**Wages Are Income — Mistaking the Camel for a Horse**

Written by Darrell Anderson.

When more of the people's sustenance is exacted through the form of taxation than is necessary to meet the just obligations of government and expenses of its economical administration, such exaction becomes ruthless extortion and a violation of the fundamental principles of a free government.

Grover Cleveland, Second Annual Message, 1886

In 1990 attorney Jeff Dickstein decided to publish his efforts of reading almost every court case cited to support the "well settled" issue that wages are income. Dickstein discovered that not a single one of those routinely cited cases discussed that issue. The issue at bar in those examined cases had nothing to do with the legal question of whether wages are income.

A fundamental question is not whether wages and salaries are income in the nature of profits and gains from capital conversion or unearned gains. They are not. To understand the difference necessarily requires defining both capital and labor:

Capital: previously produced wealth devoted to producing more wealth. Capital is a feedback mechanism from the distribution of wealth back into the production of wealth.

Wealth: anything tangible derived from labor that satisfies individual happiness. A form of usable stored energy.

Labor: the process of humans converting energy into work. Human diligence.

In common street language many people use the terms wages and income interchangeably, but within the narrow meaning and application of the tax laws, wages are not income. Wages and salaries represent the conversion of property but realize no gain in that conversion. The fundamental question then is whether the conversion of labor is taxable and if so, under what conditions. Legislators have decided to fool people into believing that wages and salaries in excess of their arbitrary and fiat exemption ceiling are taxable as income. To make this illusion succeed, proponents had to conjure up some more sleight-of-hand.

Zero Basis

Despite the 1916 Supreme Court rulings about the nature of the income tax, for several decades revenue bureaucrats and agents embraced the idea that the income tax was a direct tax not subject to the rule of apportionment. As income tax scholars and opponents began to increase in numbers, and research into the history of the income tax steadily improved, revenue bureaucrats and agents began to abandon their policy of a direct tax without apportionment — although this is the correct interpretation of original legislative intent.

One of the elements involved with this shift in public policy seems to be the research of Bill

Benson and M. J. "Red" Beckman exposing that question of whether the 16th Amendment was properly ratified. With the ratification process in dispute, the entire income tax could be attacked if there was no constitutional foundation. Although a direct tax without apportionment was the original intent of legislators, the pivotal Brushaber and Stanton cases seemed to have quashed that intent. By shifting income taxes to indirect taxes in the nature of an excise, the debate over the 16th Amendment could be rendered meaningless.

With this shift in scholarship, Internal Revenue Service employees and legislative researchers began to publicly embrace the 1916 Supreme Court rulings that the income tax was an indirect tax in the nature of an excise. But by then, seasoned and experienced revenue agents and legislators had long forgotten history. Additionally, proponents knew that the modern standard deduction and exemptions failed utterly to cover the cost of living — the necessities of life, a feature that any organized business structure was granted without second thought. Rather than promote legislation to increase the standard deduction and exemption ceilings, and revisit the original thinking that only the wages and salaries realized in excess of the statutory exemption amounts were to be treated as income for the sole purpose of taxation, proponents instead began to introduce the strange idea that every human has a zero basis in his or her labor. With a contrived cost basis of zero, all wages and salaries then were treated fully as gains and hence, subject to taxation as income. This indignant idea further entrenched the flawed and incorrect legal proposition that wages are income.

Consider the following text from the Congressional Research Service Report Frequently Asked Questions Concerning the Federal Income Tax:[1]

Wages to be taxable must pass the same type of examination. For example, if John Doe works 5 hours for $5.00 per hour, is the $25.00 he receives taxable income to him? As we have seen in the above analysis, we must determine if there has been a gain which is realized and recognized.

To see if there was a gain we do not look only to the fair market value of labor, but rather we determine the difference between what was received and the basis (cost) in the labor. Generally one has a zero basis in one's own labor. Therefore, Doe's gain is $25.00 minus 0, or $25.00. This gain is realized when Doe is paid or has right to receive payment.

The gain is recognized specifically in IRC § 61(a)(1) (compensation for services) and there is no non-recognition section which is generally applicable to wages. Therefore, John Doe has $25.00 of taxable income. [emphasis added.]

