

MEMORANDUM OF LAW

TO: Clients of the Supreme Law Firm

FROM: Paul Andrew Mitchell, B.A., M.S.
Private Attorney General

DATE: January 23, 2003 A.D.

SUBJECT: California Revenue and Taxation Code
sections 17000 thru 21020

One of you has recently shared with us a Notice from the California Franchise Tax Board ("FTB"), citing sections 17000 thru 21020 of the Revenue and Taxation Code ("RTC") aka Personal Income Tax Act as their authority for imposing the California State income tax.

With this MEMORANDUM OF LAW we are responding to your request for a professional answer to the following question: Do these statutes create a specific liability for any taxes imposed upon the receipt of compensation for professional services inside California State?

We began our investigation by examining specific legal definitions found in the RTC sections cited above. In Chapter 3, Computation of Taxable Income, please find the following statutory definitions:

Section 17002. Definitions, effect on construction

Except where the context otherwise requires, the definitions given in this chapter govern the construction of this part.

Section 17071. Gross income

Gross income shall be defined by **Section 61** of the Internal Revenue Code.

Section 17072. Adjusted gross income

Adjusted gross income shall be defined by **Section 62** of the Internal Revenue Code.

Section 17073. Taxable income, exceptions

(a) Taxable income shall be defined by **Section 63** of the Internal Revenue Code, except as otherwise provided.

Section 17074. Ordinary income

For purposes of this part, the term "ordinary income" shall be defined by **Section 64** of the Internal Revenue Code.

These five sections reveal two important characteristics of the RTC: (1) it *mirrors* the Internal Revenue Code as published in the federal Statutes at Large (read "federal municipal law"), and (2) it thereby necessarily *acquires* the same flaws that also exist in that Code.

In fact, a California court has already ruled that the policy of the California legislature is to *follow federal provisions* in the administration of the Personal Income Tax Act -- Part 10 of the RTC. Here is the pertinent holding from that court opinion:

The policy of the legislature in following federal provisions in the Personal Income Tax Act makes available to the state a groundwork of **relevant federal experience and judicial pronouncements** which **should be followed to insure effective administration of the act**.

[Holmes v. McColgan, 110 P.2d 428, 17 C.2d 426 (1941)]
[**bold emphasis added**]

Thus, before we descend into any of the particular flaws of the RTC, it is important to realize that Citizens of California are fully justified by this one court authority to follow *federal* judicial pronouncements to insure effective administration of California's Personal Income Tax Act, e.g. U.S. v. Mason, 412 U.S. 391, 399-400.

I refer you now to the book entitled "The Federal Zone: Cracking the Code of *Internal Revenue*," first published by this writer in 1992 A.D. In his concurring opinion in the case of U.S. v. Lopez in 1995 A.D., Justice Anthony Kennedy used the term "federal zone" as a household word, giving it a permanent place in the history of American constitutional jurisprudence. The electronic eleventh edition of this book is now available on-line at Internet URL:

<http://www.supremelaw.org/fedzonell/index.htm>

In Chapter 7 of that book, entitled "Inside Sources," we quote the following holding of the U.S. Court of Appeals for the Eighth Circuit, as follows:

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

[U.S. v. Ballard, 535 F.2d 400, 404]

We now incorporate "The Federal Zone" by reference, as if set forth fully here, as a "groundwork" that is essential to understanding the parallel flaws in California's Personal Income Tax Act (RTC Part 10).

If the term "income" is not defined in the IRC, and if key sections of the RTC depend upon parallel sections in the IRC, then it is correct to conclude that the term "income" is not defined in the RTC either. This discovery can be confirmed by reading the entire body of Definitions beginning at RTC section 17000.

Since the term "income" is not defined in the RTC or in the IRC, we are justified by the holding in Holmes v. McColgan *supra* to search for federal judicial pronouncements on this point. Fortunately for us, the federal courts have been unusually clear on the correct legal definition of "income". Appendix "J" in "The Federal Zone" contains a short list of those definitions, which are repeated here as follows:

Income is NOT everything that "comes in":

We must reject ... the broad contention submitted in behalf of the Government **that all receipts -- everything that comes in -- are income** within the proper definition of "gross income"

[Southern Pacific Co. v. John Z. Lowe, 247 U.S. 330]
[**bold emphasis added**]

Corporate profits are "income":

[Income] imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; **conveying rather the idea of gain** or increase arising from corporate

activities.

