Richard M. Creamer February 15, 2002
Director, Compliance Section
Department of the Treasury
Internal Revenue Service
Ogden, UT 84201

RE: 0469104150

Dear Mr. Creamer,

Thank you for responding to our request for refund of taxes paid in 1997, 98 and 99. However, we believe our claim was denied based upon the wrong conclusions drawn from your interpretation of our request, and therefore respectfully ask that our claim be reviewed by the appeals process.

We do not doubt that if the Statute under which our labor is assessable, for income tax purposes, is valid, that some portion of our "wages" might be included in taxable income. However, the question we presented for your review was: Is the "labor for hire" (common law, master/servant relationship) employee subject to the net income tax provisions of the Internal Revenue Code (Subtitle A), as levied upon sole-proprietorships and business? [Attachment A, Parts A, B, and Supporting Statements, filed 2/09/01]

The question we posed is upon the validity of the Statute, under which the employee is classified for income tax purposes, not a question of what is or is not income. It is the classification of the common law, "labor for hire", employee within the same class as sole-proprietorships and business entities that appears to violate the requirements of Article 1, Section 8. The two groups have nothing in common with each other. One is taxed upon the basis of their "net income" or yearly profits, while the other is taxed upon their annual receipts. One is taxed upon the privilege of doing business, while the other is taxed simply because of their yearly labors.

It is well recognized that Congress has the full authority to "classify" subjects for tax purposes, it is equally well recognized that such "classification" can not be arbitrary and capricious without violating Article 1, Section 8. The point being is that all "persons" similarly situated are to be taxed in the same manner upon like circumstances.

What provides the common ground between the sole-proprietorship and the hired employee, upon which the classification "individual" rests? When looking at the class "person", as defined under 26 USC 7701, you do not find the subclass "employee" mentioned, therefore, it must be concluded that the "employee" falls within the subclass "individual". When looking at the subclass "individual", in relation to the other subclasses identified, it is recognized that the common ground upon which the classification "person" rests is: "through or by means of which any business, financial operation, or venture is carried on", "in the pursuit of an independent trade, business, or profession." This same ground does not exist between the "labor for hire" employee and the sole- proprietor "individual" or any of the other "person" within the classification of

"person". Thus the inclusion of the common law employee within the subclass "individual" appears to be arbitrary and capricious in violation of Article 1, Section 8, of the U.S. Constitution.

Another distinction is based upon the difference between "net income", "gross income" and "gross receipts". It is well understood that one can not conduct business and financial transactions, or earn a living, without acquiring "receipts" in exchange, it is also recognized that those "receipts" are not the subject of the income tax. By current Statute, the tax is levied upon the "adjusted gross income", of every "person" identified by 26 USC 7701. However, the definition of "adjusted gross income" poses a question of terminology regarding the difference between "net income", "gross income", and "gross receipts" as it applies to the various subclasses. Here again, all those "persons" falling within the identified classes of business and financial transactions (sole-proprietorships, corporations) are subject to a net income tax, while those falling within the unidentified class (common law employee) are subject to a gross income tax. Is it possible for the Statute to levy both a "net income" and a "gross income" tax upon different members of the same subclass without being arbitrary and capricious in violation of Article 1, Section 8 of the U. S. Constitution?

We again draw your attention to Commissioner v. Tellier, 383 U.S. 687 (1966) where the Court cited the Congressional Record and the tax levied upon net income, not gross income. We are unable to find any reference, either in the Congressional Record, Committee Reports, Statutes, or Supreme Court cases, where the gross annual "wages" of the common law employee have ever been referred to as "net income". In fact, under the definition of what a "direct" tax is under the U.S. Constitution [Brushaber, 240 U.S. 1@ 16] it would appear that a tax levied upon the laborer's gross wages would fall squarely within that definition. Net income is a product of accounting methods, that is, it represents receipts minus capital minus expenses incurred in the business or financial process. Gross income, on the other hand, is legally defined as receipts minus the return of capital, and commonly pertains to the "use" or investment of real and personal property. Employee "wages" , as their gross annual receipts, fall within neither of those definitions, but does possibly fall within the definition of a "direct" tax..

Our questions are not based upon whether or not "wages" are taxable as income per se, our concern is based upon the validity of the Statute imposing a "gross income" tax upon the employee's gross annual receipts, under a "net income" tax system imposed by the Statute in conformity with the 16th Amendment. The rest is contained in our original submittal.

(1) The Revenue Act of 1940, H.R. 10039, changed Section 51 (a) of the Internal Revenue Code of 1939 from a reporting basis of "net income" to that of "gross income", yet did not change the levy of the tax upon "net income" to "gross income" under sections 11 and 12.
(2) The Revenue Bill of 1941, H.R. 5417, added the new section 102, titled "Optional Tax On Individuals with Certain Gross Income of $3,000 or Less". This section created a new "Tax Table" called "Supplement T", and in turn under sec. 400 of the

Statute (55 Statutes at Large, 77th Congress, 1st Sess. Chapter 412) imposed the tax, it reads:

> "In lieu of the tax imposed under sections 11 and 12, an individual may elect, for each taxable year, to pay the tax shown in the following table if his gross income for such taxable year is $3,000 or less and consists wholly of one or more of the following: Salary, wages, compensation for personal services, dividends, interest, rent, annuities, or royalties."

Sections 11 and 12 of the 1941 Revenue Act imposed the tax upon the "net income" of the "person", less an allowance for the personal exemption and itemized expenses to determine the final amount of tax due. Supplement T simply provided for a 10% reduction in the tax owed upon the gross income.