The author of this document provides no citations to validate the presumption that the cost basis for labor is zero. That no statute or legal citation is provided is noteworthy considering how well the author provided numerous legal citations throughout the remainder of the document. The presumption that the cost basis of labor is zero is without foundation.

Further demonstrating the author's uncertainty is the use of the word generally. Generally? Why not specifically? The lack of any statutory or case law is why. In other words, the author is bluffing and asking readers to pay no attention to the man behind the curtain.

Part of the reason for deriving this flawed idea was misinterpreting the original Supreme Court definition of the term income. Beginning with Stratton's Independence v. Howbert,[2] the Supreme Court justices defined income as "a gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through sale or conversion of capital assets." Legal scholars and researchers have long been confused about the phrase "derived from . . . labor."

Reading those foundational court decisions revealed that the meaning of that phrase is best understood in context. At issue in those many cases were the taxes owed by organized business entities — corporations and trusts. Well accepted for the past few hundred years is that in any human production effort, the three primary elements of production are land, capital, and labor. In any process of manufacturing and exchanging a product, people employ and use land, capital, and labor. Those expenses are considered costs of doing business. After calculating the total receipts and expenses of any business, the result, if any, is considered profit or gain. With respect to these court cases, that profit or gain was subject to an income tax in the nature of an excise.

However, the labor being described by the Supreme Court justices was not used in the context of the independent worker, artisan, or company employee, but in the context of an organized business expense. With respect to the income tax, the proper contextual way to read that original definition of income is "a gain derived from employing or using capital, derived from employing or hiring labor, or from both combined, provided it be understood to include profit gained through sale or conversion of capital assets." Consider the words found in Stratton's Independence v. Howbert:[3]

But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores, it is employing capital and labor in transmuting a part of the realty into personalty, and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process. And, however the operation shall be described, the transaction is indubitably 'business' within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly the income from that business; for 'income' may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. [emphasis added.]

Another important element in deriving such a gain is that even if capital and labor were employed to create tangible objects, the gain must be realized through the "sale or conversion" of those capital assets. If those capital assets were not sold or exchanged in a manner that created a gain, then the fact that capital and labor were employed to create that product is irrelevant. If those capital assets were not sold or exchanged in which a gain is realized, then again no income exists for the purpose of taxation.

Confusing this absurd idea that humans possess no cost basis in their labor is forgetting the approach of trying to compare the individual human to the organized business entity. This idea was the approach introduced in 1913 when legislators tried taxing "excess" wages and salaries and established a fiat exemption ceiling to create the illusion of gain. The underlying premise was that the individual human experiences similar costs of doing business (as a human) as does the artificial entity. That is why the 1913 legislators provided the exemption to cover those costs. That legislators still provide a standard deduction and personal exemption indicates some nominal acceptance of that original effort. To argue that humans possess no basis in their labor defies basic facts, let alone common sense.

Purchasing title to land has a cost basis, paying for capital has a cost basis, and hiring labor has a cost basis. Yet, with respect to individual humans and covering their necessities and expenses of living while pursuing their small-scale trade or business, labor suddenly has no cost basis. The business entity is argued to have a cost basis in an employee's labor because that is a cost of doing business. That employed or hired labor costs something and that cost is the wage or salary paid. That wage or salary is the cost basis from which to calculate profits and gains.

A challenge with this definition of income, that is, the profits and gains derived "from labor," is the perspective from that of employing labor, not of laboring. Trying to treat the conversion of labor as the same as converting capital assets introduces too much confusion. From the worker's perspective there is and always will be only a fair market exchange with no gain. Only the employer of labor can realize a gain from labor. Read the following text from the 1916 income tax act, first as an employer of labor and then as a worker:

> . . . the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. [emphasis added.]

Notice the difference when reading the text from each perspective. The key is understanding that important phrase derived from. Legislators certainly confused the issue by attempting to create an illusion of gain be establishing a fiat exemption ceiling, but cut through the smoke and mirrors and how one experiences profits and gains becomes obvious.

