THE DEPARTMENT OF THE TREASURY
OFFICE OF PROFESSIONAL RESPONSIBILITY
WASHINGTON, D.C.

DIRECTOR OF PROFESSIONAL RESPONSIBILITY Complainant, v. JOSEPH R. BANISTER, Respondent.	COMPLAINT NO. 2003-02 DATE:

MOTION FOR SUMMARY JUDGMENT

COMES NOW the Complainant, Brien T. Downing, who in his official capacity as Director, Office of Professional Responsibility (formerly the Office of the Director of Practice), Internal Revenue Service, moves for summary judgment on the subject Complaint on the basis that the Complaint and Answer, together with exhibits, demonstrate that there is no dispute as to any material fact and the Complainant is entitled to judgment as a matter of law. The motion is supported by a memorandum of law, Agency Exhibits, the attached declarations of David Finz, Attorney-Advisor, Office of Professional Responsibility (Attachment 1) and the attached *Journal of Accountancy*, Online Issue, June 1997 article "Practicing Before the IRS". (Attachment 2).

MEMORANDUM OF LAW

I. PROCEDURAL FACTS

In support of this motion, the following facts are not in dispute:

1. Respondent, Joseph Banister, is a resident of San Jose, California; whose

last address of record is 2282 Sunny Vista Drive, San Jose, California 95128. (See Complaint paragraph . IA and Answer paragraph. I,A both attached).

2. At all times material hereto, Respondent was a Certified Public Accountant (CPA) eligible to practice before the Internal Revenue Service. (See Complaint paragraph . IA, Answer paragraph . IA);

3. As a CPA who practices before the Internal Revenue Service, Respondent is subject to disciplinary authority of the Secretary of the Treasury, and the Director of Professional Responsibility. 31 U.S.C. § 330(b); 31 C.F.R. Section 10.50;

4. A Notice of Institution of Proceedings and a Complaint against Respondent were sent via both certified mail and regular mail on March 19, 2003, to the Respondent and to Respondent's counsel (See Complaint and Answer);

5. The Complaint against Respondent issued on March 19, 2003, seeks Respondent's disbarment from practice before the Internal Revenue Service pursuant to the provisions of 31 C.F.R. § 10.50, for disreputable conduct for violating 31 C.F.R. §§ 10.22 (b) and 10.22 (c); 31 C.F.R. § 10.34; 31 C.F.R. §§ 10.51, 10.51 (d), and 10.51(j), as specifically set forth in the complaint. (See Complaint);

6. A timely answer to this Complaint, was filed on April 30, 2003 (See Answer);

7. Respondent's answer admits the allegations set forth in paragraph I(A) of the complaint. (See Answer, para. 13);

8. Respondent's answer admits that portion of the allegations set forth in paragraph I(B) of the complaint, but appears to deny that he was bound by 31 C.F.R. § 10.0 et seq. and the rules and regulations contained therein. (See Answer, para. 14);

9. Respondent's answer admits the allegations of paragraph II of the complaint. (See Answer, para. 15);

10. Respondent's answer denies the allegations of paragraph III of the complaint. (See Answer, para. 16);

11. Respondent's answer denies the allegations of subparagraph III(A) of the complaint. (See Answer, para. 17);[1]

12. Respondent's answer admits the allegations of sub-subparagraph (1) of subparagraph III(A) of the complaint. Therefore, Respondent admits that he advised taxpayer Frank W. Coleman that he was not liable for income taxes for the years 1989 through 1998 because the Sixteenth Amendment to the Constitution was not ratified. (See Answer, para. 17);

13. Respondent's answer admits the allegations of sub-subparagraph (2) of subparagraph III(A) of the complaint. Therefore, Respondent admits that he advised taxpayer Frank W. Coleman that he was not liable for income taxes for the years 1989 through 1998 because Internal Revenue Code § 861 and the regulations thereunder defined "source of income" in such a way as to exclude Mr. Coleman's income from taxation. (See Answer, para. 18) ;

14. Respondent's answer admits the allegations of sub-subparagraph (3) of subparagraph III(A) of the complaint. Therefore, Respondent admits that he advised taxpayer Walter A. Thompson that he was not liable for income taxes for 1996 and

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[1] The Respondent's answer does specifically respond to allegations set forth in subparagraph III(A) of the complaint. However, in his answers to sub-subparagraphs III(A)(1), III(A)(2), and III(A)(3) of the complaint, Respondent denies the allegations set forth in subparagraph III(A) of the complaint. (See Answer, paragraphs 17-19).

