

*“You can lead a horse to water, but you can’t make it drink.”
--Folk Saying*

Secrets of the Income Tax Code

What you are not told by your CPAs and Tax Preparers

A Guide for Businessmen (Proprietors, Partnerships, Corporations, LLCs)

If you are blindly heeding the directions of your Certified Public Accountant or other “tax professional” regarding the filing and paying of income taxes, the great likelihood is that for many years now, you have been paying taxes that you don’t actually owe.

That’s because most of the American public, including the accountants they have depended upon, have been misdirected by the wording of the United States tax code. The tax code is legal and constitutional, but its terminology is misleading, to the point of being fraudulent, as you will see in this report.

Until fairly recently, when the tax code was fully digitized and thus easily accessible to computer searches, it was virtually impossible to penetrate its 3.5 million words and make sense of it. It was an undecipherable mess. Now, all has been made clear.

Specifically, it is now known that the entire tax code, as a practical matter, is keyed to the legal definitions of certain terms which are used constantly throughout the code and in virtually all IRS forms, letters, and instructions. What follows here is an insight into these legal definitions (“Terms of Art”) and what they legally mean.

This is not theory, nor is it conjecture. It is based on the actual terms in the code which anyone can read. The IRS hates this information to become public knowledge, because it results in more and more folks becoming wise to the true nature of the tax.

Following in **Bold Face** are some key terms used constantly in the tax code but which are unknowingly given ordinary definitions. Ordinary meanings for those words don’t apply. They are superseded by the tax code definitions. Study them, and show them to your tax accountant for his study and background. Very probably he hasn’t a clue about them.

To start, let me ask you if you as a business individual are engaged in a “**Trade or Business**?” If you are like most others, you will answer quickly “yes.” However, your particular enterprise is not likely to be the “**trade or business**” defined in the tax code. Moreover, you may be working for yourself, but you are probably not “**self-employed**.” You may have workers on your payroll, but you are very probably not an “**employer**.” nor are you paying your workers “**wages**.” Note the following legal terms very closely.

Section 7701 (a) – Definitions

“When used in this title [*Title 26—Federal Taxes*], where not otherwise distinctly expressed or manifestly incompatible with the intent thereof –

(26) Trade or business

The term “Trade or Business” includes the performance of the functions of a public office.”

Important Note:

Concerning the terms “**includes**” and “**including**” as used in tax law: we are instructed by the Supreme Court and as further clarified by Treasury Department regulation that “the terms ‘includes’ and ‘including’ do not exclude things not enumerated which are in the same general class.” [27 CFR 72.11]

In light of this we must apply the principle that a list of terms should be construed to include by implication only those additional terms of like kind and class as the expressly included terms.

Thus, when we read (above) that the term “trade or business includes the conduct of the functions of a public office,” we know that the proper legal meaning of “a public office” has to do with an official federal entity of some sort that has the very same characteristics. We cannot guess it may mean something else of our own choosing.

What exactly is a “public office” that the definition indicates? According to Black’s Law Dictionary, 6th Edition, “Essential characteristics of ‘public office’ are: (1) authority conferred by law, (2) fixed tenure of office, and (3) power to exercise some portion of sovereign functions of government; key element of such test is that ‘officer’ is carrying out sovereign function.... Position must be created by constitution, legislature, or through authority conferred by legislature, portion of sovereign power of government....” Accordingly, it is clear that the “public office” defined in the federal tax code is directly connected to a federal government function. It most certainly is not related to private enterprise.

And from the corresponding Treasury regulation, we see “**trade or business**” further explained:

26 CFR § 1.1402 (c) 1 Trade or Business. "In order for an individual to have net earnings from **self-employment**, he must carry on a **trade or business**, either as an individual or as a member of a partnership. Except for the exclusions discussed in Sections 1.1402 (c) (2) to 1.1402 (c) (7), inclusive, the term ‘**trade or business**,’ for the purpose for the tax on **self-employment** income, shall have the same meaning as when used in section 162."

(Note: Section 162 does not in fact provide another definition for “**trade or business**,” but only describes the type and amount of expenses that may be deducted from the gross income of a “**trade or business**.”)

