ibid*, § 3401(d), emphasis added.

33 *Ibid*, § 3401(c), emphasis added. The use of the term “corporation” refers only to United States corporations, as will be explained later.

Chapter 9 Crafting a Trade or Business Plan: A Guide for the Self-Employed

Let's say you have your own business. The federal income tax applies to your earnings, right? That's why you spend so much time trying to keep track of everything that comes in, along with all of your expenses, right?

Well, the Internal Revenue Code has a definition of “trade or business” that will surprise you:

“The term **‘trade or business’** *includes* the performance of a public office.”³⁴

So this makes the definition for “net earnings from self-employment” rather revealing:

“The term **‘net earnings from self-employment’** means the gross **income** derived by an individual from any **trade or business** carried on by such individual, less the deductions allowed by this subtitle which are attributable to such **trade or business**...”³⁵

Now that we know what a “trade or business” is, the use of the term “income” makes sense here. Elsewhere in Section 6401, it even refers explicitly to the familiar term “gains, profits, and income”, the true meaning of which you now understand.

In fact, you will see the term “trade or business” employed throughout the Code, just like that. Since the Code must remain lawful, it must employ the term as defined throughout and cannot casually refer to a “trade” or a “business” in the common-usage sense.

Granted, it is important to keep your books to determine profit and loss in your business, but it should be clear that unless you are performing the duties associated with a public office, and thus earning federally privileged income, these regulations do not apply to you.

Now, what about the people you employ, or who subcontract to you? Aren't you supposed to complete Forms 1099-MISC for such payments? As the instructions for the form itself state:

“Trade or business reporting only. Report on Form 1099-MISC **only** when payments are made in the course of your **trade or business**.”

Therefore, no private employer or company should ever issue a Form 1099-MISC.

The author has an admonishment in this section which is important enough to reproduce here:

Always ask yourself, “Why is it written like this? Is it written like this because it means what its beneficiaries want me to believe that it means, or is it written like this because it *doesn't* mean what its beneficiaries want me to believe that it means?”³⁶

If you've gotten this far in the book, congratulations. You are in for a treat in the latter half of this

34 U.S. Code, Title 26, Subtitle C, Chapter 24, § 7701(a)(26), emphasis added.

35 U.S. Code, Title 26, Subtitle C, Chapter 24, § 1402(a), emphasis added.

36 *CtC*, p. 87.

chapter. Having explored enough of the Code to reveal most of the subterfuge within, the author concisely summarizes the objects to which the Code lawfully applies:

[A]ctivities for which one is paid by the federal government or a federal agency or instrumentality; activities effectively connected with the performance of the functions of a public office; activities as a federal, federal instrumentality, or federally chartered "State" worker; or activities as a paid officer of a federal corporation...

He could have said this in the beginning, of course, but who would have believed him if he had not walked us through his examination of the Constitution, the revenue acts, the Supreme Court decisions, and the Code, step by step?

Chapter 10 Interlude

Having made a strong case for the limited nature of the income tax, the author addresses some doubts that the reader may be having. Surely, some readers will be saying, this can't possibly be true. Someone would have blown the lid off of this scam a long time ago. Surely the author is taking passages in the Internal Revenue Code, the revenue acts and the Supreme Court decisions completely out of context.

The skeptical reader is, once again, encouraged to do his or her own research. Indeed, such research is always welcome. But the author has already plumbed the Code sufficiently to demonstrate that private sector earnings are not generally subject to the federal income tax. As he says, if he is wrong, then the job of debunking *CtC* would be laughably simple. All one would have to do is point to the salient passages in the Code that disprove the assertions in the book.

However, the government workers, bureaucrats, judges, lawyers, and accountants that feed off of the public's broad misunderstandings of the Code don't much encourage such research. Most of them are laboring under the same misunderstandings; some may suspect the truth; a few of them know. Those that know are counting on widespread fear and apathy to keep the truth hidden. But as successful challenges start to mount, the truth is not going to remain hidden for long.