People and court judges today argue endlessly about whether taxes on income are direct taxes without apportionment or indirect taxes in the nature of an excise. Yet, a tax can be both direct or indirect. What is critical is stating specifically the subject and nature of a tax. The fact is that with respect to the specific property of income and the 16th Amendment, such a tax is a direct tax not subject to apportionment, but because of the Supreme Court justices' faulty logic the tax is now often explained as an indirect tax in the nature of an excise. This is certainly acceptable with respect to organized business profits or passive investment gains, but what about wages and salaries? A tax on income in the nature of wages and salaries is a direct tax because those receipts represent only a conversion of property assets. Unlike a tax on profits and gains, a direct tax diminishes the source. Whether those assets are interpreted as human labor or the tangible products derived from the process of laboring, the effect is the same: a direct tax that diminishes the source. Taxing income in the nature of wages and salaries is a tax on a property asset conversion whereas a tax on incomes in the nature of profits and gain is a tax on net income —

receipts minus expenses — what remains after incurring all expenses. Clumping the two different types of income under one umbrella and tax is why there exists so much confusion. This is not a classic case of you saying tom-ah-to and me saying tom-ay-to, this a classic case of political ignorance, deceit, obfuscation, and greed.

The legislators during the 16th Amendment era seem to grasp this difference. Consider the words of Senator Bailey of Texas in 1909:[4]

> I believe in earning an income by personal service every man consumes a part of his principal, and that fact ought always to be taken into consideration. The man who has his fortune invested in securities may find in a hundred years, if he spent his income, that the fortune [is] still intact, but the lawyer or the physician or the man engaged in other personal employment is spending his principal in earning his income. That fact ought under every just system of income taxation to be recognized and provided against.

Notice today, however, that if an individual argues that an income tax is an excise tax, the Court judges easily can respond that the tax is an unapportioned direct tax, and if an individual argues the income tax is an unapportioned direct tax the Court justices can respond that the tax is an excise tax. Heads they win, tails you lose!

Did the 16th Amendment create a third class of taxation? No, there are still only two classes of taxes, direct and indirect. The Brushaber and Stanton decisions certainly beat that question to death. Direct taxes are still subject to the rule of apportionment and indirect taxes are subject to the rule of uniformity. All the 16th Amendment did was eliminate the need for the rule of apportionment when attempting to tax the specific property of income. A tax on income is still a direct tax. Income is still property. If income is property and a tax on income is still a direct tax, then there still exists only two classes of taxation. The 16th Amendment merely removed all rules from how a tax is collected on the property of incomes. Therefore, the 16th Amendment did not create a new third class of taxation, but created a new method of collection.

Despite that historical inspection, do not skirt the issue. The Supreme Court justices can wink and say tom-ah-to and call taxes on income an indirect tax in the nature of an excise. Today, thanks to gross confusion between the words income and wages, legislators assume the cost basis for labor at zero, and the out-of-pocket effect of that argument is the same as an unapportioned direct tax — just like the framers of the 16th Amendment intended.

Do not confuse cost basis with exchange value, the terms are not the same. Cost basis is the amount paid for an asset in cash or property. Exchange value is the instantaneous parity of a thing at the time of the exchange. The argument often used by proponents of this left-field theory is that one “pays nothing” for one’s labor. Anybody with an ounce of reason knows that such a statement defies reality. Even Senator Bailey understood this in 1909. So too did the legislators in 1862 — they allowed for people to deduct the rent they paid for dwelling houses they resided. Humans must continually sustain their lives in numerous ways or they die. This is a fundamental observation throughout the entire universe. If people do not sustain their lives, they die and they do not work. Because individual humans seldom maintain books and records, the costs involved are perhaps not as easy to enumerate as an organized business's costs, but those costs nonetheless exist. Through this bizarre concept of zero basis, the individual human is rendered to a status of having no such cost basis in the "costs of doing business." For the individual human, those costs are the costs of living — sustaining life.

The typical, everyday, average human will read such a declaration and probably jump through the roof. The cost basis for my labor is zero? According to legislators and some judges, yes. Proponents claim that people do not pay anything for their labor — labor is an asset that costs nothing to produce. Yet, such a declaration is from la-la land. People need to eat, clothe themselves, sleep, exercise, provide shelter, maintain and improve skills and knowledge, prepare for the future, etc. All of these "ordinary and necessary expenses" are required to provide and support the process of laboring. Business entities are allowed to deduct their "ordinary and necessary expenses" but humans cannot? Furthermore, labor is only something humans do, the products of labor is what are exchanged. Indeed, by examining a corporate income tax return people observe exactly this mentality, that expenses are allowed to be considered in calculating net income — gain. Yet, the common worker is not allowed to do the same?