1998 because his income for the stated tax years was not taxable income per Internal Revenue Code §§ 861-865 because Internal Revenue Code § 861 and the regulations thereunder defined "source of income" in such a way as to exclude Mr. Thompson's income from taxation. (See Answer, para. 19) ;

15. Respondent's answer denies the allegations of subparagraph 3(B) of the complaint as concerns his engaging in disreputable conduct, but admits the remaining allegations of subparagraph (3)(B) of the complaint. Therefore, Respondent admits that on February 29, 2000 and on January 31, 2000, he signed as the preparer for taxpayer Walter A. Thompson's Amended U.S. Tax Returns (Forms 1040X) for calendar years 1996 and 1998, respectively. The aforementioned amended returns stated that Mr. Thompson's income for the stated tax years was not taxable income per Internal Revenue Code §§ 861-865 and were filed with the Internal Revenue Service. (See Answer, para. 20) ;

16. Respondent's answer denies the allegations of subparagraph IVA of the complaint. (See Answer, para. 21);

17. Respondent's answer denies the allegations of subparagraph IV(B) of the complaint (See Answer, para. 22);

18. Respondent's answer denies the allegations of subparagraph IV(C) of the complaint (See Answer, para. 23);

19. Respondent's answer denies the allegations of subparagraph IV(D) of the complaint (See Answer, para. 24);

20. Respondent's answer denies the allegations of subparagraph IV(E) of the complaint (See Answer, para. 25);

21. Respondent's answer states that when he prepared the amended returns for Walter A. Thompson (Complainant Exhibits 4 and 5) , no published authority held that income of the type received by Mr. Thompson was not excluded from federal income taxation by the operation of §§ 861-865 and corresponding Treasury Regulations and that the position taken by him was not frivolous. (See Answer, para. 8).

22. Respondent's answer states that he represented Frank W. Coleman in a Collection Due Process Hearing before the IRS in which his arguments that Mr. Coleman's income was not subject to federal income taxation was predicated largely on 26 U.S.C. §§ 861-865 and corresponding Treasury Regulations. In addition, Respondent stated that in his written submissions, he did state that he had researched the 16th Amendment ratification process and found it to be fraudulent. He included that observation in support of the doubt as to liability argument, based on his belief that the actual evidence of fraud he had personally seen had never been sufficiently reviewed, much less decided by any authority. He alleges his position taken on behalf of Mr. Coleman was therefore not frivolous. (See Respondent's Answer, para, 9).

23. Respondent's answer sets forth six affirmative defenses as follows:

(1) That the Secretary of the Treasury is estopped from attempting to suspend or disbar the respondent by the legal effect of his own acts and/or omissions, or the acts and/or omissions of officers, employees, or

agents under his control;

(2) that prosecution of the instant complaint violates the Respondent's right against self-incrimination and right to due process of law secured by the Fifth Amendment to the Constitution of the United States;

(3) that prosecution of the instant complaint violates the Respondent's First Amendment rights;

(4) that the complaint contains claims which fail to state a claim upon which relief can be granted as against the Respondent;

(5) that the complaint and prosecution of the same is barred as impermissible retaliation; and

(6) that prosecution of the complaint violates principles of sound pubic policy, fundamental fairness, and equity. (See Answer, pp. 7-8);

24. The Amended Complaint against Respondent issued on October 17, 2003, incorporating the charges set forth in the original Complaint ,seeks Respondent's disbarment from practice before the Internal Revenue Service pursuant to the provisions of 31 C.F.R. § 10.50 for disreputable conduct for violating 31 C.F.R. §§ 10.51(f), as specifically set forth in the complaint. (See Complaint);

25. On October 21, 2003, Complainant filed a Motion to Amend the Amended Complaint including a revised Amended Complaint. The revised Amended Complaint charged Respondent with violating 31 C.F.R. § 10.51(d) under 31 C.F.R. Part 10, Revised July 1, 1994 for failure to file individual Federal income tax returns for 1999,

2000, and 2001 tax years and for violating 31 C.F.R. § 10.51(f) for failure to file his individual Federal income tax return for tax year 2002.

