It's not the Money, It's the Principal (whatever *that* is)

by Alfred Adask

I have photocopies of three letters allegedly written by officials of the U.S. Department of The Treasury discussing the nature of Federal Reserve Notes (FRN's). I can't prove the photocopies are legitimate, but I believe they are. The dates on the first two letters are 1977 and 1982; the third letter's date is unclear. Assuming these letters are legitimate and the statements they contain accurate, they offer some interesting insights into our money system.

The first letter is marked "Exhibit 0-8" and was apparently used in someone's trial, but the name of the recipient has been whited out and is unknown to me. It's simply one of those millions of document's that float like autumn leaves through the constitutionalist community. (The italicized highlights are my additions.)

Department of The Treasury
Office Of The General Counsel
Washington, D.C. 20220
Feb 18, 1977

Dear Mr.

This is to respond to your letter of November 23, 1976 in which you request a definition of the dollar as distinguished from a Federal Reserve note.

Federal Reserve notes are not dollars. Those notes are *denominated* in dollars, which are the unit of account of the United States money. The Coinage Act of 1792 established the dollar as the basic unit of the United States currency, by providing that "The money of account of the United States shall be expressed in dollars or units, dimes or tenths, cents or hundredths . . ." 31 U.S.C. Sect. 371.

The fact that Federal Reserve notes may not be converted into gold or silver does not render them worthless. Mr. Bernard of the Federal Reserve Board is quite correct in stating that the *value* of the dollar is its *purchasing power*. Professor Samuelson, in his text Economics, notes that the dollar, as our medium of exchange, is wanted not for its own sake, but *for the things it will buy.*

I trust this information responds to your inquiry.

Sincerely yours,
Russell L. Munk
Assistant General Counsel

The second letter was written in 1982 from the Department of The Treasury to Bryon Dale – a student of the American money system.

As Mr. Dale knew (and the letter confirms), in 1982 the Federal government printed our paper money (Federal Reserve Notes) for $20.60 per thousand physical notes, then sold the Notes *at cost* to the Federal Reserve, which ultimately issued the notes to the public *at full face value* – plus interest (the interest alone is typically more than the cost for printing the Note).

Under this arrangement, in 1982 the Federal Reserve could buy a $100 FR note from our government for two cents (today the cost is about four cents), and ultimately loan it back to the American people at full face value ($100). Plus interest. (Quite a deal, hmm? How'd you like to buy pieces of paper for two cents and sell 'em for $100 each?)

Based on a similar analysis, Byron Dale enclosed a $1 Federal Reserve Note with his letter to the Bureau of Engraving and Printing and offered to buy a freshly printed $100 bill directly from the government for $1 FRN. It sounds silly, but technically, it might be a good deal. After all, the Federal Reserve would only pay two cents for that $100 bill, so Byron's $1 offer was 50 times greater.

Here's government's response to Mr. Dale's "generous" offer (again, I've emphasized some sections with *italics*):

Department Of The Treasury
Bureau Of Engraving And Printing
Washington, D.C. 20228
December 14, 1982

Mr.. Byron C. Dale
R.R. 2, Box 72
Timberlake, South Dakoka 57656

Dear Mr. Dale:

This is in response to your letter of November 15, 1982 in which you enclose a $1 Federal Reserve note and request to purchase a one hundred dollar bill.

The Bureau of Engraving and Printing produces the Nation's paper currency and sells it to the Federal Reserve system for $20.60 per one thousand notes. The notes, however, are not money until they are monetarized and issued by a Federal Reserve Bank. To obtain notes, a *Federal Reserve Bank must pledge collateral* equal to the face value of the note. Collateral must consist of the following assets, alone or in any combination: 1) gold certificates, 2) special Drawing Right certificates, 3) U.S. Government securities, and 4) "eligible paper," as described by Statute.

Federal Reserve Notes are *obligations of the United States*, and have a first *lien* on the assets of the issuing Federal Reserve bank. *Money without backing is worthless*, and in effect, you are suggesting that currency be printed without the necessary collateral which is required of the Federal Reserve Bank.

