

Chapter 7:
Inside Sources

Frank Brushaber was taxed on a dividend he received from the stock of a *domestic* corporation. Remember, the term "domestic" in this context means "inside the federal zone". The dividend came, therefore, from a "source" that was situated inside this zone. The exact legal meaning of the term "source" has been the subject of much debate, both inside and outside the federal courts. We would not presume to be the ones who settle this debate once and for all, least of all in the few pages dedicated to this chapter.

It is important to understand that the Brushaber Court's decision turned, in large part, on a determination of the "source" of the dividend which Frank Brushaber received. That source was a domestic corporation which had been chartered by Congress to build a railroad and telegraph through the Utah Territory (from the "Union" to the "Pacific"). As such, it was an "inside source" -- a source that was situated (read "domiciled") inside the federal zone.

Frank Brushaber's income was "unearned" income. This means that he did not exchange any of his labor in order to receive the dividend paid to him by the Union Pacific Railroad Company. Earned income, on the other hand, is income which is derived from exchanging labor for something of value, like money. Also beyond the scope of this chapter are the sad debate, and considerable mass of IRS-sponsored confusion, that surround the legal definition of "income". Whatever you do, do not waste your time searching the IRC for a clear definition of the term "income", because it just simply does not exist:

The general term "income" is not defined in the Internal Revenue Code.

[U.S. v. Ballard, 535 F.2d 400, 404]
[(8th Circuit, 1976)]

Author Jeffrey Dickstein has done an extremely thorough job of documenting the history of judicial definitions of this term. Many of those definitions are in direct conflict with each other, but *all* Supreme Court decisions on the question have been completely consistent with each other.

In Appendix J of this book, you will find one of our formal petitions to Congress, in which are summarized a number of rulings on this issue by the Supreme Court and by lower courts which concur. If you must also review the courts which do *not* concur, you gluttons for punishment should buy Dickstein's great book on the subject.

Back to sources. IRS Publication 54 explains in simple terms that: "The source of earned income is the **place** where you perform the services." I always enjoyed it when Sister Theresa Marie would tell our third-grade class in parochial school that the whole world is divided into persons, places and things. How I long for those simpler days! The courts have used the technical term "situs", instead of the word "place", as follows:

We think the language of the statutes clearly demonstrates the intendment [sic] of Congress that the **source** of income is the **situs** of the income-producing service.

[C.I.R. v. Piedras Negras HB Co., 127 F.2d 260 (1942)]
[emphasis added]

It is useful to repeat the IRC section which was quoted in the last chapter. Specifically, in the case of a nonresident alien individual, except where the context clearly indicates otherwise, gross income **includes only**:

- (1) gross income which is derived from **sources within the United States**** and which is not effectively connected with the conduct of a trade or business within the United States**, and
- (2) gross income which is **effectively connected with the conduct of a trade or business within the United States****.

[IRC 872(a), emphasis added]

The term "gross income" is crucial, because it is the quantity which triggers the filing requirement. It is like a threshold, or so we are told by august members of the black robe, like Judge Eugene Lynch of the United States District Court ("USDC") in San Francisco. IRC Section 6012 reads, in pertinent part:

General Rule. -- Returns with respect to income taxes under subtitle A shall be made by the following:

- (1)(A) Every individual having for the taxable year **gross income which equals or exceeds the exemption amount ...**

except that subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Secretary, **nonresident alien individuals** subject to the tax imposed by section 871 ... **may be exempted from the requirement of making returns** under this section.

[IRC 6012(a), emphasis added]

Section 6012 is a pivotal section, if only because the IRS is now citing this section (among others) as their authority for requiring "taxpayers" to make and file income tax returns. As you can plainly read with your own eyes, nonresident alien individuals may be *exempted* from the requirement of making returns.

Diving into the many thousands of regulations which have been "prescribed by the Secretary" is also beyond the scope of this book. For now, realize that the regulations do exist, and that the quantity "gross income" for nonresident aliens includes *only* the following two things: (1) gross income derived from sources within the United States** and (2) gross income that is effectively connected with a U.S.** trade or business. That's it!