Here’s a good example of how the Internal Revenue Service hides the truth from you. Following is the definition of the legal term “Trade or Business” as presented on its IRS website (www.irs.gov). It is essentially a tap dance around the truth.

The term *trade or business* generally includes any activity carried on for the production of income from selling goods or performing services. It is not limited to integrated aggregates of assets, activities, and goodwill that comprise businesses for purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which gross income is derived do not lose their identity as trades or businesses merely because they are carried on within a larger framework of other activities that may, or may not, be related to the organization's exempt purposes.

Compare that with the actual definition of ‘**trade or business**’ contained in the tax code itself at 26 USC Section 7701(a)(26). The term is used some 250 times in the code. It is often used within the definitions of other terms as well. For example, see the following:

Section 1402 – Definitions

(a) **Net earnings from self-employment**

“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**, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any **trade or business** carried on by a partnership of which he is a member” (emphasis added)

(b) **Self-employment income**

“The term “**self-employment income**” means the net earnings from **self-employment** derived by an individual....”

Concerning Forms 1099 (the reporting of taxable income)

Section 6041 – Information at source

(a) Payments of \$600 or more

“All **persons** engaged in a **trade or business** and making payment in the course of such **trade or business** to another **person**, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable **gains, profits, and income**...of \$600 or more...shall render a true and accurate return....”

Section 6041A –Returns regarding payments of remuneration for services and direct sales.

(a) Returns regarding remuneration for services if

(1) Any service-recipient engaged in a **trade or business** pays in the course of such **trade or business** during any calendar year remuneration to any **person** for services performed by such **person**, and

(2) The aggregate of such remuneration paid to such **person** during such

calendar year is \$600 or more, then the service-recipient shall make a return...

(d) [337 words later] “Applications to governmental units

(1) Treated as **persons**

The term “**person**” **includes** any governmental unit (and any agency or instrumentality thereof).

“The income tax is, therefore, not a tax on income as such. It is an excise tax with respect to certain activities and privileges which is measured by reference to the income which they produce. The income is not the subject of the tax: it is the basis for determining the amount of tax.”

–F. Morse Hubbard, Treasury Dept legislative draftsman. House Congressional Record, March 27, 1943.

1099-DIV: “Use only for Section 404(k) dividends reportable under Section 6047.” [Note: *These sections are two very narrow ones affecting only a small minority of those engaged in a **trade or business**.*] (emphasis added)

1099-INT: “File Form 1099-INT, Interest Income, for each **person**:

1. To whom you paid amounts reportable in boxes 1,3, and 8 of at least \$10 (or at least \$600 of interest paid in the course of your **trade or business** described in the instructions for Box 1, interest income on page INT-2).

1099-MISC: “Use for **Trade or Business** reporting only when payments are made in the course of your **trade or business**.” (emphasis added)

You should understand clearly by now that, based on the tax code itself, unless you are engaged in a **trade or business**, as that term is defined in the law, and are paying funds to a **person**, also as that term is defined in the law, then there is no requirement to file a 1099 of any sort, nor a W-2 for workers. In fact, it is contrary to law to do so!

It is equally clear that unless you are a **person** (i.e., receiving gross income from some governmental unit or agency (i.e., “public office”), there is no basis for you to have “**gains, profits, and income**” as that term is defined in the law. Without such basis, there is no tax applicable.

For Enterprises Known as “Partnerships”

A Partnership is an enterprise that is defined in the code as follows: “A partnership is the relationship between two or more persons who join to carry on a ‘**trade or business**,’ with each person contributing money, property, labor, or skill and each expecting to share in the profits and losses of the business whether or not a formal partnership agreement is made.”

Again you see that key term “**trade or business**” prominent in the definition. Thus, there may be an enterprise agreement between two or more individuals, but unless they

conduct the affairs of a public office (as “**trade or business**” is defined in the code), then the net earnings of such enterprise are exempt from the federal income tax! It is NOT a “**taxpayer**,” which term is itself defined in the code, as a “**person**” subject to the federal income tax. That’s more good news for you: *the entire tax code applies only to “taxpayers!”*

Moreover, only “**Domestic Partnerships**” are subject to filing Form 1065 (K-1) which details what each partner’s share is of profits and losses. A “**domestic partnership**” is one created or organized in the “**United States**” or under the law of the “**United States**,” or of any “**State**.” (*Please note the critically important lawful definitions of those terms farther on in this report*). If a “**partnership**” is not domestic, then it is a **Foreign Partnership**, and thus subject to the federal income tax only to the extent that any of its affairs cause it to have earnings from a federally-connected source.