[Emanuel J. Doyle v. Mitchell Brothers Co., 247 U.S. 179]
[**bold emphasis added**]

Congress CANNOT change the Constitution:

In order, therefore, that the clauses cited above from Article I of the Constitution may have proper force and effect ... **it becomes essential to distinguish between what is and what is not "income,"** as the term is there used; and to apply the distinction ... according to truth and substance, without regard to form. **Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.**

[Mark Eisner v. Myrtle H. Macomber, 252 U.S. 189]
[**bold emphasis added**]

Again, "income" is a gain, a profit:

Here we have the essential matter -- not a gain accruing to capital, not a growth or increment of value in the investment; but **a gain, a profit**, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being "derived," that is received or drawn by the recipient (the taxpayer) for his separate use, benefit, and disposal -- **that is income derived from property. Nothing else answers the description.**

[Mark Eisner v. Myrtle H. Macomber, 252 U.S. 189]
[**bold emphasis added**]

The Supreme Court has REPEATEDLY ruled that compensation for professional services is not "income":

In determining the definition of the word "income" thus arrived at, **this court has consistently refused to enter into the refinements of lexicographers and economists** and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term

We continue entirely satisfied with that definition, and, since the fund here taxed was the amount realized from the sale of the stock in 1917, less the capital investment as determined by the trustee as of March 1, 1913, it is palpable that it was a "gain or profit" "produced by" or "derived from" that investment, and that it "proceeded," and was "severed" or rendered severable, from, by the sale for cash, and thereby became that **"realized gain" which has been repeatedly declared to be taxable income**

[Merchant's Loan & Trust v. Smietanka, 255 U.S. 509]
[bold emphasis added]

"Income" has been legally and officially defined:

And the definition of "income" approved by this Court is: **"The gain derived from capital, from labor, or from both combined,"** provided it be understood to include profit gained through a sale or conversion of capital assets. ... It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that *gains* are derived therefrom by the vendor

[Goodrich v. Edwards, 255 U.S. 527]
[bold emphasis added]

You do NOT obtain "income" by charging for services rendered:

The phraseology of form 1040 is somewhat obscure But it matters little what it does mean; the statute and the statute alone determines what is income to be taxed. It taxes only income "derived" from many different sources; **one does not "derive income" by rendering services and charging for them.**

[Edwards v. Keith, 231 F. 111 (2nd Cir.)]
[bold emphasis added]

No gain, no income -- no income, no tax:

Income is nothing more nor less than realized gain It is not synonymous with receipts Whatever may constitute income, therefore, must have the essential feature of gain to the recipient **If there is no gain, there is no income.**

[Conner v. U.S., 303 F.Supp. 1187]
[bold emphasis added]

"Income" means "gain" -- "gain" means "profit":

Income ... means **gain** "derived" from, and not accruing to, capital or labor or from both combined, including profit gained through the sale or conversion of capital, the gain not being taxable until realized, and, in such connection, **gain** means profit or something of exchangeable value, and "derived" means proceeding from property, severed from capital, however invested or employed, and coming in, received or drawn by taxpayer for his separate use, benefit, and disposal.

[Staples v. U.S., E.D. Penna., 21 F.Supp. 737]
[**bold** emphasis added]

Wages and profits are two DIFFERENT things:

There is a clear distinction between "profit" and "wages" or compensation for labor. Compensation for labor cannot be regarded as profit within the meaning of the law.

[Oliver v. Halstead, 196 Va. 992; 86 S.E. 2d 858]
[**bold** emphasis added]

Payment for labor is NOT profit:

Reasonable **compensation for labor or services rendered is not profit.**

[Laureldale Cemetery Assoc. v. Matthews]
[345 Pa. 239; 47 A. 2d 277, 280]
[**bold** emphasis added]

The meaning of "income" has been CONSISTENT in law:

... **"Income" has been taken to mean the same thing** as used in the Corporation Excise Tax Act of 1909, in the Sixteenth Amendment and in the various revenue acts subsequently passed

[Bowers v. Kerbaugh-Empire Co., 271 U.S. 174]
[**bold** emphasis added]

Again, "income" has had the SAME MEANING in law:

... and before the 1921 Act this Court had indicated ... what it later held, that **"income,"** as used in the revenue acts taxing income, adopted since the 16th Amendment, **has the same meaning that it had in the Act of 1909.**

[Burnet v. Harmel, 287 U.S. 103]
[**bold** emphasis added]

"Income" is NOT the same as "gross receipts":

Constitutionally the only thing that can be taxed by Congress is "income." And the tax actually imposed by Congress has been on net income as distinct from gross income. **The tax is not, never has been and could not constitutionally be upon "gross receipts"**

[Anderson Oldsmobile, Inc. v. Hofferbert, USDC Maryland]
[102 F.Supp. 902, **bold** emphasis added]

Try to find a principle that is better settled:

Remember that our source is not some "tax protest" group. Just about everything we are telling you comes from the U.S. Supreme Court. **It would be difficult, and perhaps impossible, in our system of jurisprudence, to find a principle better settled** than the one we have been citing.