You will note that the Code and its regulations make frequent use of the terms "within" and "without", in order to contrast the two terms as antonyms, or opposites. In this context, the term "within" is synonymous with "inside"; the term "without" is synonymous with "outside". "Within" and "without" are antonyms. And the term "antonym" is an antonym for a synonym! ("Good grief," declared Charlie Brown.) Thus, if you are outside the federal zone, you are "without" the United States** in the languid language of federal tax law. (Languid: drooping or flagging from, or as if from exhaustion.) Can we ever get along "without" the United States**? :-)

The importance of "within" and "without" cannot be emphasized too much. In the context of everything we now know about jurisdiction within the federal zone, these terms are *crucial* to understanding the territorial extent of the IRC. To underscore this point, consider IRC Section 862, entitled "Income from Sources Without the United States**":

(a) Gross Income from Sources without United States**. --

The following items of gross income shall be treated as income from **sources without the United States****: ...

(3) **compensation for labor or personal services performed without the United States**.**

[IRC 862(a)-(a)(3), emphasis added]

Now, turn to IRS Form 1040NR. A copy of this form is found in Appendix K. The "NR" stands for "Non Resident". Nonresident aliens file this form to report and pay tax on gross income as defined in IRC Section 872(a). On page one of the 1990 version of this form, there is a block of line items numbered 8 thru 22. These items are summed to produce a total on line 23. "This is your **total effectively connected income**," states the form. Now, turn the form clockwise 90 degrees. Note, in particular, the phrase near the left margin of page one, which reads:

Income Effectively Connected With U.S.** Trade/Business

If you are a nonresident alien and you have no income which is effectively connected with a U.S.** trade or business, then you can, in good conscience, put a big fat ZERO on line 23. But, this is not the whole story. On page 4 of Form 1040NR, there is a table for computing "Tax on Income Not Effectively Connected with a U.S.** Trade or Business". What would this be?

Recall IRC Section 872(a), quoted above. The **only other** component of gross income for nonresident aliens is income derived from sources within the United States**, like Frank Brushaber's stock dividend. Lo and behold, this table itemizes such things as dividends, interest, royalties, pensions, and annuities. These are all items of *unearned* income, i.e., profits and gains derived from U.S.** sources *other than* compensation for labor or personal services performed "within" the United States**. The total tax is computed and entered on line 81 of Form 1040NR. Unfortunately, true to form, line 81 in this table says that "This is your tax on income **not effectively connected with a U.S.** trade or business.**" This is very deceptive. Remember, gross income for nonresident aliens includes *only* two kinds of gross income:

- (1) gross income derived from sources within the U.S.** which is **not effectively connected with a U.S.** trade or business** and
- (2) gross income which **is** effectively connected with the conduct of a trade or business within the United States**

Line 81 of Form 1040NR is referring to the first kind of gross income, namely, gross income which is "not effectively connected with a U.S.** trade or business". The second kind of gross income is entered on page 1 at line 23 of this form. Again, it's simple when you know enough to decode the Code. It's also very easy to get confused when the confusion is intentional. ("Encode" and "decode" are antonyms, by the way.)

Unfortunately, the filing requirements for nonresident aliens are not as straightforward as you might think, because the regulations contain certain rules that are not found in the Code itself, and the Code is frequently vague. To understand these requirements, the regulations must be reviewed as they apply to your particular situation. A brief overview is in order here.

If you are a nonresident alien with no gross income from sources within the U.S.**, and with no U.S.** trade or business, is it a good idea to file a 1040NR with zeroes everywhere? No, it is not. The main reason is that filing any 1040 form can provide the IRS with a legal reason to **presume** that you are a "taxpayer", as that term is defined in the IRC. A later chapter of this book will explore the "law of presumption" in some detail. Your filed return can be used as evidence that you are a taxpayer, that is, one who is subject to any internal revenue tax because you are engaged in a "revenue taxable activity". A U.S.** trade or business is a revenue taxable activity. **Thus, a key issue for nonresident aliens is whether or not they are engaged in any U.S.** trade or business.** The CFR says this about the filing requirement for nonresident aliens:

... [E]very nonresident alien individual ... who is engaged in a trade or business in the United States at any time during the taxable year or who has income which is subject to taxation under subtitle A of the Code shall make a return on Form 1040NR. For this purpose it is immaterial that the gross income for the taxable year is less than the minimum amount specified in section 6012(a) for making a return. Thus, **a nonresident alien individual who is engaged in a trade or business in the United States** at any time during the taxable year is required to file a return on Form 1040NR** even though

- (a) he has no income which is effectively connected with the conduct of a trade or business in the United States**,
- (b) he has no income from sources within the United States**, or
- (c) his income is exempt from income tax by reason of an income tax convention or any section of the Code.

[26 CFR 1.6012-1(b) (1)]
[emphasis added]

Thus, the gross income "threshold" defined in the filing requirement at IRC 6012(a) is not relevant if a nonresident alien is engaged in *any* U.S.** trade or business. Conversely, the rules are somewhat different if a nonresident alien is *not* engaged in any U.S.** trade or business. The regulations have this to say about a nonresident alien in the latter situation:

A nonresident alien individual ... who at no time during the taxable year is engaged in a trade or business in the United States** **is not required to make a return for the taxable year if his tax liability for the taxable year is fully satisfied by the withholding of tax at source** under chapter 3 of the Code.

[26 CFR 1.6012-1(b)(2), emphasis added]

If a nonresident alien has no U.S.** trade or business and no tax liability that required withholding (such as U.S.** source income), **then a return is not required.** If you are a nonresident alien and you remain in doubt as to whether or not you are required to file a Form 1040NR, you might begin by reading all the rules found in the Instructions for Form 1040NR. In general, the instructions are much easier to read than the regulations, but also understand that the regulations have the force of law and the instructions do not. The instructions for Form 1040NR address the question of who must file as follows:

Use Form 1040NR if any of the four conditions listed below and on page 2 applies to you:

1. You were a nonresident alien engaged in a trade or business in the United States** during 1990. You must file Form 1040NR even if:
 - a. none of your income came from a trade or business conducted in the United States**,
 - b. you have no income from U.S.** sources, or
 - c. your income is exempt from U.S.** tax.

In any of the above three cases, do not complete the schedules for Form 1040NR. Instead, attach a list of the kinds of exclusions you claim and the amount of each.

2. You were a nonresident alien not engaged in a trade or business in the United States** during 1990 with income on which not all U.S.** tax that you owe was withheld.
3. You represent a deceased person who would have had to file Form 1040NR.
4. You represent an estate or trust that would have had to file Form 1040NR.

[Instructions for Form 1040NR, page 1]

Now, what is a "trade or business" within the United States**? Author and legal scholar Lori Jacques has concluded that the meaning of a "trade or business" is confined to performing the functions of a public office. This conclusion is supported by an explicit definition of "trade or business" that is found in the IRC itself:

Trade or Business. -- The term "trade or business" includes the performance of the functions of a public office.

[IRC 7701(a) (26)]

The Informer has come to the same conclusion, after years of research. All of this "trade or business" activity, thus defined, boils down to one simple thing: government employment. If you work for the federal government, even if you are a nonresident alien, the Congress reserves the power to define that work as a "privilege", the exercise of which Congress can tax. The measure of that tax is the amount of income derived. Author Lori Jacques summarizes government employment as follows:

It appears that the federal income tax is the graduated tax on income effectively connected with a U.S.** trade or business as described in IR Code Sec. 871(b) which is government employment. Remember the nonresident alien does not pay tax on non U.S.** source income. If the nonresident alien signs a Form W-4 he is obviously presumed to be a government employee with "effectively connected income."