Are you getting the picture here? The entire excise tax system connected to personal and business earnings is based on tightly defined meanings of Terms of Art. When you know this and understand its true and actual legal nature, the U.S. Income Tax is not the all-inclusive thing that the government encourages you to believe it is.

For Corporations and LLCs:

Concerning the applicability of the income tax to corporations and LLCs, we must note that there is no difference at all in what is **taxable income** for a corporation or LLC and what it is for a **self-employed** natural person, or a **partnership**. The excise tax is levied on the taxable income of both individuals and corporations. But remember that it is not the dictionary meaning of “income” that pertains, but what the laws underlying the tax code define “gains and profits” to be. The word “income” itself is nowhere defined in the code, but the term “**gains and profits**” is.

Another startling revelation: The tax code itself is not the law (since it has itself never been passed into law by Congress), but is only evidence of the law. The statutes underlying the tax code (“Statutes at Large”), not the code itself, provide the substance of terms and their meanings, and thus the governing basis for how the tax is to be applied. **The biggest error which tax return preparers and accountants make is to regard “all that comes in” to be the governing definition of what constitutes taxable income.** That’s the error that has caused you to pay taxes on earnings that are exempt and private under the law. You cannot have taxable income without it first being **gains and profits**, and you cannot have **gains and profits** unless it pertains in some way—by license, privilege, or contract—to the federal government. Remember that a federal excise tax is an indirect “piece of the action” tax, not a direct tax on income. Big difference!

What is a “domestic corporation”? Here are the pertaining definitions:

Section 7701(a)(4) Domestic

‘The term “**domestic**” when applied to a corporation or partnership means it is

created or organized in the **United States** or under the law of the **United States** or of any **State** unless, in the case of a partnership, the Secretary provides otherwise by regulations.” (He has not done so!)

(9) **United States**

“The term "**United States**" when used in a geographical sense **includes** only the States and the District of Columbia.”

(10) **State**

“The term "**State**" shall be construed to **include** the District of Columbia, where such construction is necessary to carry out provisions of this title.” [i.e., to remain Constitutional].

And from **Section 3121. Definitions**

(e) The term "**State**" **includes** the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

Thus you understand that if your corporation or LLC is organized under the laws of one of the 50 states, it is foreign to the **United States**, the legal entity of the federal government! A corporation formed elsewhere in the world is an alien corporation. That’s sometimes a difficult concept to comprehend, especially since all of this is probably entirely new to you. Whether domestic or foreign, a corporation or LLC which engages in a **trade or business** is subject to the **United States** excise tax regardless of where it conducts its affairs.

Concerning small business (or personal) earnings from interest, dividends, rents—to the extent that they derive from federal contracts, activities, or privileges—they must be included in gross taxable income and reported. Otherwise, they do not constitute **gains, profits, and income** from a **trade or business**, and do not thus constitute gross taxable income. Those not engaged in a **trade or business** are not required to issue 1099s and w-2s, and in fact, must not knowingly do so.

IRS’s own INSTRUCTIONS for Forms 1099-MISC, 1099-INT, and 1099-DIV tell the story. (underlining and boldface added for emphasis) Here’s what they say:

Form 1099-MISC -

“**Trade or business** reporting only. Report on Form 1099-MISC only when payments are made in the course of your **trade or business**. Personal payments are not reportable. You are engaged in a **trade or business** if you operate for **gain or profit**.”
[Note: “operating for gain or profit” is a true but misleading appendage there, unless you remember that “**gain or profit**” is itself a legal term that means net earnings derived from a “**trade or business**.”

Form 1099-INT

“...Report only interest payments made in the course of your **trade or business**, including federal, state, and local government agencies and activities deemed nonprofit, or for which you were a nominee/middleman....”

Form 1099-DIV –Form 1099-DIV is filed only when “**dividends**” (as defined) are paid out.