I hope this information is helpful. Your $1 FR note is returned.

Sincerely,
M. M. Schneider
Acting Executive Assistant

Well, the government didn't take Mr. Dale's deal, but then they didn't keep his "$1 FR note", either. Although they conceded that "Money without backing is worthless", they also assured Mr. Dale that any mix of "gold certificates, special drawing Right certificates, U.S. Government securities, and 'eligible paper' as described by statute" would provide the necessary backing to make Federal Reserve Notes "worth something" (as opposed to "worthless").

Here's the third letter (date uncertain) from the government which discusses Federal Reserve Notes (italicized highlights, my addition):

Department Of The Treasury
Washington, D.C. 20220

Gaylon L. Harrell
Latham, Illinois

Dear Mr. Harrell:

This is in response to your letter to me of August 10 in which you asked a further question about Federal Reserve notes.

Federal Reserve notes are legal tender currency (31 U.S.C. 5103). They are issued by the twelve Federal Reserve Banks pursuant to Section 16 of the Federal Reserve Act of 1913 (12 U.S.C. 411). A *commercial bank* which belongs to the Federal Reserve System can obtain Federal Reserve notes from the Federal Reserve Bank in its district whenever it wishes, but it must pay for them in full, dollar for dollar, by drawing down its account with its district Federal Reserve Bank.

The Federal Reserve Bank in turn obtains the notes from the Bureau of Engraving and Printing in the United States Treasury Department. It pays to the Bureau the cost of producing the notes. The Federal Reserve notes then become liabilities of the twelve Federal Reserve Banks. Because the notes are *Federal Reserve liabilities*, the issuing Bank records *both* a *liability* and an *asset* when it receives the notes from the Bureau of Engraving and Printing, and therefore *does not show any earnings* as a result of the transaction.

In addition to being liabilities of the Federal Reserve Banks, Federal Reserve notes are *obligations of the United States* Government (12 U.S.C. 411). Congress has specified that a Federal Reserve Bank must hold collateral (chiefly gold certificates and United States securities) equal in value to the Federal Reserve notes which that Bank receives (12 U.S.C. 412). The purpose of this section, initially enacted in 1913, was to provide backing for the note issue. The idea was that if the Federal Reserve System were ever dissolved, the United States would take over the notes (liabilities) thus meeting the requirements of [12 U.S.C.] 411, but would also take over the assets, which would be of equal value. The notes are a first *lien* on all the assets of the Federal Reserve Banks, as well as on the collateral specifically held against them (12 U.S.C. 412).

Federal Reserve notes are not redeemable in gold or silver or in any other commodity. They have not been redeemable since 1933. Thus, after 1933, a Federal Reserve note did not represent a promise to pay gold or anything else, even though the term "note" was retained as part of the name of the currency. *In the sense that they are not redeemable, Federal Reserve notes have not been backed by anything since 1933*. They are valued not for themselves, but for what they will buy. *In another sense*, because they are a legal tender, Federal Reserve notes are "backed" by all goods and services in the economy.

I hope that this information is useful to you.

Sincerely,
Russell L. Munk
Assistant General Counsel

In a sense . . . ?

Interesting. Note that the second letter explained that "Money without backing is worthless", and the undated letter declared, "Federal Reserve notes have not been backed by anything since 1933." Are FRN's therefore worthless?

Well, we can't quite tell from the third letter. After all, the writer hedged his comments by saying "*In the sense* that they are not redeemable, Federal Reserve notes have not been backed by anything since 1933," but also "*In another sense*, because they are a legal tender, Federal Reserve notes are 'backed' by all goods and services in the economy."

Hmm. Sounds mysterious. "In the sense" vs. "In another sense" . . . golly, which "sense" do you suppose is correct? (And which is "politically correct"?) Is the FRN worthless or not? And why do you suppose the assistant General Counsel wouldn't give us a straight answer?