26. Respondent filed his Amended Answer and Affirmative Defenses on October 29, 2003.

27. Respondent's Amended Answer admits the allegations set forth in paragraph I of the Amended Complaint. See Respondent's Amended Answer and Affirmative Defenses, para.2, p. 1.

28. Respondent's Amended Answer denies the allegations set forth in paragraph II of the Amended Complaint. See Respondent's Amended Answer and Affirmative Defenses, para.3, p. 1.

29. Respondent's Amended Answer denies the allegations set forth in subparagraph II(A) of the Amended Complaint. See Respondent's Amended Answer and Affirmative Defenses, para. 4, pp. 1-2.

30. Respondent's Amended Answer denies the allegations set forth in subparagraph II(B) of the Amended Complaint. See Respondent's Amended Answer and Affirmative Defenses, para. 5, p. 2.

31. Respondent's Amended Answer denies the allegations set forth in subparagraph II(C) of the Amended Complaint. See Respondent's Amended Answer and Affirmative Defenses, para. 6, p. 2.

32. Respondent's Amended Answer denies the allegations set forth in subparagraph II(D) of the Amended Complaint. See Respondent's Amended Answer and Affirmative Defenses, para. 7, p. 2.

33. Respondent's Amended Answer provides the same affirmative defenses set forth in his original answer. See Respondent's Amended Answer and Affirmative Defenses, para. 8, pp. 2-3. See paragraph 23, above.

II. STANDARDS FOR SUMMARY JUDGMENT

Summary judgment is appropriate when there exists "no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); *Jung v. FMC CorCorp.* 755 F.2d 708, 710 (9th Cir. 1985). The moving party bears the initial burden of establishing, through affidavits or otherwise, the absence of a genuine issue as to any material fact. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970); *see T.W. Elec. Service, Inc v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir. 1987). If the moving party meets its initial burden, the burden then shifts to the opposing party to establish that a genuine issue of material fact actually does exist. *Matsushita Elec. Indus Co., Ltd. V. Zenith Radio Corp.*, 475 U.S. 574, 585-87 (1986).

In attempting to establish the existence of this factual dispute, the opposing party may not rely upon the denials of its pleadings, but is required to tender evidence of specific facts in the form of affidavits or admissible discovery material which support its contention that the dispute exists. Fed. R. Civ. P. 56(e); *Strong v. H.G. France*, 474 F.2d 747, 749 (9th Cir. 1973).

To prevail on a summary judgment motion, the moving party does not necessarily have to put on evidence which negates the opponent's claim. *Celotax Corps v. Catrett*, 477 U.S. 317, 323 (1986). Where the opposing party will bear the

burden of proof at trial on a particular issue, the moving party may prevail by simply pointing out "those portions of the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, which it believes demonstrate the absence of a genuine issue of material fact." *Id.* (Emphasis added).

III. FACTUAL BACKGROUND

The Director of Professional Responsibility has instituted the subject complaint due to his determination that the Respondent, a Certified Public Accountant (CPA), should be disbarred from practicing before the Internal Revenue Service (IRS).[2] This action is being taken as a result of the Respondent's representation of two taxpayers in which he rendered the opinion that the taxpayers were not required to file Federal income tax returns because the Sixteenth Amendment to the Constitution was not properly ratified and because Internal Revenue Code §§ 861-865 excludes certain income earned by the Taxpayer, even though reliance on such arguments has been consistently and repeatedly rejected by the courts. The instant action is also being taken due to the Respondent's failure to file his Individual Federal Income Tax Returns for tax years 1999, 2000, 2001, and 2002.

More specifically, the Respondent advised taxpayer Frank W. Coleman that he was not liable for income taxes for the years 1989 through 1998 because the Sixteenth Amendment to the Constitution was "not ratified." See Complainant's Exhibits 6, 9-11, and 21-38. Respondent signed as the preparer for taxpayer Walter A. Thompson's Amended U.S. Tax Returns(Forms1040X) for calendar years 1996 and 1998, respectively. The aforementioned Amended U.S. Tax Returns reflected Respondent's

position that taxpayer Thompson was not liable for Federal income taxes for 1996 and 1998 because his income for the stated tax years was not taxable income per I.R.C. §§ 861-865. Specifically, Respondent took this position on behalf of Mr. Thompson based on Respondent's assertion that I.R.C. § 861 and the regulations thereunder defined "source" of income in such a way as to exclude Mr. Thompson's income from taxation. Said returns were filed with the Internal Revenue Service. See Complainant's Exhibits 4 and 5.