[United States Citizen v. National of the United States]

[page 39, emphasis added]

Another competent author and IRS critic, Frank Kowalik, has also arrived at similar conclusions about the "taxability" of employment with the federal government. In his thorough book entitled IRS Humbug, IRS Weapons of Enslavement, Kowalik argues with exhaustive proof that a tax "return" is really just a kickback. Government employees are expected to return or "kick back" some of their earnings to the Treasury, in obvious and grateful tribute to the great giver of all federal privileges, Uncle Sam. Kowalik's arguments and accompanying complaints are so persuasive that Rep. Jack Brooks, Chairman of the House Judiciary Committee, scheduled Kowalik's request for redress as Petition No. 107. In a personal letter to me, Frank Kowalik wrote the following:

I read with interest your Redress (12-24-90) to Barbara Boxer. I also delivered a Redress to Congress making Tom Foley, House Speaker, my personal representative. My book "IRS Humbug" was an exhibit in this Redress. Jack Brooks, Chairman of the House Judiciary Committee, was among those copied. From his letter (copy attached) my Redress has been referred to the Committee on the Judiciary as Petition No. 107. As I understand it, it will be heard in the session after the holidays. I also provide information on "IRS Humbug" that covers the fact that federal income tax is not a tax on labor. **It is a kickback program between the federal government and its employees.**

[personal communication, December 10, 1991]

[emphasis added]

Taken together, The Informer, Lori Jacques and Frank Kowalik appear unanimous in understanding the term "trade or business" to *include only* the performance of the functions of a public office. This conclusion is, of course, supported by the explicit definition of "trade or business" which is found in the IRC itself at Section 7701(a)(26). Note, however, that this definition does not say "includes only"; it says "includes".

Once again, we are haunted by the ambiguity that results from not knowing *for sure* whether "includes" is expansive or restrictive. If "includes" is restrictive, then The Informer, Lori Jacques, and Frank Kowalik are all correct about the inferences they have drawn from the Code and its regulations. If "includes" is expansive, however, then we have to look elsewhere for things that are "otherwise within the meaning of the term defined", that is, otherwise within the meaning of "U.S.** trade or business". Remember the Kennelly letter?

An expansive *intent* is manifested by the explicit definitions of "includes" and "including" that are found at IRC 7701(c). The issues of statutory construction that arise from these definitions of "includes" and "including" are so complex, a subsequent chapter of this book will revisit these terms in more detail. The conclusions in *that* chapter should already be obvious to you. For now, suffice it to say that the intended clarification at 7701(c) is anything but. The hired lawyers who wrote this stuff should have known better than to use terms that have a long history of semantic confusion. For this reason, and for this reason alone, we are now convinced that the confusion is inherent in the language chosen by these hired "guns" and is, therefore, deliberate.

There is some evidence that the meaning of "trade or business" is not limited to the performance of the functions of a public office. The Code itself contains a second definition of "trade or business within the United States**" as follows:

Trade or Business within the United States**. --

For purposes of this part, part II, and chapter 3, the term "trade or business within the United States**" includes the **performance of personal services** within the United States** at any time within the taxable year

[IRC 864(b), emphasis added]

It is tempting to interpret this definition only "for purposes of this part, part II, and chapter 3". We will not take the bait, because it is more important to stay above a major addiction of the federal zone: obfuscation. You may have already begun to notice how frequently the IRC makes reference to other sections, subsections, subparts, subtitles, and subchapters. Sure, these other places in the law must be taken into account before the "performance of personal services" can be fully understood as defined. We can see that as well as anybody else. But two can play this game. Is there any reason in the statute to suspect that these remote references might not even be valid? First, read the following sub-statute within the statute, and then decide for yourself (go ahead, you have our permission):

Construction of Title.

[Sec. 7806(b)]

- (b) Arrangement and Classification. -- No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis, or descriptive matter relating to the contents of this title be given any legal effect. The preceding sentence also applies to the side notes and ancillary tables contained in the various prints of this Act **before its enactment into law.**

[IRC 7806(a), emphasis added]

Many people, unschooled in the finer points of statutory construction, interpret this section of the IRC to mean that the entire Code has no legal effect. However, a close reading reveals that this section is limited to tables of contents, tables of cross references, side notes, ancillary tables and outlines, in other words, everything *but* the meat of the Code.