[Alan Stang, Tax Scam, Mt. Sinai Press, POB 1220]
[Alta Loma 91701, CALIF. 1988, **bold** emphasis added]

Other cases not cited here say the SAME THING:

In addition to the cases cited above, the following also support and affirm this definition of "income": ... United States v. Supplee-Biddle Hardware Co., 265 U.S. 189; United States v. Phellis, 257 U.S. 156; Miles v. Safe Deposit & T. Co., 259 U.S. 247; Irwin v. Gavit, 268 U.S. 161; Edwards v. Cuba R. Co., 268 U.S. 628.

[Irwin Schiff, The Great Income Tax Hoax, Freedom Books]
[POB 5303, Hamden, Connecticut 06518, 1985, page 475]

On this point, therefore, the pertinent decisions of federal and State courts, particularly the U.S. Supreme Court, are quite clear in holding that: (1) one does not derive income by rendering services and charging for them, (2) reasonable compensation for labor, or for services rendered, is legally not income because it is not "profit", and (3) income is definitely not everything that "comes in."

The FTB Notice goes on to allege that RTC section 17041 imposes an income tax on every individual who is in California for more than a temporary or transitory purpose. Let us examine this claim critically, in order to determine whether or not it is supported by the pertinent statutes in California State, specifically the RTC.

First of all, it is essential to understand that California's courts have already ruled that the provisions of tax statutes must be *strictly* construed:

Provisions of a tax statute are to be construed strictly.

[Burnham v. Franchise Tax Board]
[341 P.2d 833, 172 C.A.2d 438 (1959)]

The income tax law is purely a revenue measure, and upon the rule of strict construction applied to such laws, its scope may well be restrained to such matters as are clearly covered by it.

[California Emp. Com. v. Black-Fox Military Inst.]
[110 P.2d 729, 43 C.A.2d Supp. 868 (1941)]

For guidance on the meaning of "strict construction" we find the following explanation in Bouvier's Law Dictionary, Rawle's Revision (1914):

A strict construction is one which limits the application of the provisions of the instrument or agreement to cases clearly described by the words used. It is called, also, literal.

[Bouvier's Law Dictionary, Rawle's Revision (1914)]

In light of these established guidelines, we are now forced to confront a very important question: Is California State clearly mentioned in pertinent definitions of the Personal Income Tax Act? Our answer is "No" for the following verifiable reasons.

RTC section 17017 defines the term "United States" as follows:

"United States," when used in a geographical sense, includes the states, the District of Columbia, and the possessions of the United States.

Be careful not to *assume* that the term "states" refers to the 50 States of the Union, because RTC section 17018 defines the term "State" expressly as follows:

"State" includes the District of Columbia, and the possessions of the United States.

Obviously, California State is not the District of Columbia and California State is not a possession of the United States.

Federal Territories and Possessions are those lands which have been acquired by the federal government pursuant to the Territory Clause in the U.S. Constitution; they do include such places as Guam, Virgin Islands, American Samoa and Puerto Rico (read "the federal zone"). Federal territories are decidedly not States of the Union; they are not stars on the American flag! See IRC 3121(e).

Therefore, observing the stated mandate of *strict* construction, inhabitants of California do not normally reside "in this state" [*sic*], because the term "state" here has a very specific definition which does not even mention "California" as such.

There is another, very important rule of statutory construction known as "*inclusio unius est exclusio alterius*" (in Latin). Black's Law Dictionary, Sixth Edition, carefully explains this rule as follows:

Inclusio unius est exclusio alterius. The inclusion of one is the exclusion of another. The certain designation of one person is an absolute exclusion of all others. ... This doctrine decrees that where law expressly describes [a] particular situation to which it shall apply, **an irrefutable inference must be drawn that what is omitted or excluded was intended to be omitted or excluded.**

[bold emphasis added]

Thus, an inference must be drawn that California was *omitted* from the definition of "State" at RTC section 17018, because the California Legislature *intended* to omit or exclude California. Not only is this an inference that must be drawn; it is also an irrefutable reference.