As stated above, the Director of Professional Responsibility has determined that Respondent should be disbarred from practicing before the IRS due in part to the opinions expressed in his representation of the two taxpayers discussed above (See Complainant's Exhibits 4-6, 9-11, and 21-38), as these opinions were incorrect, and encouraged the taxpayers to take actions regarding their tax returns that were clearly inconsistent with well established Federal Law. It is clear that the respective Taxpayers' actions regarding their Federal income tax returns were based at least in part on their reliance on Respondent's advice. In a statement provided to the IRS, Taxpayer Coleman specifically stated:

> It is my sincere belief that had I known the information, seen the documentation, and heard the explanations provided by Mr. Banister prior to the preparation and filing of Form 1040 for 1985, 1986, 1987, 1988, 1989, 1990, 1991, 1992, 1993, 1994, 1995, 1996, 1997, or 1998, I never would have filed such forms because I would have realized that there was no statute or regulation that required me to file them.

See Complainant Exhibits 10 and 27. Clearly, the above quoted statement demonstrates Mr. Coleman's complete reliance on the Respondent's advice.

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[2]See Complaint.

As concerns taxpayer Thompson, the amended returns prepared by the Respondent on Thompson's behalf state in part that: "After examining the applicable sections of the Internal Revenue Code (IRC) and Code of Federal Regulations (CFR)... and obtaining the opinion of professionals familiar with those sections of the IRC and CFR...".See Part II of Complainant Exhibits 4 and 5. Although the afore quoted statement does not specifically state that Complainant's opinion was sought, it can be reasonably assumed that as the return preparer and representative of Mr. Thompson, the Complainant, a Certified Public Accountant, who advocates the opinions set forth in Mr. Thompson's Amended Returns, was one of the "professionals" whose opinion was relied upon.

IV. ARGUMENT

A. Complainant Is Entitled To Summary Judgment Concerning It's Assertion That Respondent Has Engaged In Disreputable Conduct For Which He Should Be Disbarred From Practice Before The Internal Revenue Service

As stated previously, summary judgment is appropriate when there exists "no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); *Jung v. FMC CorCorp.*, 755 F.2d 708, 710 (9th Cir. 1985). The moving party bears the initial burden of establishing, through affidavits or otherwise, the absence of a genuine issue as to any material fact. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970); *see* T.W. *Elec. Service, Inc v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir. 1987). We have met that burden as concerns Respondent's violating 31 C.F.R. sections 10.51 (d) and 10.51(j) through the submission of Exhibits 1-44, applicable statute and case law, the declaration of David Finz, and the Respondent's own admissions that he provided the opinions to taxpayers

Coleman and Thompson which led to the instant action to seek his disbarment from practicing.

Pursuant to 31 C.F.R. Sections 10.54 and 10.100 issued under the authority of 31 U.S.C. 330(b), the Secretary of the Treasury after notice and an opportunity for a proceeding, may suspend or disbar any practitioner from practice before the Internal Revenue Service. The Secretary may take such action against any practitioner who is shown to be incompetent or disreputable. 31 C.F.R. § 10.50.

31 C.F.R. § 10.51 generally concerns incompetence and disreputable conduct for which an attorney, certified public accountant, enrolled agent, or enrolled actuary may be disbarred or suspended from practice before the Internal Revenue Service. Section 10.51 provides specific conduct that is considered incompetent or disreputable. Sections 10.51(d),[3] 10.51(f)[4], and 10.51(j)[5] are examples of such specific conduct.

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[3] 31 C.F.R. § 10.51(d)(July 1994), including the preamble, states: " Disreputable conduct for which an attorney, certified public accountant, enrolled agent, or enrolled actuary may be disbarred from practice before the Internal Revenue Service includes, but is not limited to: (d) Willfully failing to make a Federal tax return in violation of the revenue laws of the United States, or evading, attempting to evade, or participating in any way in evading or attempting to evade any Federal Income tax or payment thereof, knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof, or concealing assets of himself or another to evade Federal taxes or payment thereof.