The answer to which "sense" applies is suggested in the 1977 letter which declares the value of a dollar is in its "purchasing power", in "the things it will buy". Virtually every analyst agrees that due to inflation, today's Federal Reserve "dollar" is worth less than a nickel as compared to the FRN of 1933. Therefore, although we can't truly say the FRN dollar is "worthless" (it's still worth a couple of cents as compared to 1933), it is fair to say the FRN is almost worthless – and, given it's persistent six decade decline, "in that sense" likely to become "completely" worthless (i.e., "obviously worthless" -- even to the public") in the foreseeable future. That is, the time may be approaching when there'll be no more suckers dumb enough to take FRNs in trade for real property or services.

Every FRN has a silver lining?

Does this mean we should abandon our FRNs and start hoarding gold coins in a tin can buried in the back yard? Could be. After all, even government subtly discourages use of FRN's by encouraging suspicions about anyone who pays his bills with cash. Aren't we a little embarrassed if we don't have credit cards? Think you can pay cash for a new home or car without arousing the suspicions of the real estate agent or car dealer?

We are taught that the common denominator among drug pushers, prostitutes, criminals, and especially tax evaders is a tendency to do business in cash. In fact, carrying "too much" cash has become prima facie evidence of criminal activity. By encouraging the anti-cash bias, government pushes for a "cashless, FRN-less society" where everyone uses plastic cards to conduct computer-recorded business that can't take place without government getting its cut.

Nevertheless, the beleaguered FRNs may still have some surprising value. For example, when we pay for something with a check, the check is denominated in "dollars". Although the vast majority of Americans haven't seen real (gold or silver) dollars or paid for anything with real dollars in their lives, the fact that we denominate our checks in "dollars" may constitute prima facie evidence that we have received income and paid our bills with "dollars" subject to taxes. This distinction might be important since real "dollars" are assets and therefore taxable, while the nature of FRN dollars is less clear.

According to the third letter: **"**Because the notes are *Federal Reserve liabilities*, the issuing Bank records *both a liability and an asset* when it receives the notes from the Bureau of Engraving and Printing, and therefore does not show any earnings as a result of the transaction."

Conventional thinking in the patriot community (whatever that is) regards the previous statement and others like it as evidence that FRNs are pure liabilities, debt instruments having a negative financial value. As such, the more FRNs you have, the more you owe. Sounds nuts, but it's probably not.

However, I read that quote and am intrigued by the idea that FRNs are "recorded" by the Bank that buys them as *both* liabilities *and* assets.

It's easy to see that if you earn $100,000 in real, *asset-based* money, your personal assets have increased and you may be subject to income tax. It's also possible to imagine that if your "income" is denominated in a *debt-based* money, you've actually suffered a loss and might be exempt from income taxes. But what can you see or imagine if your income is denominated in a currency that is *both* assets and liability?

If, as the third letter claims, FRNs are both "liabilities" and "assets," what are they? Accounting units. What else could they be?

Moreover, the third letter says "the issuing Bank records both a liability and an asset when it receives the notes from the Bureau of Engraving and Printing, and therefore does not show any earnings as a result of the transaction." This implies that the liabilities and assets inherent in each FRN are *equal*, and therefore the *value* of any FRN is *zero*. I.e., I have a $100 FRN that represents $100 in assets and $100 in liabilities -- what is my FRN worth? Subtract the liabilities from the assets. If they're equal ($100 - $100), the answer's *zero*.

So what is my FRN? It's a *unit of measure*, no different from inches, feet, pounds, tons, and centigrams. It's an accounting unit. A number.

What is the tax on a *number*? Is the tax on 100,000 more than the tax on 1,000? It depends. 100,000 what? 1,000 what? The tax on 100,000 *dollars* is clearly more than the tax on 1,000 *pennies*. The tax on 1,000 dollars and 100,000 pennies is identical. And a tax on 1,000 pennies is greater than the tax on 100,000 grains of sand. The taxable item is not the unit of measurement, but the *commodity* it describes.