Although this finding may appear extremely strange at first, there *is* a rational explanation. By way of introduction, and to set the right foundation for what is to follow, the reader is strongly encouraged to read and study this writer's publication entitled "31 Questions and Answers about the Internal Revenue Service," abbreviated "31Q&A" and available on-line at Internet URL:

<http://www.supremelaw.org/sls/31answers.htm>

Briefly, the population of federal citizens who inhabit the 50 States is now legally regarded as a *legislative democracy* that is subject to the *municipal* jurisdiction of the federal government. Within that municipal jurisdiction, the rights that were once designed to be insured by the U.S. Constitution are now considered to be matters of legislative and judicial *discretion*, and no longer *mandatory* guarantees over which government has no discretion whatsoever.

Using strict construction of the Guarantee Clause in the U.S. Constitution and contrived precedents decided by the Supreme Court, chief among which is Downes v. Bidwell, a doctrine has evolved for over 100 years whereby the Constitution of the United States, as such, does not extend beyond the limits of the several States which are united by and under it. This doctrine is now called the Downes Doctrine.

Later, the U.S. Supreme Court elaborated this doctrine, in the case of Hooven & Allison v. Evatt, by holding that the guarantees of the U.S. Constitution extend into the federal zone only as Congress makes those guarantees applicable, by enacting statutes for that specific purpose. In other words, fundamental Rights do not exist inside the federal zone until and unless Congress decides to extend them into that zone.

The main problem with the Downes Doctrine, strictly speaking, is that it was contrived without *any* reference whatsoever to two Acts of Congress which expressly extended all guarantees of the U.S. Constitution into the District of Columbia in 1871, and then into all federal territories in 1873. Thus, the Downes Doctrine was effectively destroyed 30 years before the fact, and the U.S. Supreme Court is at fault for systematically overlooking these two Acts of Congress for over 100 years.

In the present context, the Downes Doctrine is relevant because the U.S. Supreme Court has also issued a series of decisions which uphold the concept of a "State within a state". See the discussion of this concept at paragraph 25 in the winning brief found at Internet URL:

<http://www.supremelaw.org/cc/jetruman/oppososc.htm>

The population of federal citizens who inhabit California State is legally regarded as a "state within a State": collectively they are a federal legislative democracy that is co-habiting with the sovereign Citizens of the California Republic inside the territorial limits of California State.

The U.S. Constitution is controlling, however, in part because the Tenth Amendment guarantees to all federal citizens and to all State Citizens that the common law of California shall be preserved.

Why is this so? Answer: because the Tenth Amendment is in the U.S. Constitution, and the *entire* U.S. Constitution has already been extended into D.C. and into all federal territories, without exception.

For example, section 22.2 of the California Civil Code ("CCC") states that the common law shall be the rule of decision in all California courts.

CCC sections 1427 and 1428 acknowledge that an obligation arises either from the operation of law, or from the contract of the parties (and nothing else).

And CCC section 1708 states that the only obligation that arises from the operation of law is to abstain from injuring the person or property of another, or infringing upon any of his rights.

As such, these sections are a nearly perfect re-statement of the common law as transported here from England by early colonial Americans. Without damage or injury, there is no jurisdiction.

It is quite obvious now that the Internal Revenue Code is federal *municipal* law that was deliberately written to appear as *if* it applies throughout the 50 States of the Union. This intentional deception was accomplished by means of deliberate vagueness in several key places, most notably in the definitions of key terms like "State" and "United States" and elsewhere too. For example, see IRC 7851(a)(6)(A).

Because the Sixth Amendment guarantees our fundamental Right to know the nature and cause of every accusation, such deliberate deceptions necessarily render those definitions *void for vagueness*. Accordingly, such intentional deceptions are unconstitutional.

Insofar as, and *to the same extent* that California's Personal Income Tax Act was expressly written to *mirror* the underlying assumptions and deceptions of the Internal Revenue Code, it too is a deception upon all the Citizens and other inhabitants of California State because:

- (1) it intentionally omits any definition of the key term "income";
- (2) it appears to encourage the Franchise Tax Board to expand the meaning of "income" beyond the limits already established by standing decisions of the U.S. Supreme Court;
- (3) it apparently fails to create a specific tax liability for the receipt of compensation for professional services in California;
- (4) it omits "California" from its definition of the term "State";
- (5) it contradicts the common law of California as re-stated and codified in California Civil Code sections 22.2, 1427, 1428, 1550, 1567 and 1708;
- (6) it appears to create *obligations* to pay income taxes on compensation for professional services when no valid, binding *contracts* exist to that end between the Citizens of California and the State of California; and,
- (7) no such *obligations* arise under operation of any valid California State laws.

If the Supreme Law Firm can provide any further assistance in these matters, please do not hesitate to contact us at the email address published at our Internet website:

<http://www.supremelaw.org>

Thank you for your professional consideration.

Sincerely yours,

/s/ Paul Andrew Mitchell

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