

The Challenge

Contributed by Web Master
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\$2,000 Challenge Accepted. The Challenge had been offered to any CPA, attorney, tax professional, IRS agent or Enrolled Agent for more than two years. Attorney and CPA, A. James Lynn finally accepted the \$2000 challenge and in a special two hour broadcast, addressed the 6 questions regarding the determination of taxable income on-air on March 25th, 2005. Larken Rose was also on hand to cross examine and ask follow-up questions. The questions are shown below and supporting exhibits are linked below in PDF format. EXHIBITS FOR CHALLENGE BROADCAST MARCH 25, 2005 (requires Adobe Acrobat Reader) Note: This show is available for purchase as a two CD set for \$15.00. Contact Peter McCandless for details.

Pt. 1 {enclose PeterMacShow20050325-01.mp3}
 Pt. 2 {enclose PeterMacShow20050325-02.mp3}
 Pt. 3 {enclose PeterMacShow20050325-03.mp3}
 Pt. 4 {enclose PeterMacShow20050325-04.mp3}
 Pt. 5 {enclose PeterMacShow20050325-05.mp3}

Questions Regarding Determining Taxable Income

1) Should I use the rules found in 26 USC § 861(b), and the related regulations beginning at 26 CFR § 1.861-8, to determine my taxable domestic income?

2) If some individuals—including myself—should not use those sections for determining their taxable domestic income, please show me where the regulations say who should or should not use those sections for that.

** Reason for first two questions: The regulations under 26 USC § 861(b) (26 CFR § 1.861-8 and following) begin by stating that Sections 861(b) and 863(a) state in general terms “how to determine taxable income of a taxpayer from sources within the United States” after gross income from the U.S. has been determined. (The regulations then say that Sections 862(b) and 863(a) describe how to determine taxable income from outside of the U.S.) Section 1.861-1(a)(1) of the regulations confirms that “taxable income from sources within the United States” is to be determined in accordance with the rules of 26 USC § 861(b) and 26 CFR § 1.861-8. (See also 26 CFR §§ 1.862-1(b), 1.863-1(c).)

3) If a U.S. citizen lives and works exclusively within the 50 states, and receives all of his income from within the 50 states, do 26 USC § 861(b) and 26 CFR § 1.861-8 show such income to be taxable?

** Reason for question: Section 217 of the Revenue Act of 1921, statutory predecessor of 26 USC § 861 and following, stated that income from within the U.S. was taxable for foreigners and for U.S. citizens and corporations deriving most of their income from federal possessions (but did not say the same about the domestic income of most Americans). The regulations under the equivalent section of the 1939 Code (e.g. §§ 29.119-1, 29.119-2, 29.119-9, 29.119-10 (1945)) showed the same thing. The current regulations at 1.861-8 still show income to be taxable only when derived from certain “specific sources and activities,” which, concerning domestic income, still relate only to foreigners and certain Americans receiving income from federal possessions (26 CFR §§ 1.861-8(a)(1), 1.861-8(a)(4), 1.861-8(f)(1)).

4) Should one refer to 26 CFR § 1.861-8T(d)(2) to determine whether the “items” of income he receives (such as compensation, interest, rents, dividends, etc.) are excluded for federal income tax purposes?

** Reason for question: The regulations (26 CFR § 1.861-8(a)(3)) state that a “class of gross income” consists of the “items” of income listed in 26 USC § 61 (e.g. compensation, interest, etc.). The regulations (26 CFR §§ 1.861-8(b)(1)) then direct the reader to “paragraph (d)(2)” of the section, which provides that such “classes of gross income” may include some income which is excluded for federal income tax purposes.

5) What is the purpose of the list of non-exempt types of income found in 26 CFR § 1.861-8T(d)(2)(iii), and why is the income of the average American not on that list?

** Reason for question: After defining “exempt income” to mean income which is exempt, eliminated, or excluded for federal income tax purposes (26 CFR § 1.861-8T(d)(2)(ii)), the regulations give a list of types of income which are not exempt (i.e. which are subject to tax), which includes the domestic income of foreigners, certain foreign

income of Americans, income of certain possessions corporations, and income of international and foreign sales corporations, but which does not include the domestic income of the average American (26 CFR § 1.861-8T(d)(2)(iii)).

6) What types of income (if any) are not exempted from taxation by any statute, but are nonetheless excluded by law (not subject to the federal income tax) because they are, under the Constitution, not taxable by the federal government?

** Reason for question: Older income tax regulations defining "gross income" and "net income" said that neither income exempted by statute or fundamental law were subject to the tax (§ 39.21-1 (1956)), and said that in addition to those types of income exempted by statute, other types of income were exempt because they were, under the Constitution, not taxable by the Federal Government (§ 39.22(b)-1 (1956)).