Therefore, is the tax on $100 in gold-backed money the same as the tax on $100 FRN? Can I be taxed on the basis of an income denominated in *units of measurement* that the issuing Federal Reserve Bank implicitly says are worth *zero*? If the Federal Reserve Bank can count a FRN as both an asset and liability, can I do the same and also have no earnings to be taxed?

Those questions sound ridiculous, but there is some supporting law. Consider 31 U.S.C. § 742 (which deals with "Public Debt"):

"Exemption from taxation. Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other *obligations of the United States*, shall be *exempt from taxation* by or under *State* or *municipal* or *local* authority. This exemption extends to *every* form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes." (R.S. § 3701; Sept. 22, 1959, Pub.L. 86-346, Title I, § 105(a), 73 Stat. 622.) [emph. add.]

Now consider, 18 U.S.C. §8:

"Obligation or other security of the United States defined.

"The term 'obligation or other security of the United States' includes all bonds, certificates of indebtedness, national bank currency, *Federal Reserve notes, Federal Reserve bank notes*, coupons, United States notes, Treasury notes, gold certificates, silver certificates, fractional notes, certificates of deposit, bills, checks, or drafts for money, drawn by or upon authorized officers of the United States, stamps and other representatives of value, of whatever denomination, issued under any Act of Congress, and canceled United States stamps." [emph. add.]

Hmm. According to our last two letters and 18 U.S.C. §8, FRNs are "obligation[s] . . . of the United States". According to 31 U.S.C. 31 §742 "**. . .** obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority".

Therefore, it might be argued that anyone paid in cash (FRN's) for their work or products might be exempt from paying a *state* income or sales tax.

Further, "This exemption extends to *every* form of taxation that would require that either the *obligations* or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax." Therefore, it appears that if I bought a car or a house and made it abundantly clear on the bill of sale that I paid cash with FRNs (I might even list the serial number of each bill used to pay the bill), that car or house might not be subject to state or local property taxes since its value was computed "directly or indirectly" in FRNs ("obligations of the United States").

If this were so, you can see why government would want a FRN-less society. With an all-electronic financial system, every transaction would be automatically denominated in "Dollars", there'd be no opportunity to claim you were paying or being paid in tax-exempt FRNs, and if you didn't like it, you'd have to do without. Result? Every financial transaction would not only be taxable but electronically and instantly taxed.

However, until government establishes its FRN-less utopia, it's remotely possible that, with additional research and effective argument, use of "virtually worthless" FRNs might enable you to avoid state and local taxes of "every form".

Crazy, hmm?

Welcome to the Alice In Wonderland world of paper money, taxes, and "high" finance. (Makes you wonder what bankers and IRS officials are smoking, doesn't it?) But it gets even more bizarre.

Viva Villa!

I remember a black and white movie called *Pancho Villa* from the 1930's (maybe 1940's) which starred Victor McLaughlin as the Mexican revolutionary. There's a scene where some Europeans arrive with some enormous amount of new paper money ($20 million?) that Pancho Villa ordered printed, and ask to be paid the agreed fee ($100,000?). The childlike Villa orders his Lieutenant to peel $100,000 from the freshly printed $20 million and pay the printers. The printers, of course, refuse to accept a *portion* of the money they printed as payment for *all* the money they printed. Simplistic Villa does not understand money, is bewildered by the printers' demand, but eventually pays the printers in real money (gold-backed) .

It's an amusing scene, but it makes a point that should also apply to our government's "sale" of freshly-printed FRNs to the Federal Reserve. Unless our government is truly dumber than Pancho Villa (and I don't deny the possibility), it's pretty hard to imagine Washington is fool enough to print $1 billion in $100-denominated FRNs and then sell 'em to the Federal Reserve for just $400,000 (current production costs are about four cents per note) in the *same* FRNs they just printed. This is equivalent to General Motors selling Cadillacs to the public for one spare tire (which can be found in the trunk of each new Cadillac).