IRS Instructions refer you to Section 6042(b) for the definition of “**dividend.**”

Section 6042(b) - Dividend defined

(1) General rule

For purposes of this section, the term “**dividend**” means -

- (A) any distribution by a corporation which is a dividend (as defined in Section 316); and
- (B) any payment made by a stockbroker to any person as a substitute for a dividend (as so defined).

(2) Exceptions

For purposes of this section, the term “**dividend**” does not include any distribution or payment –

- (A) to the extent provided in regulations prescribed by the Secretary -
 - (i) by a foreign corporation, or
 - (ii) to a foreign corporation, a nonresident alien, or a partnership not engaged in a **trade or business** in the United States and composed in whole or in part of nonresident aliens, or
- (B) except to the extent otherwise provided in regulations prescribed by the Secretary, to any person described in section 6049(b)(4).

The “Secretary’s” regulations (26 CFR 1.6042-2 and 1.6042-3) about dividends, after involved wording, state that the “exception” comes down again to corporations engaged in a **trade or business**. Section 316 contains the general rule that defines a dividend as a payment out of corporate earnings, but the key to understanding the taxability of a dividend is to be found above in the “exceptions” item of Section 6042, where again it is tied to **trade or business**.

For those who work for themselves, the matter of the “self-employment” tax is of interest. Here’s what the code says about that:

--Concerning OASDI (self-employment) tax:

(a) Old-age, survivors, and disability insurance

“In addition to other taxes, there shall be imposed for each taxable year, on the **self-employment income** of every individual, a tax equal to the following percent of the amount of the **self-employment income** for such taxable year....”

But remember, if you are not “**self-employed**” as that term is defined in the code, there is no OASDI tax to be paid.

For enterprises which hire workers or use independent contractors, there are other key term definitions which must also be known. Terms such as “**employer,**” “**employee,**”

“wages,” and “U.S. Person” are key to the requirements for use of Forms W-4 and W-9, routinely used to enroll new workers. **Those forms are the subject of a separate report.**

The IRS Trap

Those who (rightly or wrongly) issue 1099s, W-2s, and K-1s are testifying to IRS that they are engaged in a **trade or business** and have paid to the named **person** the amount of taxable income stated on the form. *That sworn testimony forms the trap that the tax code sets for the unwary and unknowing, to induce them, in their ignorance, to “volunteer” themselves into IRS hands and to pay taxes not owed.* The forms are happily accepted by IRS as prima facie evidence that the individual named in the form was paid gross taxable income. **Unless that testimony is rebutted, withdrawn, or corrected, the individual testified against is held accountable by IRS with the full might and weight of the federal government.** If your enterprise is wrongly issuing these “information” forms, you are an integral part of the trap that causes your people to pay taxes they do not owe.

The rebuttal procedure is beyond the scope of this report to provide. Suffice to say here that there are thousands of recorded cases that demonstrate vividly that IRS will and does accede to correct and lawful reporting, as they must. However, neither the federal government nor IRS publicize it or will explain it. If you ask, you will either be ignored or threatened with fines or levies for pursuing a frivolous position. After all, if the true facts about the income tax become widespread public knowledge, as they should be, the income stream from the tax would quickly peter out.

Important to note: the tax code does not highlight its legal terms, or underline them, or italicize them. You must know about them in advance of reading the code. Otherwise you will continue to be misled.

A word about the 16th Amendment: The so-called Income Tax Amendment is widely believed to have amended the Constitution to permit a direct tax on incomes without regard to apportionment, etc. **That most certainly is not true.** The Supreme Court’s Brushaber ruling (January 24, 1916), clarified the intent and meaning of the amendment. Several other rulings since then have done the same; namely, to point out that the 16th Amendment did not grant Congress any new power to tax incomes. Indeed, Congress always had that power. **The amendment did not change the Constitution one whit.** What it did do was to correct an earlier Supreme Court ruling (Pollack, 1895) that prevented an indirect (excise) tax on certain earnings from being properly levied.