Only by arguing that a human pays nothing for his or her labor can proponents create an illusion of gain and hence, find standing to argue for an income tax on those fair market exchanges or asset conversions in which no gain actually exists.

Consider a worker receiving $35,000 a year in wages, a proprietorship or partnership receiving $35,000 a year in sales, and a corporation likewise receiving the same amount in revenues. The corporation is allowed to deduct all costs of doing business while producing their product or service — mortgages, rents, utilities, training costs, etc. After deducting those expenses, what remains is the basis for any possible income tax liability.

The proprietorship or partnership might be able to deduct those same expenses and might not, depending upon whether or not those expenses are determined as part of doing business or "personal" expenses. Thus, the tax burden for those entities is higher than the corporation.

Any such expenses for the human worker are always defined as "personal" expenses and not deductible; thereby substantially increasing the worker's tax liability. Notice that with individual "income" taxes that "everything that comes in" is declared taxable, but with a corporation only net income (profits) are declared taxable. Yet, wasn't the income tax originally enacted in order to tax the incomes of corporations and businesses and not workers? Wasn't net income and unearned gains the focus of the 16th Amendment?

Arguably, because of this futile exercise in comparing a human to a business entity, the legislators in 1894 and 1913 derived their statutory exemption to ensure that the typical working man or woman retained his or her wage and salary to provide all of those basic necessities of life — the "ordinary and necessary" costs involved of a human "doing the business" of living. The legislators then provided an ample cushion to ensure that the working man or woman could save for a rainy day and provide for times when one is not working. They at least understood and accepted that taxing the conversion of labor is fundamentally different from taxing the conversion of capital. They understood this difference because they referred to the conversion of labor as earned income and the conversion of capital as unearned income. A noticeable difference between the two concepts is the element of time. Receiving earned income always includes the sacrifice of time. Receiving unearned income does not.

Reading these court cases in context reveals that the issue of a wage or salary being subject to the income tax was not an issue at bar. The Supreme Court justices never have directly addressed the issue of whether wages and salaries are considered income in the nature of profits and gains. In these many cases the profits or gains derived from employing or hiring labor is subject to taxation, but with respect to the original intent of the 1913 legislators, for individual humans only the wages and salaries in excess of the statutory exemption ceilings were subject to taxation. Those original exemption ceilings ensured that the cost of living was not being impeded or touched. This is how those 1913 legislators avoided critical debates from the common worker.

The zero basis theory is the wrong answer to the wrong question. Legislators long ago established that the cost basis of individual humans must include the ordinary and necessary expenses to support life and add some cushion for creature comforts. Legislators at that time even exempted interest received from mutual savings and loans because that income was part of the common worker's ability to provide a meaningful life and that amount seldom exceeded the statutory exemption ceiling. Although arbitrary and fiat, the $3,000/$4,000 exemption ceiling established in 1913 purposely provided and acknowledged the cost basis of life. That exemption ceiling provided a foundation in reality and basic compassion for human existence. The zero basis theory is merely a red herring — a distraction — from the real issue that the current standard deduction and exemption ceiling creates a modern feudalistic social system. The entire zero basis theory is not only flawed, but nonsensical, misleading, and unnecessary.

To counter the absurd theory that the cost basis of the individual worker's labor is zero, opponents have promoted a legal theory of their own. They treat labor as property and then attempt to use court cases and the Internal Revenue Code to argue that there is no gain and only a fair market exchange. The argument goes something like this:[5]

"The property that every man has is his personal labor, as it is the original foundation of all other property so it is the most sacred and inviolable . . . to hinder his employing [it] . . . in what manner he thinks proper, without injury to his neighbor, is a plain violation of the most sacred property." Butcher's Union Co. v. Crescent City Co.[6]

"Included in the right of personal liberty . . . is the right to make contracts for the acquisition of property. Chief among such contracts is that of personal employment, by which labor and other services are exchanged for money and other forms of property." Coppage v. Kansas.[7]