(3) The Revenue Bill of 1942, H.R. 7378, under Subchapter D, imposed what was called a Victory Tax and provided for the withholding of such tax from employee "wages". The Victory Tax was imposed upon a "person's" "Victory Tax net income", which was defined for those filing under Supplement T as "gross income from salaries, wages, and compensation" [Senate Report #1631]. The tax was to be temporary and was in addition to the normal tax on net income imposed under section 11 and 12. Senator George, Chairman of the Senate Finance Committee, recorded this statement in the Congressional Record of October 9, 1942 on page 7987:

"If we are going to depart during this war, as an emergency matter, from the concept which has run through our tax system, that is to say, imposing a tax on net income, there would seem to me to be little or no purpose to the pending proposal if no one would be reached who was not subject to the net income tax provisions of the bill as passed by the House and as reported to the Senate. In other words, if it would not bring in additional taxpayers; if it would not reach the vase number of income producers who will not pay taxes on net income, there would seem to be very little reason in departing from the net income system and going to the gross income system in collecting a tax"

(4) The "Current Tax Payment Act of 1943, H.R. 2570 changed the provisions for the collection of the tax due from the following year in which it was normally paid, to the current year in which the tax was actually due. The Act extended the withholding at the source provisions and added the requirement for filing and paying quarterly tax estimates. The Committee Reports filed with the Bill deals almost exclusively with "wages" and the collection of both the "Victory Tax" and "withholding at the source on wages". This Revenue Bill is noted as being the first Revenue Bill vetoed by the President, it was then passed by the majority vote of both the House and the Senate, only to be superceded by the "Individual Income Tax Bill of 1944. However, a provision contained in the Senate Report #221 provides an interesting perspective in relation to the contents of the Revenue Bill. This provision is found on pages 34 and 35 and is titled "Rule where no tax liability". Section 4 (d) of the Bill adds a new subsection (c) to section 3770 of the Internal Revenue Code. In part it states:

"The income tax law requires the taxpayer to make a return of his tax and to pay the tax so returned. These requirements contemplate that in the discharge of these duties at the time, place, and manner prescribed honest mistakes will occur—mistakes both as to the amount of the tax and as to the existence of any tax liability; and that such honest mistakes made incident to the bona fide orderly compliance with the actual or reasonably apparent duties of the taxpayer are to be corrected under the provisions of law governing overpayments."

Why this clarification of existing law was added is not made clear, however, this is the beginning of the "net income" tax system being imposed upon the "gross income" of the common laborer. The explanation is provided in 1944.

(5) The Individual Income Tax Bill of 1944, the Act of May 29, 1944, Chapter 210, 58 Stat. 231, H.R. 4646. This Act added subsection (n) "adjusted gross income" to section 22 "Gross Income Defined", of the Internal Revenue Code of 1939, and at the same time repealed the Victory Tax, and provided for the "Standard Deduction". This is the first Revenue Act to specifically identify the common law employee's "wages" as being taxable under Chapter 1. The income tax was still levied upon "net income" by virtue of section 11 and 12, but the requirements under Supplement T changed to mandatory in relation to employee "wages". The definition of "adjusted gross income" was given as gross income minus the allowed deduction. A clearer definition is provided on page 8 of the Senate Report #885, again by Senator George, Chairman of the Senate Finance Committee. The definition is short and to the point, it reads:

"In general, adjusted gross income is gross income less business deductions and for most wages earners represents gross income."

Section 22 (n) of the 1944 Internal Revenue Code not only provided a new concept in "net income" taxation, but a new creative way of merging the "labor for hire" employee into the classification of "individual" thus acquiring the title "taxpayer" [Congressional Record]. Unfortunately it does not stop here, for the tax system is still predicated upon the term "net income", not gross income.

(6) The Internal Revenue Code of 1954, H.R. 8300. This revenue act is best explained by the committee reports and completes the transition from a "net income system of income taxation to a new concept called "taxable income". First, from page A18 of the detailed discussions:

Section 61, Gross income defined

"This section corresponds to section 22(a) of the 1939 Code. While the language in existing 22 (a) has been simplified, the all inclusive nature of statutory gross income has not been affected thereby, Section 61 (a) is as broad in scope as section 22(a).

Section 61 (a) provides that gross income includes "all income from whatever source derived". This definition is based upon the 16th Amendment and the "word" income is used in its constitutional sense. …"

Section 62. Adjusted Gross Income

"This section corresponds to section 22(n) of the 1939 Code. Paragraph (1) corresponds to paragraph (1) of section 22(n) of the Code of 1939. No substantive change is made."

Section 63. Taxable income defined

This section is derived generally from section 21 of the 1939 Code. …

This change of the term "net income" as used in section 21 of the Code to "taxable income" creates a new concept. It eliminates terms such as "normal tax net income", "surtax net income" in the case of individuals, and "adjusted net income", "normal tax net income" and "corporation surtax net income" in the case of corporations and "net income" for both individuals and corporations. The change in language clarifies the tax base. It eliminates the necessity for credits against net income and exemptions which become deductions in arriving at "taxable income" for both corporations and individuals."

In other words, the term "net income" is replaced with the term "taxable income" meaning the "net income" derived from the operation of business and financial transactions, plus the gross income of "labor for hire" wages.

We are looking forward to discussing this matter with you in a hopes that our concerns might be resolved outside the court room. Perhaps we are mistaken with our interpretation and what appears to be is really not. Thank you for taking the time to research this question and hopefully any information you can provide us will resolve our concerns.

Sincerely,

John Gary Given Sr.

Michele Louise Given

Bibliography

Congressional Record, H.R. 10039, 1940, House Report 2491
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