Nevertheless, notice the last sentence; it contains a rule which also applies the "preceding sentence" to the side notes and ancillary tables contained in the various prints of the Code *before its enactment into law*. So, the obvious question is this: has Title 26 been enacted into law? The shocking answer is: NO, it has not been enacted into positive law. In a preface dated January 14, 1983, and included in the 1982 edition of the United States Code, Speaker of the House Thomas P. O'Neill wrote the following:

Titles 1, 3, ... 23, 28, ... have been revised, codified, and enacted into positive law and the text thereof is legal evidence of the laws therein contained. The matter contained in the other titles of the Code is *prima facie* evidence of the laws.

Notice that Title 26 is clearly missing from the list of titles which have been enacted into positive law. This fact can also be confirmed by examining the inside cover page of any volume of the United States Codes in any law library. There you will find that Title 26 is missing the asterisk "*" which indicates that the title has been enacted into positive law.

The implications of this finding can be found in Subtitle F, Subchapter B, which deals with effective dates and related provisions. There the general rule for provisions of subtitle F reads as follows:

General Rule. -- The provisions of subtitle F shall take effect **on the day after the date of enactment of this title** and shall be applicable with respect to any tax imposed by this title.

[IRC 7851(a)(6)(A)]
[emphasis added]

Believe it or not, subtitle F contains all the enforcement provisions of the IRC, such as filing requirements, assessment and collection, liens, levies and seizures. In other words, the enforcement provisions of the Internal Revenue Code have *still* not taken effect because, as of this writing, Title 26 has still not been enacted. If you don't mind getting frustrated, notice also that IRC section 7851 is *also* part of subtitle F!

If the Code itself is entirely too frustrating to decipher, it is no wonder why the IRS has published literally hundreds of instruction booklets and official IRS "Publications" to help "clarify" the myriad rules and forms. At last count, there were more than 5,000 IRS forms in the IRS Printed Product Catalog quoted elsewhere in this book.

To conclude our discussion of "U.S.** trade or business", you might want to obtain a copy of IRS Publication 519, U.S. Tax Guide for Aliens. This 40-page booklet expresses the English language in words that are much easier to understand than the Code itself. It even has its own Index. Be forewarned, however, that official IRS "Publications" do not have the force of law because they have not been published in the Federal Register, nor do any of them display control numbers and expiration dates issued by the Office of Management and Budget ("OMB"). (If the IRS makes an error, it's not their fault anyway.) Publication 519 has this to say about a trade or business inside the United States**:

Trade or Business

Whether you are engaged in a trade or business in the United States** depends on the nature of your activities. The discussions that follow will help you determine whether you are engaged in a trade or business in the United States**.

Personal Services

If you perform personal services in the United States** at any time during the tax year, you usually are considered engaged in a trade or business in the United States**. You are engaged in a trade or business in the United States** if you perform services in this country and receive compensation such as wages, salaries, fees, tips, bonuses, honoraria, or commissions.

[Publication 519: U.S. Tax Guide for Aliens]
[page 8]

Back to sources one more time. (It's so easy to get sidetracked by some remote code reference that has no legal effect!) The interested reader and intrepid investigator will be happy to know that there are literally "oodles" of regulations which go into details, great and small, about the life and times of Mr. and Mrs. Nonresident Alien. Here is a blockbuster for which I am eternally grateful to Tarzan The Informer for weeding out of the jungle of slippery lines and double negatives:

Nonresident aliens. **A nonresident alien individual never has self-employment income.** While a nonresident alien individual who derives income from a trade or business carried on within the United States**, Puerto Rico, the Virgin Islands, Guam, or American Samoa (whether by agents or employees, or by a partnership of which he is a member) may be subject to the applicable income tax provisions on such income, such nonresident alien individual will not be subject to the tax on self-employment income, since **any net earnings which he may have from self-employment do not constitute self-employment income.**

[26 CFR 1402(b)-1(d), emphasis added]

A nonresident alien individual never has self-employment income. We agree completely with The Informer: "never" always means never.