"In our opinion that section, in the particular mentioned, is an invasion of the personal liberty, as well as of the right of property, guaranteed by that Amendment (5th Amendment). Such liberty and right embraces the right to make contracts for the purchase of the labor of others and equally the right to make contracts for the sale of one's own labor." Adair v. United States.[8]

Although not addressing the issue of taxes on incomes, consistent with their rulings in Butchers' Union Co., Coppage, and Adair, in Adkins v. Children's Hospital,[9] the Supreme Court justices wrote that "In principle, there can be no difference between the case of selling labor and the case of selling goods."

The conclusion is that labor is property.

Legislators recognizes at section 64 of the Internal Revenue Code that "ordinary income" is a gain from the sale or exchange of property.

In sections 1001, 1011 and 1012 of the Internal Revenue Code, legislators established the method for determining the gain derived from the sale of property. Section 1001(a) states that: "The gain from the sale or other disposition of property shall be the excess of the amount realized there from over the adjusted basis provided in section 1011 for determining gain . . . ." Section 1001(b) states that: "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received." Section 1011 states that: "The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 . . . ), adjusted as provided in section 1016." Section 1012 states that: "The basis of property shall be the cost of such property . . . ." In the case of the sale of labor, none of the provisions of Section 1016 of the Internal Revenue Code are applicable.

Therefore, the cost of property exchanged under contract is the fair market value as evidenced by the contract itself, provided neither the buyer nor seller were acting under compulsion in entering into the contract, and both were fully aware of all of the facts regarding the contract. When a person pays another person the amount agreed upon by their contract, there is no excess amount realized over the adjusted basis, and thus no gain under Section 1001 of the Internal Revenue Code.

A fair market value exchange creates no profits or gain, and hence, no gross income. With no gross income there can be no requirement to file a return as required under section 6001, 6011, and 6012.

Without a gain there can be no "self-employment income" and no subsequent requirement to file a return appears under section 6017.

As zero basis proponents are quick to notice, however, section 1012 requires establishing a cost basis. The cost of property exchanged by contract establishes an exchange value but not a cost basis. But the rebuttal is that the "ordinary and necessary" expenses of life are the cost basis.

A significant crisis with taxing wages and salaries as income in the nature of an excise is that legislators have willfully failed to maintain an exemption ceiling that allows the employed and independent worker to sustain the basic costs of living — those "ordinary and necessary" costs of doing business as a human. Organized businesses are allowed to deduct the cost of "living," that is, the expenses of doing business; but the human being is not allowed to deduct equivalent costs. The 1913 legislators at least provided such a mechanism. The practical effect is the modern income tax, with respect to artificial entities such as corporations, is indeed a tax on incomes in the nature of profits and gains; but with respect to the individual human the tax is a direct tax without apportionment because the tax is taken directly out of the revenues needed to sustain the basic costs of living.

Today the argument about whether wages and salaries are income is never-ending. Opponents are correct to notice that the income tax with respect to individual humans is a direct tax without apportionment. Proponents are correct if they root themselves back to the original thinking of

1913 and tax “excess” wages and salaries as income.

The 1913 legislators allowed the camel’s nose into the tent. Today the entire camel is in the tent and few people seem to know of a way to peacefully remove the camel. The result is much hate, discontent, anger, and frustration, not to mention a smelly tent.

Finis.

Endnotes

[1] Luckey, John R., Congressional Research Service Report, Frequently Asked Questions Concerning the Federal Income Tax, page CRS-11, Order Code 97–59A, updated January 7, 2005.

[2] 231 U.S. 399 (1913), at page 413.

[3] 231 U.S. 399, at page 415.

[4] Hart, Constitutional Income, p. 176, citing the 44th Congressional Record, p. 4007.

[5] The argument was publicly popularized by Alan Stang in his 1988 book, Tax Scam. Jeff Dickstein included an expanded argument in his 1990 book, Judicial Tyranny.

[6] 111 U.S. 746, 757 (1883).

[7] 236 U.S. 1, 14 (1914).

[8] 208 U.S. 161, 172 (1908).

[9] 261 U.S. 525, 558 (1922).