This chapter is clearly written and does not reference the Code or court decisions, so does not need much simplification. In fact, it serves as good inspiration for readers who have gotten bogged down in the book. They will be encouraged once again to continue reading.

Part Two: The Nature of the Scheme

Chapter 11 “W” is for Weapon

Anyone who has paid any attention to the controversies surrounding the income tax has heard the phrase, “voluntary compliance”. Usually, it's trotted out by an apologist for the IRS to describe a system in which people comply with federal tax laws rather than have the IRS do it for them. The truth of the matter is both more simple and more sinister than most Americans suspect.

A few choice quotes from past IRS Commissioners and Supreme Court decisions regarding “voluntary compliance” starts off this chapter. (Additionally, after reading this chapter, one might be interested in a recent interview with Senator Harry Reid on this very subject.³⁷) The author also includes the legal definition of “voluntary”:

“In its legal aspect, and as commonly used in law, the word 'voluntary' is defined as meaning gratuitous; without valuable consideration; acting, or done, of one's own free will without valuable consideration; acting, or done, without any present legal obligation to do the thing done.”³⁸

The usage of the phrase is clear and correct. One establishes one's income tax liability, in the absence of any requirement to do so, merely by complying with the government's request to report one's earnings, or the remuneration paid to others, as privileged income. At its base, it really is that simple.

Now for the sinister part. The Internal Revenue Service has spun this intricate web of regulations precisely in order to trap people into declaring, voluntarily, their own private sector earnings as deriving from a federal privilege, or declaring themselves to be government workers or “United States persons”.³⁹ It does so by demanding certain informational returns from individuals and companies, the vast majority of whom cannot see past the ruse.

But before we get into the various kinds of returns in subsequent chapters, the author discusses the proper relationship of statutes and regulations. **Statutes** are the legislative acts passed by Congress that must be in conformance with the Constitution; **regulations** describe the way in which the statutes are to be implemented by the bureaucracy. A regulation is always subordinate to the associated statute, and while it might not demand all that a statute does, it cannot exceed the authority of the statute itself. However: “A statute can mislead the unwary while remaining lawful, if it imposes no requirement to act; or if it, *or its associated regulations*, contains clarifying elements.”⁴⁰ In other words, while context always imposes proper limits to any statute, not all statutes contain language expressly revealing those limits; however, in such cases, that expressly clarifying language is often found in the associated regulations instead.

Let's look at one example: “Every person doing business as a broker shall, when required by the Secretary, make a return, *in accordance with such regulations as the Secretary may prescribe*, showing

37 <http://www.freeliberale.com/blog/archives/003277.php>. It is clear that Senator Reid knows what he is talking about. The interviewer does not.

38 Corpus Juris Secundum (C.J.S. 92: 1031).

39 See CtC, pp. 111-112 for a discussion of “United States person”.

40 CtC, p. 113, emphasis added.

the name and address of each customer, with such details regarding gross proceeds and such other information *as the Secretary may by forms or regulations require* with respect to such business.”⁴¹

Although it appears that anyone doing business as a broker has to return this information on one's customers, in this case the statute refers to the regulations that implement it. Let's see what those regulations say about who a broker is:

“The term broker means any person (other than a person who is required to report a transaction under section 6043), U.S. or foreign, that, in the ordinary course of a *trade or business* during the calendar year, stands ready to effect sales to be made by others.”⁴²

The use of the term “trade or business”, as discussed in Chapter 9, limits the statute to its proper scope: the performance of a public office. Therefore the statute is lawful, however misleading it may be.

Additional examples may be found in this chapter and they all reach the same general conclusion once the clarifying terms are discovered.

41 U.S. Code, Title 26, Subtitle F, Chapter 61, Subchapter A, Part III, Subpart B, § 6045, emphasis added.

42 26 CFR 1.6045-1, emphasis added.