Perhaps one obstacle to understanding FRNs is the assumption that statements like, "The Bureau of Engraving and Printing produces the Nation's paper currency and sells it to the Federal Reserve system for *$20.60* per one thousand notes" (second letter), mean the Federal Reserve pays $20.60 in *FRNs* for the newly printed FRNs. If that were true, we'd be right back in the land of Pancho Villa, using $20.60 in FRNs to pay the printer for 1,000 in freshly-printed FRNs. Even in government, that's too crazy to be true. The "$20.60" paid for printing 1,000 FRNs, must designate a currency *other than FRNs*.

Let's hypothesize that the federal government will not accept FRNs to pay for the printing of FRNs, but instead insists on being paid in gold. This is not implausible. After all, back around 1913, when Washington first agreed to print and sell FRN's to the Federal Reserve, the country was only using real, gold-backed money. Just like the printers in the Pancho Villa movie, our government's Bureau of Engraving and Printing could not have agreed to accept *FRNs* in payment for printing *FRNs*. They must have demanded payment in something tangible, probably gold or some gold equivalent and it's likely that form of payment is *still* required. So let's play with the idea that, although each FR note currently costs only four cents to print, those "four cents" are not "FRN-cents" but are denominated in *gold*-backed currency.

There are approximately 480 grains to an ounce. Prior to 1933, the conversion rate for "real" paper money to gold was $20 / ounce; a real dollar was worth about 25 grains of gold; and each *real* penny (gold-backed; not FRN-pennies) was worth about 0.25 grains of gold. Today, if the Fed were still paying four cents in *real* money (gold) for each FR note, their cost for each "FR note" ($1, $5, $10, etc.) would be roughly 4 cents times 0.25 grains of gold/ cent, which equals 1 grain of gold.

With current conversion rates approaching $400 FRN per ounce (480 grains) of gold, each grain of gold is worth about $0.83 FRN ($400 FRN divided by 480 grains). So if the Federal Reserve were paying four *real* (gold-backed) cents for each FR note, it would cost them about one grain of gold or $0.83 FRN to print a single FR note. If so, the Fed's real cost ($0.83) for buying a paper $1 FR note would be very near to its face value. As a result, the exorbitant profit the Federal Reserve enjoyed on $1 bills when gold was still worth $32 FRN, is gone.

Of course, $5 FR notes are still lucrative, since they also only cost about $0.83 (FRN; 1 grain of gold) to print. $10, $20, $50, and $100 FR notes are even more lucrative, but like the $1 FR note, also subject to the ravages of inflation. As a result, it is conceivable that *paper* FRN's are becoming so costly (in real money, gold), that it may be unprofitable for the Fed to continue buying and then loaning them. If so, the Fed may also be secretly conniving to eliminate the paper FRN and restructure the money system to retain its extraordinary profit potential relative to real, gold-backed dollars.

Regardless of whether any of this fanciful speculation is remotely valid, I suspect that an overlooked but critical process takes place in our money system when we *sell* the FRNs we've printed to the Federal Reserve, and thereby allow the Fed to legally *own* and then *loan* those same FRNs back to us -- and even charge us interest (rent?) on use of *their* notes. In a sense, since the Fed *owns* every paper FRN until both the principal and *interest* are paid off on whatever loan originally released the particular FRN into the economy, the Federal Reserve could be said to be the true "owner" of every FRN in your wallet.

The possibility that you don't really "own" the money in your pocket, might explain stories about government simply seizing someone's cash and refusing to give it back, even if the original possessor did nothing illegal. If it's not really "your" money -- only pieces of paper someone borrowed but which truly belong to the Federal Reserve -- you have possession but no lawful title to "your" FRNs. Can government legally "detain" your cash (FRNs) until the issue of lawful title (ownership) is determined? Until you produce a bill of sale or some other proof that you *own* (not merely *possess*) those FRNs, government might be able to "presume" they are stolen and hold them pending claim by the "lawful" owner. And unless the original loan that "monetized" your specific FRN has been paid in full with interest, no such proof of ownership would be possible.

