To: Chairmen and Members
Presidential Advisory Panel on Federal Tax Reforms
1440 New York Ave, NW Suite 2100 Washington DC, 20220

From: David Mann
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Subject: IRS Administrative problems

I would hope that your reported reply to a questioner at your last hearing regarding the constitutionality of the application of the income tax would not be interpreted to mean that you have excluded all discussions on the application of the income tax. I agree the income tax is constitutional and the laws under which the IRS is to operate are constitutional. My personal experience has been a very discouraging attempt asking the IRS, the treasury department, and my congressional delegation as to what laws determine what is taxable income. This information should be readily available as it is the first thing everyone must know before they pay taxes. The answer delivered by all has been basically section 26USC section 61a which says income from whatever source is taxable- this would mean all income is taxable. We know there are certain sources of tax free income, so in examining the code further I found three basic sections and one Supreme Court decision that answer my question. I can not get a specific response from official sources regarding my research. I would urge your committee to look at the following sections of law and attempt to disapprove them before spending effort on the income tax code which primarily deals with deductions against taxable income. To do this the law must describe taxable income.

The 26USC section 61a law was clarified by the treasury with their 26CFR section 1.61-1 which stated "Section 61 lists common items of gross income for purposes

of illustration. To the extent another section of the code or regulations provide specific treatment for any item of income such other section shall apply, not with standing section 61 and the regulations there under." Treasury also then followed this action up with another section of their code- 26CFR section 1.861T(d)(2)(iii) entitled "Income not considered tax exempt." The use of double negatives in this remote section of law conveys the exact wrong impression to the reader. This section obviously means "Income that is taxable" for if it is not tax exempt it is taxable. There are four taxable sources listed under this heading. The Supreme Court in Gould 245US(1917) "... ruled that the interpretation of tax statues can not be extended to cover maters not specifically pointed out." As applied to 26CFR 1.861T(d)(2)(iii) code this decision means that the list of A-D is all inclusive – no further adding of categories is allowed. These four listings of taxable income are the only income sources subjeced to the income tax. They are all foreign sources- sources most US tax payers do not get income from. See enclosed copy of the CFR.

I don't believe you want to spend much time discussing income tax exemptions if they do not apply to the income tax payers. An alternative tax such as the sale tax would be an appropriate substitute for the income tax. Looking forward to your comments.

Sincerely Yours,

David Mann

26 CFR s 1.861-8T

(d) Excess of deductions and excluded and eliminated items of income.
(1) [Reserved]
(2) Allocation and apportionment to exempt, excluded or eliminated income--(i) In general. In the case of taxable years beginning after December 31, 1986, except to the extent otherwise permitted by § 1.861-13T, the following rules shall apply to take account of income that is exempt or excluded, or assets generating such income, with respect to allocation and apportionment of deductions.
(A) Allocation of deductions. In allocating deductions that are definitely related to one or more classes of gross income, exempt income (as defined in paragraph (d)(2)(ii) of this section) shall be taken into account.
(B) Apportionment of deductions. In apportioning deductions that are definitely related either to a class of gross income consisting of multiple groupings of income (whether statutory or residual) or to all gross income, exempt income and exempt assets (as defined in paragraph (d)(2)(ii) of this section) shall not be taken into account.

For purposes of apportioning deductions which are not taken into account under § 1.1502-13 in determining gain or loss from intercompany transactions, as defined in § 1.1502-13, income from such transactions shall be taken into account in the year such income is ultimately included in gross income.
(ii) Exempt income and exempt asset defined--(A) In general. For purposes of this section, the term exempt income means any income that is, in whole or in part, exempt, excluded, or eliminated for federal income tax purposes. The term exempt asset means any asset the income from which is, in whole or in part, exempt, excluded, or eliminated for federal tax purposes.
(B) Certain stock and dividends. The term "exempt income" includes the portion of the dividends that are deductible under--
(1) Section 243(a)(1) or (2) (relating to the dividends received deduction),
(2) Section 245(a) (relating to the dividends received deduction for dividends from certain foreign corporations).

Thus, for purposes of apportioning deductions using a gross income method, gross income would not include a dividend to the extent that it gives rise to a dividend received deduction under either section 243(a)(1), section 243(a)(2), or section 245(a). In the case of a life insurance company taxable under section 801, the amount of such stock that is treated as tax exempt shall not be reduced because a portion of the dividends received deduction is disallowed as attributable to the policyholder's share of such dividends. See § 1.861- 14T(h) for a special rule concerning the allocation of reserve expenses of a life insurance company. In addition, for purposes of apportioning deductions using an asset method, assets would not include that portion of stock equal to the portion of dividends paid thereon that would be deductible under either section 243(a)(1), section 243(a)(2), or section 245(a). In the case of stock which generates, has generated, or can reasonably be expected to generate qualifying dividends deductible under section 243(a)(3), such stock shall not constitute a tax exempt asset. Such stock and the dividends thereon will, however, be eliminated from consideration in the apportionment of interest expense under the consolidation rule set forth in § 1.861-10T(c), and in the apportionment of other expenses under the consolidation rules set forth in § 1.861-14T.
(iii) Income that is not considered tax exempt. The following items are not considered to be exempt, eliminated, or excluded income and, thus, may have expenses, losses, or other deductions allocated and apportioned to them:
(A) In the case of a foreign taxpayer (including a foreign sales corporation (FSC)) computing its effectively connected income, gross income (whether domestic or foreign source) which is not effectively connected to the conduct of a United States trade or business;
(B) In computing the combined taxable income of a DISC or FSC and its related supplier, the gross income of a DISC or a FSC;
(C) For all purposes under subchapter N of the Code, including the computation of combined taxable income of a possessions corporation and its affiliates under section 936(h), the gross income of a possessions corporation for which a credit is allowed under section 936(a); and
(D) Foreign earned income as defined in section 911 and the regulations thereunder (however, the rules of § 1.911-6 do not require the allocation and apportionment of certain deductions, including home mortgage interest, to foreign earned income for purposes of determining the deductions disallowed under section 911(d)(6)).