The Brushaber ruling is reflected in Treasury Decision No. 2303: *“The provisions of the sixteenth amendment conferred no new power of taxation, but simply prohibited [Congress’ original power to tax incomes] from being taken out of the category of indirect taxation, to which it inherently belonged, and being placed in the category of direct taxation subject to apportionment.”*

The foregoing content is meant to whet your appetite for knowing more, much more, about the true nature of the income tax and how it came to be the misbegotten political tool it is today. For the full story and all the eye-opening revelations concerning the income tax, you are directed to ***Cracking the Code—the Fascinating Truth About Taxation in America***, by Peter E. Hendrickson. But start your journey with the short and simple introductory drill-down at losthorizons.com/The16th.htm.

An important further note:

Taxes are specifically addressed twice in the United States Constitution. One prohibits a “capitation” (or direct) tax of any sort unless it is apportioned equally by population through the States. Such apportionment has occurred only five or six times in the entire history of the nation. The second mention gives Congress the power to lay “duties, imposts, and excises” but only if applied uniformly throughout the nation.

The Supreme Court has decreed several times that a tax on earnings, since it is not apportioned, is necessarily of the second type of tax permitted by the Constitution: a “duty, impost, or excise.” However, any such tax is governed by the fact that the federal government is granted 17 specific powers by the States and their people. Over the years, the feds have claimed much greater reach by usurping powers under the so-called “Welfare clause” and by the “Interstate Commerce” clause.

Nevertheless the reach of any “impost, duty, or excise” is limited to areas of federal governance—a “piece of the action.” To be more precise, the income tax is actually an *impost* on certain taxable privilege having a nexus to the federal government. However, the distinction is not of practical importance. Earnings derived from personal enterprise, including the right to contract and/or make a living, are exempt from any sort of taxation because they are based on unalienable individual rights.

The federal government and the IRS maneuver to have you remain ignorant of all of this, hoping you will continue to volunteer yourself into the ranks of “taxpayers.”

Disclaimer: None of the foregoing material is presented here as a protest of the income tax itself, nor is it intended in any way to encourage engaging in an illegal tax shelter or in not paying those excise taxes actually owed. It is intended only to alert the reader to the fact that the tax, as written and practiced, is widely misconstrued, and that those widespread misunderstandings are tacitly and dishonestly encouraged by the federal government and the IRS.

--Thomas Bottaro, Chartered Financial Consultant

Concerning the author of this report:

Thomas Bottaro is a retired financial consultant, achieving his professional designation (ChFC) in 1978 from American College, Bryn Mawr, PA. Part of his course of studies required gaining full knowledge of the U.S. income tax, which he learned from textbooks having the imprimatur of the Internal Revenue Service. As with certified public accountants, Bottaro was schooled in the legal methodology of avoiding or

reducing the tax bite on individual and business incomes. The emphasis was on procedure, deductions, exemptions, etc., but there was nothing at all covering the legal essence or history of the tax itself.

In the course of his study, Bottaro noticed certain anomalies in the tax code; such as wording that seemed to indicate that there were exceptions to the code, but nothing at all about what they are or how they work. Running his own business prevented his devoting time to any deep searches, especially since the tax code itself at the time was contained in a huge volume of 3.5 million words with only an inadequate index to aid in locating pertinent code sections. Today, computer searches of the code are relatively simple.

After retiring in 1995, Bottaro devoted his spare time to seeking out the answers to his main question: Why do so many tax code sections begin with the words “Anyone required under this title to . . . do this or file that or pay this. . . .” He reasoned that if there are those who are required to do such and such, there must also be those who are not so required. If there are “taxpayers,” there must also be “non-taxpayers.” The guiding questions became: Who are those people? How does one get to be among those not required to do such and such? It seemed to him that the answers were critical to fully understanding the legitimacy and reach of the tax.

The search for answers led him up several blind alleys. Clearly there were all sorts of theories that at first seemed reasonable, but none that proved true. Then, in 2005, he stumbled upon Peter Hendrickson’s landmark study of the tax code and the resulting book. Immediately, he bought a copy and read it from cover to cover in one sitting. Then he re-read it again, this time underlining critical points, and writing notes in the margins. That completed, he re-read it for the third time. He also acquired the Statutes at Large,” upon which the tax code is based. The answers he had long been seeking were there, in full, the result of many long computer searches by Hendrickson. Bottaro verified each of Hendrickson’s findings for himself. Since that time, he has talked and written to as many people as he can reach about the powerful and enabling insight that comes with learning the truth about the federal excise tax commonly but wrongly known as the “income tax.”

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