[4] 31 C.F.R. § 10.51(f)(July 1994), states in part (not including preamble which is set forth in footnote 3): "Willfully failing to make a federal; tax return in violation of the revenue laws of the United States, willfully evading, attempting to evade or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

[5] 31 C.F.R. section 10.51(j) states in part (not including preamble which is set forth in footnote 3): "Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or a

The provisions of 31 C.F.R. §§ 10.50 under both the 1994 and 2002 regulations permits suspension or disbarment of a practitioner who is shown to be incompetent or disreputable or who refuses to comply with any regulation in 31 C.F.R. Part 10. Respondent's failure to exercise due diligence in the instant case in violation of 31 C.F.R. §§ 10.22 (b) and 10.22 (c), evidences a failure to comply with the regulations in 31 C.F.R. Part 10. Likewise, Respondent's violation of 31 C.F.R. § 10.34 as set forth in the Complaint also evidences a failure to comply with the regulations in 31 C.F.R. Part 10.

B. The Court Should Treat As Without Merit, the Respondent's Claim That His Advice to Taxpayers Coleman and Thompson Was Not Frivolous.

Respondent claims that when he prepared the amended returns for Walter A. Thompson, no published authority held that income of the type received by Mr. Thompson was not excluded from federal income taxation by the operation of §§ 861-865 and corresponding Treasury Regulations. He asserts this means he did not assert a frivolous position. (See Complainant Exhibits 4 and 5 and Answer, para. 8). Respondent signed the amended tax returns for Mr. Thompson on February 29, 2000 and January 31, 2000. As the preparer, Respondent completed Part II of those returns and submitted statements (Statement 1 attached to each return) that set forth the basis for the amended returns. Those submissions set out the Taxpayer's contention that the items previously reported on the 1996 and 1998 Form 1040's came from sources within the United States not specifically listed in 26 U.S.C. §§ 861-865 and thus not reportable as income. Respondent has also admitted at paragraph 9 of his answer that in the

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pattern of providing incompetent opinions on questions arising under the Federal tax

Coleman Collection Due Process Hearing he argued doubt as to liability based on what he identified as fraud in the ratification of the 16th Amendment.

Respondent's argument ignores the general rule that taxable income consists of gross income, i.e. income from whatever source derived, less allowable deductions. I.R.C. §§ 61, 63. It also ignores the general principal that a taxpayer can only exempt income from taxable income an item of income for which Congress has created a specific exemption. Finally it ignores many decades of court rulings on the validity of the ratification of the 16th Amendment.

C. Courts Have Long Rejected Respondent's Interpretation of I.R.C. § § 861-865

The earliest assertion in a published case of what has become known as the "IRC § 861 argument" is in *Solomon v. Commissioner*, T.C. Memo 1993-509, 66 T.C.M. (CCH) 1201 (1993*), aff'd without published opinion*, 42 F.3d 1391 (7th Cir. 1994). The Tax Court found that Mr. Solomon made an absurd argument that the State of Illinois was not part of the United States. The court in rejecting Mr. Solomon's arguments that some combination of I.R.C. § 911 and § 861 made his income nontaxable stated:

> We find no support for petitioner's position in the authorities he cites. Section 911(d)(2)(A) provides a definition of "earned income" for purposes of section 911. Section 911(a) allows an exclusion from gross income for foreign earned income at the election of a qualified individual, defined as an individual whose tax home is in a foreign country. Sec. 911(d)(1). Petitioner had no foreign earned income and is not a qualified individual for purposes of section 911. Similarly, petitioner's position is not bolstered by the regulations under section 861. To the contrary, section 861(a)(1) and (3) provides that interest from the United States and compensation for labor or personal services performed in the United States (with

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laws...".

> exceptions not applicable here) are items of gross income which shall be treated as income from sources within the United States.

In a subsequent case, *Aiello v. Commissioner*, T.C. Memo 1995-40, 69 T.C.M. (CCH) 1765 (1995), the taxpayer asserted the section 861 argument along with several other frivolous arguments or theories. The Tax Court rejected all the theories and sustained a penalty because the taxpayer had "offered no plausible explanation for his failure to file." The court responded to the section 861 argument as follows:

> Petitioner also contends that no Federal statute imposes a tax on the income of citizens or residents of the United States that is derived from sources within the United States. Instead, petitioner asserts that Federal income taxes are excise taxes imposed only on the privilege of nonresident aliens and foreign corporations to receive income from sources within the United States. Petitioner's argument is unclear. Apparently, petitioner believes that the only sources of income for purposes of section 61 are listed in section 861, that income from sources within the United States is taxed only to nonresident aliens and foreign corporations pursuant to sections 871, 881, and 882, and that section 1461 is the only section of the Internal Revenue Code that makes anyone liable for the taxes imposed by sections 1 and 11. Section 61(a) defines gross income generally as "all income from whatever source derived," including, but not limited to, compensation for services and interest. Sec. 61(a)(1), (4). Section 63 defines and explains the computation of "taxable income". Section 1 imposes an income tax on the taxable income of every individual who is a citizen or resident of the United States. Sec. 1.1-1(a)(1), Income Tax Regs.; *see Habersham-Bey v. Commissioner*, 78 T.C. 304, 309 (1982).

Internal Revenue Code (I.R.C.) § 61(a) provides that "gross income means all income from whatever source derived...". "Gross income includes income realized in any form, whether in money, property, or services. Regulation § 1.61-a(a). The Courts have repeatedly held that § 61 gross income includes amounts earned by United States citizens living and working in the United States. *See e.g., Reese v. United States*, 24 F.3d 228, 231 (Fed. Cir. 1994)(wherein the court stated, "an abiding principle of federal

tax law is that, absent an enumerated exception, gross income means all income from whatever source derived."). *Also see*, *Great-West Life Assur. Co. v. United States*, 678 F.2d 180, 183 (Ct. Cl. 1982), and *Corcoran v. Commissioner*, T.C. Memo 2002-18, 83 T.C.M. (CCH) 1108, 1110 (2002). While Congress could create the type of exception Respondent argues for, it has not chosen to do so.

Moreover, I.R.C. § 861 does not purport to define or limit section 61's broad definition of "gross income." Rather, the source rules found in sections 861-865 merely provide guidance for determining, only in those relatively uncommon situations where there is a need to do so, whether an item of a taxpayer's gross income (as defined in section 61) has its source or origin within the United States or without. Thus, the section 861 argument is frivolous. The Tax Court *Williams v. Commissioner*, 114 T.C. 136 (2000), *quoting Crain v. Commissioner*, 737 F.2d 1417 (5th Cir. 1984), imposed sanctions against a taxpayer asserting the § 861 argument without analyzing it in detail stating:

> We shall not painstakingly address petitioner's assertions "with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit."

The Tax Court recently ruled against two other taxpayers who asserted the § 861 argument. *See*, *Furniss v. Commissioner*, T.C. Memo 2001-137, 81 T.C.M. (CCH) 1741 (2001); *Madge v. Commissioner*, T.C. Memo 2000-370, 80 T.C.M. (CCH) 804 (2000). In *Furniss*, the Tax Court granted summary judgment for the Commissioner in a decision that specifically rejected the § 861 argument stating:

> Petitioner contends that income is defined only by section 911 and the regulations under section 861 and that his receipts are excluded from

> those definitions. Neither Section 911 nor section 861 operates to prevent section 61 from applying to petitioner's receipts.

The I.R.C. §§ 861-865 foreign-source rules have no role in determining or defining I.R.C. § 61 "gross income." Rather, these rules merely provide the framework for determining the location of a source of income (*i.e.*, domestic or foreign) for those relatively few taxpayers (primarily nonresident aliens, foreign corporations, and taxpayers possibly eligible for the foreign-tax credit) for whom the source's location matters.

For the same reason as discussed above, the Treasury regulations interpreting I.R.C. §§ 861-865 also generally have no application for the vast majority of taxpayers (United States citizens and resident aliens who are not eligible for the foreign-tax credit) for whom the source of income does not matter. Those taxpayers, as we have shown, must (under I.R.C. § 61) pay tax on "all income, from whatever source derived."

Ironically, Treas. Reg. § 1.861-8(f) confirms this longstanding principle, rather than overriding it as the section 861 argument proponents perversely claim. In providing a non-exhaustive list of "operative sections" to which the foreign-source rules apply, Treas. Reg. § 1.861-8(f) merely lists I.R.C. sections dealing with taxpayers (primarily nonresident aliens, foreign corporations, and taxpayers who may be eligible for the foreign-tax credit) who do need to allocate their total worldwide income between the portion that comes from within the United States and the portion from foreign sources. The vast majority of taxpayers, including United States citizens and resident aliens not eligible for the foreign-tax credit, have no need to make such an allocation.