The point of this chapter is to stress the extreme importance of understanding "sources" as they affect the nonresident alien like you and me. Remember how Frank Brushaber ultimately lost his bid to the Supreme Court of the United States. He received a dividend that was issued by a "domestic" corporation. Even though he was found to be a nonresident alien *with respect to* the United States**, his dividend was found to be unearned income from a source *inside* the United States**, *inside* the federal zone.

The Informer nicely summarizes the overall situation as follows:

YOU ARE NOT TAXABLE IF YOU ARE:

- ITEM 1:** a non resident alien NOT carrying on a trade or business with the U.S.** or State of a Union State;
- ITEM 2:** a non resident alien NOT making source income from within the United States**;
- ITEM 3:** a non resident alien NOT having a trademark, patent, or copyright;
- ITEM 4:** a non resident who is NOT a fiduciary, so you cannot be a person of incidence with respect to a person of adherence;

then the income tax is not imposed, under subtitle A, chapter 1 on a non resident alien. So you fit the description under 26 USC Sections 2(d) & 872.

[Which One Are You?, page 24]
[emphasis in original]

The complex issues of patents, trademarks, copyrights and fiduciaries are beyond the scope of this book. Our "sources" tell us that The Informer is writing another book, hopefully to clarify some of the legal in's and out's of being a fiduciary. Author Lori Jacques has arrived at a remarkably similar conclusion about nonresident aliens. The first person "I" in the following excerpt is author Lori Jacques:

It is conclusive the Department of Treasury, Internal Revenue Service, has no authority within the several states, **it is just as conclusive that any income deriving from within the jurisdiction of the national government is taxable to the person receiving it.** The treasury decision on Brushaber confirms that.

The tax on the nonresident alien conforms to all constitutional provisions:

1. Uniform taxation of 30% on unearned income from U.S.** sources.
2. No reporting of private information as the tax is withheld at source or else the government has all the information of amount it has paid -- just return the receipt to prove the tax was paid.
3. **Graduated taxation on income received from trade or business conducted within the United States****, permitted because only the states are parties to the compact guaranteeing unalienable rights and uniform/apportioned taxation. The federal areas are always exempt from laws guaranteeing equal treatment.
4. No public notice has been published in the Federal Register since state citizens, nonresident to the United States** as defined, are not affected by the delegation of authority orders.

After the evidence is in, I now believe that under the internal revenue law I am a "national" and a nonresident alien to federal jurisdiction who has no U.S.** source income nor any effectively connected income with a U.S.** trade or business for which I am liable to render a return.

[United States Citizen v. National of the United States]
[page 44, emphasis added]

This lengthy excerpt does an excellent job of summarizing a mountain of earnest legal research and writing by author and scholar Lori Jacques. Our hat's off to you, Lori, for doing a "totally boss" and uniquely thorough job. We take issue *only* with Lori's statement above that "the Internal Revenue Service has no authority within the several States." Without clarifying the tax liability that attaches to income from "inside sources", this statement could be misleading. Remember that Frank Brushaber's liability attached to income from such a source, and he lived in New York City, in the Borough of Brooklyn.

The Informer has accurately qualified the precise extent of federal tax jurisdiction within the 50 States of the Union as follows:

[Please see next page.]

Yes, the IRS can go into the States of the Union by Treasury Decision Order, to seek out those "taxpayers" who are subject to the tax, be they a class of individuals that are United States** citizens, or resident aliens. **They also can go after nonresident aliens that are under the regulatory corporate jurisdiction of the United States**, when they are effectively connected with a trade or business with the United States** or have made income from a source within the United States**** that they have entered into an agreement with, for then they are in the state of the forum.

[Which One Are You?, page 98]
[emphasis added]

For the reader who is motivated to investigate the question of "inside sources" in greater detail, Appendix V in this edition of The Federal Zone contains an Affidavit of Applicable Law. This affidavit contains numerous citations to IRC sections which are pertinent to the crucial distinction between "inside" sources and "outside" sources. This same affidavit can be used formally to deny specific liability for federal income taxes during any given calendar year(s). You might also share this Affidavit with tax attorneys you may know, and solicit their evaluations. Updating this Affidavit with appropriate changes is the legal responsibility of the Affiant who signs it.

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Reader's Notes:

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