

STEP 8: Taxable Domestic Income

(when domestic income is taxable)

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This is the eighth in a series of messages written especially for people new to the "861 evidence." This follows [Step 7: Flawed Assumptions](#) (some income is still exempt). The various documents referred to in the discussions are hyperlinked ([blue letters](#)) to the Internet so that you can see the words for yourself. Where the law is quoted, all emphasis has been added.

- The **BLUE** links take you to the documents on the **Internet**; when finished reading, hit the "**back**" button to return to the discussion.
- **ALL** the messages in this series can be found linked through the following website: <http://www.861.info/pgs/861course.php>.

There will only be a few more messages in this series, since it is only meant to be an **INTRODUCTION** to the "861 evidence." But so far, we haven't yet even talked about what "861" is. I have heard a **LOT** of claims about what 861 is about, who should look there, and what it means. Most of the time, IRS employees and CPAs will tell you that "average" Americans shouldn't even be looking in that part of the law. Let's see what the **LAW BOOKS** have to say about it.

Here's the short version. As we saw, **Subchapter N** of the tax code talks about different kinds of commerce, such as nonresident aliens doing business in the U.S., Americans receiving income from outside of the country, etc. If all income was taxable *no matter where it comes from*, there would **NOT BE** a Subchapter N.

The very **FIRST** section of Subchapter N is **Section 861**, which is titled "Income from sources within the United States." (The next section, **862**, is about income from **OUTSIDE** the U.S.) The first subsection of **861** is about "gross income" from sources within the United States, and the second subsection is about "taxable income" from sources within the United States.

According to the first official ruling the Treasury Department ever made about Section 861 (**Treasury Decision TD 6258**), Sections 861 through 864 and the related regulations give the rules for **determining** domestic **AND** foreign "gross income" and "taxable income." Here is the basic organization of the relevant sections:

- **Section 861:** about income from sources **WITHIN** (domestic) the U.S. (861(a) = domestic "gross income"; 861(b) = domestic "taxable income")
- **Section 862:** about income from **OUTSIDE** (foreign) of the U.S. (862(a) = foreign "gross income"; 862(b) = foreign "taxable income")
- **Section 863:** about "combination" income; inside **AND** outside the U.S. (gives rules for dividing up such income into domestic and foreign)

If you want to see the same thing explained using several hundred more words than I just used, you can read the first section of regulations related to Section 861, found here ([1.861-1](#)).

The **main** regulation about **determining taxable domestic income** starts by saying this:

*"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 sources within the United States has been determined. Sections 862(b) and 863(a) state in general terms how to determine taxable income of a taxpayer from sources **WITHOUT** [meaning outside of] the United States after gross income from sources without the United States has been determined." [26 CFR § 1.861-8]*

And another section says this:

*"(c) Determination of taxable income. The taxpayer's **taxable income** from sources **WITHIN OR WITHOUT** the United States **WILL BE DETERMINED** under the rules of Secs. 1.861-8 through 1.861-14T for determining taxable income from sources within the United States." [26 CFR § 1.863-1]*

In light of the above, doesn't it seem reasonable to ask whether **WE** should use Section 861 and its regulations to determine **OUR** taxable domestic income? (If anything, the question is sort of silly because the answer is so obviously "**YES**" according to the citations shown above.)

Most tax professionals insist that we need look no further than that very **GENERAL** definition of "gross income" found in Section 61. What is particularly humorous about that, however, is that in most printings of the tax code, **Section 61** itself **directs us** to **Section 861**. See for yourself at the bottom of the link.

(Some of those cross-references were removed after 2001 by the GPO (government printing office) version of the USC after having been on the books for **47 years**. Before that, the cross-reference was found in the **text** of statutes, as Section 22(g) of the 1939 Code. But if I start to get into all that now, it will only make things more confusing (what this shows is how government lawyers **deliberately changed words** to make the truth harder to find).)

The most important observation is that Section 61 **DIRECTED THE READER** to go to **Subchapter N**. Once again, if all income was taxable no matter where it comes from, then this section would not be necessary, but of course all income is **NOT** taxable no matter where it comes from.)

Here is what the index of the tax code says about where to go:

<http://www.taxableincome.net/exhibits/uscaindex.html>

Okay, so we **SHOULD** look to Section 861 and its regulations after finding out about the various “items” of income. (In light of the above citations, I **DARE** anyone to call that a “frivolous” statement.)

So why does it matter if we use Section 861 and its regulations? In the next message, we'll see what those sections show to be taxable. (Do you think it will include **YOUR** income?)

Sincerely,

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NEXT: [STEP 9: Taxable for Whom?](#)

It helps to keep a mental image of the “steps” in the law **in sequence**, as follows:

TITLE 26, Subtitle A, Chapter 1 (Income tax):

Subchapter A. Determination Of Tax Liability

Subchapter B. Computation Of Taxable Income

Subchapter N. Tax Based On Income From **Sources** Within Or Without The United States

1. **26 USC § 1** imposes the income tax on “***taxable income.***”
2. **26 USC § 61** defines “***gross income***” as income “***from whatever source derived.***”
3. **26 USC § 61 cross-reference** (under notes at the bottom which directs the reader to where the law treats income from “***sources***”):
 - Income from **sources** -*
 - Within*** the United States, see ***section 861*** of this title.
 - Without the United States, see section 862 of this title.*
4. **26 USC § 63** defines “***taxable income***” as “***gross income***” minus deductions.
5. **26 USC § 861 and 26 CFR § 1.861** determine the taxable “***sources of income.***”
6. **26 CFR § 1.861-8** shows that the taxable “***sources of income***” from **within** the United States apply ***only*** to those engaged in international or foreign commerce (including commerce within federal possessions).