Accordingly, I.R.C. sections pertaining to those sorts of taxpayers are not listed among Treas. Reg. § 1.861-8(f)'s operative sections.

By expressing the § 861 argument clearly, its true absurdity becomes self-evident. Stated simply, the proponents of the argument contend that an obscure subsection of an obscure Treasury regulation (Treas. Reg. § 1.861-8(f), entitled "Miscellaneous matters") overrides the plain words of I.R.C. § 61 (which words were copied verbatim from the Sixteenth Amendment) and exempts United States citizens and resident aliens earning income in the United States from the federal income tax. The Tax Court in *Williams*, *supra*, was fully warranted in imposing sanctions against a proponent of this frivolous, irrational argument.

All levels of federal courts have upheld the taxation of wages and other income in the face of challenges by United States citizens and resident aliens working within the United States. One court recognized that if a taxpayer who lives and works in the United States was not subject to tax under section 861, then all of his income was gross income under section 61 and therefore taxable under section 62. *See*, *Peth v. Breitzmann*, 611 F. Supp. 50 (E.D. Wis. 1985). In that case, the taxpayer argued that he did not live within the United States because Wisconsin did not fit within the definition of United States in the I.R.C. He therefore argued that he was entitled to claim his income did not come from a source within the United States under section 861 and was thus excludable under § 61. The court first rejected his argument that Wisconsin was excluded from the Code's definition of United States, and then determined that section 861 did not apply to him because he lived and worked within

the United States. The court then concluded that his income was includable in gross income under § 61 and was therefore taxable.

The courts have consistently interpreted I.R.C. §§ 861-865 as provisions that merely categorize the source of income for those limited situations in which the source's location is relevant. After discussing the predecessor of I.R.C. §§ 861-865 (§119 *et seq.* of the 1939 Code), one court noted that:

> [t]he respective sections recognize that a taxpayer would incur expenses attributable to the earnings of income in the United States and otherwise, and it was the intention of Congress to apportion properly or to allocate to the respective sources of income the incurred expenses attributable to the earnings of each."

Commissioner v. Ferro-Enamel Corp., 134 F.2d 564, 566 (6th Cir. 1943).

It is instructive to examine a case involving the routine application of section 861. In *Iglesias v. United States*, 848 F.2d 362 (2nd Cir. 1988) a nonresident alien sued a United States company for conversion of mutual fund shares. He won and was awarded the value of the shares, plus pre-judgment interest. The Government sought to tax him on the pre-judgment interest because the interest was gross income to him, and the income resulted from a United States source. The Second Circuit agreed, finding that the prejudgment interest flowed from a United States source, and was therefore subject to income tax. The taxpayer was not subject to tax on the remaining portion of the judgment because he was a non-resident alien and the source was not within the United States (and only United States citizens or resident aliens can be taxed on income received from non-United States sources). *Iglesias* represents the universal application of section 861; certain taxpayers must allocate sources to within and without

the United States. The equally universal application of income taxes on all sources of income for United States residents under section 61 shows that the two statutes can coexist, and that section 861 neither trumps nor negates the broad reach of section 61.

In sum, the supporters of the section 861 argument such as the Respondent have spent considerable time and effort to construct a sham. Analysis of the Internal Revenue Code, Treasury Regulations, and case law confirms that, as section 61 unambiguously states, gross income includes all income, from whatever source derived.

Based on the above, the Court should find that Respondent frivolously asserted that Mr. Coleman and Mr. Thompson could rely on I.R.C. §§ 861-865 to exclude their income from taxable income subject to Federal income tax. The court should follow the long established legal precedent on this subject. The court should also reject Respondent's assertion that he made this argument in good faith as the analysis above clearly shows that reasonable research by Respondent in 2000 would have disclosed the lack of support for his assertion. For example, opinions expressed in cases such as *Crain*, *supra*, in 1984, *Solomon*, *supra*, in 1994, and *Aiello*, *supra*, in 1995 would have given the Respondent adequate notice that the arguments he had made on behalf of Thompson and Coleman had no merit.

Only a few months after Respondent prepared the Thompson returns, the United States Tax Court issued its opinion in *Williams*, *Id.* at 138, reiterating the position set forth in *Crain, Id.* at 1417, that arguments such as those made by the Respondent are so scurrilous that they need not be addressed. In *Williams*, *Id.*, the