On the other hand, if you could show that the original loan for the Bank series and serial number on your FRN had been paid, your mere possession of that FRN would be prima facie evidence of your ownership unless someone else could produce a superior title. If you owned your money, you could *pay* rather than *discharge* your debts. If you could actually *pay* your bills, you could actually *own* property.

Perhaps that's why the Fed routinely burns millions of "old" FRNs every day. Not because they're worn out, but because they are so old that it might be argued that the principal and *interest* had been paid off on the original loan and therefore those "old" FRN's were truly "owned" by the possessor.

When I asked a friend to proofread this article, he thought it was interesting, but incomplete. At the end of the article he wrote, "Does this piece have an ending?"

No.

I have no conclusion. And that bothers me. I'm pretty sure I'm dealing with interesting (possibly important) concepts, but I can't find a conclusion.

However, in a sense, maybe that's the point. A conclusion requires answers, data, evidence. All I seem to have is questions, suspicions and inferences. But why? Is my inability to reach a conclusion based on my own laziness and inability to find facts?

Normally, I'd say Yes – the inability to reach a conclusion is my fault. But in this instance, I'm not so sure. The problem is that the same questions and suspicions I've raised have been banging around the constitutionalist community for several decades. And yet, to my knowledge, government has refused to provide a coherent answer to questions concerning either the income tax or the money system.

Why?

And note that the lack of information and inability to reach supportable conclusions is not confined to myself. On April 14, 1993, Former IRS Commissioner Shirley Peterson said publicly that the Internal Revenue Code (IRC) is now:

". . . a virtual impenetrable maze. The rules are unintelligible to most citizens – including those holding advanced degrees and . . . specialize in tax law. The rules are equally mysterious to many government employees who are charged with administering and enforcing the law . . . ."

Based on a an alleged system of laws that even an IRS Commissioner can't understand, our government takes so much of our earning as to drive us toward poverty, precipitate divorces, bankrupt businesses, incarcerate some of us and drive others to suicide or plots to bomb government facilities. And our money system is every bit as "impenetrable . . . unintelligible . . . mysterious" as the IRC.

How can this be? How can an entire nation be unable to understand its own tax and monetary systems? Are our laws incomprehensible because of endless tinkering by generations of well-meaning but incompetent politicians? Are we to believe that the creation of a relatively brief, comprehensible tax code is simply impossible? Or is it more likely that our laws are incomprehensible by intent?

Every adult understands the ancient refrain, "Oh, what a tangled web we weave, when first we practice to deceive." You start lyin', and it quickly turns into a endless labyrinth of more lies and anxieties. We recognize the "tangled web" phenomenon in our own adrenaline-soaked attempts to weave deceptions.

But do we ever recognize the "tangled webs" of others? When we see millions of words in the IRC, are we looking at law? Or are we witnessing the most complex, tangled web of lies and deceit the world's ever seen?

The IRC was written in 1939, rewritten in '54, and again in '86. And not once has government succeeded in producing a document the American people can read and understand. After a half century of ambiguity, imprecision, mystery and misunderstanding, isn't it time to ask if maybe the reason we can't understand the tax and monetary laws is because some very powerful people don't want us to?

In the end, how can we dismiss even the most bizarre "patriot" theory of tax law, if we can't first show what the "real" law is? How can you tell me I'm wrong, if you can't first show me what's right?

And if you can't show me the "right" tax or monetary law, why not? Because you're ignorant? Or because the tax and monetary laws are inherently "wrong"? Perhaps there is no "right" to be found in the IRC and so the true law must be concealed, buried under millions of words.

So, for those of you who feel cheated out of a conclusion to this article, just wait. I guarantee a conclusion of monstrous proportions is headed our way. Within ten years, maybe five, you'll see the conclusion of the IRS – or you'll see the conclusion of the American Dream.

And it's up to you and me to write that conclusion.

(To be continued.)