

Part III – Administrative, Procedural, and Miscellaneous

Frivolous Arguments to Avoid

Notice 2004-22

SECTION 1 INTRODUCTION

As April 15 approaches, taxpayers are reminded to steer clear of tax-avoidance schemes that purportedly reduce or eliminate taxes. If an idea to save on taxes seems too good to be true, it probably is.

Tax-avoidance schemes are based on frivolous arguments that the Service and the federal courts have repeatedly rejected. These schemes typically are sold by promoters for a substantial fee, and may be sold over the Internet, through advertisements in newspapers and magazines, at conferences and seminars (including conferences for professional groups such as doctors or dentists), and through recommendations of friends or acquaintances who have learned about these schemes.

Section 2 of this Notice sets out many of the most common frivolous arguments used by these tax-avoidance schemes. The Service is committed to identifying taxpayers who attempt to avoid their tax obligations by using schemes based on these and other frivolous arguments. Frivolous returns and other similar documents submitted to the Service are processed through its Frivolous Return Program. The Service also reviews other non-return documents making frivolous arguments submitted by taxpayers, such as correspondence, to determine whether these individuals have filed required tax returns and paid all taxes due for previous years.

Section 3 of this Notice identifies potential civil and criminal penalties. Taxpayers who engage in tax-avoidance schemes will be liable for unpaid taxes and interest. In addition, the Service will impose civil and criminal penalties against taxpayers where appropriate. The Service also will determine appropriate penalties against persons who promote these schemes and who prepare frivolous returns based these schemes.

SECTION 2 COMMON FRIVOLOUS ARGUMENTS

This section sets out many common frivolous arguments used by taxpayers to avoid or evade tax.

- ***“The 16th Amendment is invalid because it contradicts the original Constitution, and it was not properly ratified.”*** The 16th Amendment, which authorizes the income tax, was properly ratified and is valid.
- ***“A taxpayer can make a ‘claim of right’ to exclude the cost of his labor from***

income.” There is no “claim of right” doctrine under any federal law, including the Internal Revenue Code, that permits a taxpayer to deduct or exclude the value of his labor.

- **“Only income from a foreign source is taxable under section 861.”** Sections 861-865 do not exclude income from tax. In particular, nothing in these sections or the Treasury regulations provides that only income earned from certain foreign sources is subject to U.S. tax.
- **“I am not a ‘citizen’ or a ‘person’ within the meaning of the Internal Revenue Code.”** A citizen of each of the 50 States (e.g., New York or California) of the United States and the District of Columbia is also a citizen of the United States.
- **“Citizens of States, such as New York, are citizens of a foreign country and therefore not subject to tax.”** Section 911 permits a taxpayer to elect to exclude income from U.S. income tax only when the taxpayer earns income and resides outside the United States under the conditions and limitations set forth in that section. For purposes of section 911, States (e.g., New York or California), Commonwealths, and Territories (e.g., Johnston Atoll) of the United States are not foreign countries.
- **“A taxpayer can escape income tax by putting assets in an offshore bank account.”** A citizen or resident of the United States cannot use an offshore arrangement (such as a foreign bank or brokerage account, or a credit card issued by a foreign bank) to avoid his tax obligations. In addition, taxpayers are required to disclose foreign financial accounts to the Treasury Department and may face civil and criminal penalties if they fail to do so.
- **“A taxpayer can eliminate tax by establishing a ‘corporation sole.’”** A taxpayer cannot avoid income tax by establishing a corporation sole for the purpose of avoiding tax on the taxpayer’s income. A corporation sole may be used only by a bona fide religious leader for specific, limited purposes relating to the religious leader’s office.
- **“A taxpayer can place all of his assets in a trust to escape income tax while still retaining control over those assets.”** A taxpayer who places assets in a trust but retains certain powers or interests over the assets, including the power to control the beneficial enjoyment of the assets, is treated as the owner of the assets and is subject to tax on the income from those assets.
- **“A taxpayer can deduct any amount paid to maintain his household by establishing a home business.”** Business expenses, including expenses related to a home-based business, are not deductible unless the expenses relate to a bona fide, profit-seeking business. Promoters of home-based business schemes improperly encourage taxpayers to claim household expenses as

business deductions although the purported home-business used in these schemes is not a bona fide trade or business.

- **“Nothing in the Internal Revenue Code section imposes a requirement to file a return.”** Section 6011 expressly authorizes the Service to require, by Treasury regulation, the filing of returns. Section 6012 identifies persons who are required to file income tax returns. Under Treasury regulations, taxpayers who receive more than the statutory minimum amount of gross income must file returns. Taxpayers also are required to pay any tax owed.
- **“Filing a tax return is ‘voluntary.’”** Some people mistake the word "voluntary" for "optional" -- but filing a tax return is not optional for those who meet the law's requirements. The word "voluntary," as used in IRS publications, refers to the fact that the U.S. tax system is a voluntary compliance system, which means that taxpayers themselves determine the correct amount of tax and complete the appropriate returns, rather than have the government determine tax for them. For those who do not comply with their tax obligations, the tax law authorizes various compliance measures.
- **“Because taxes are voluntary, as an employer, I don’t have to withhold income or employment taxes from my employees.”** Every taxpayer is responsible for completing and filing required returns and paying the correct amount of tax. An employer is required by law to withhold income and employment taxes from salary and wages paid to employees. Employers also must deposit the amounts withheld with the IRS.
- **“A taxpayer can refuse to pay taxes if the taxpayer disagrees with the government’s use of the taxes it collects.”** No law, including the Internal Revenue Code, permits a taxpayer to avoid or evade tax obligations on grounds that the taxpayer does not agree with the Government’s past or possible future use of the taxes collected.
- **“A taxpayer can avoid tax by filing a return that reports zero income and zero tax liability.”** All taxpayers who receive more than the statutory minimum amount of gross income must file returns and pay tax. No law, including the Internal Revenue Code, permits a taxpayer who has received wage and other income to file a return with zero income and zero tax liability.
- **“A taxpayer can escape income taxes or the tax system by filing a set of documents in lieu of a tax return.”** Taxpayers must file income tax returns using the forms prescribed by the Service. No law, including the Internal Revenue Code, permits a taxpayer to file a document or series of documents to remove himself from the income tax system.
- **“A taxpayer can avoid tax by filing a return with an attachment that disclaims tax liability.”** A return with an attached disclaimer of tax liability is not

a valid tax return under the law. Filing a disclaimer of tax may result in penalties for failure to file in addition to other applicable civil and criminal penalties.

- **“A taxpayer can file a return with an altered penalties of perjury statement to generate a tax refund.”** Alterations to an income tax return or to the penalties of perjury statement may nullify a return. Filing an altered document may result in penalties for failure to file in addition to other applicable civil and criminal penalties.
- **“Certain taxpayers can claim a ‘reparations tax credit’ to right wrongs done in the past.”** No law, including the Internal Revenue Code, permits a “reparations tax credit.”
- **“By purchasing equipment and services for an inflated price, a taxpayer can use the Disabled Access Credit to reduce tax or generate a refund.”** The Disabled Access Credit, which is limited to specific medical equipment, may only be claimed for amounts actually paid by a taxpayer. Promoters of this scheme improperly offer to sell equipment or services at highly inflated prices in order to generate a large credit. Taxpayers participating in this scheme, however, ultimately are not required to pay, and do not pay, the entire price stated in the sales contract.
- **“A taxpayer can deduct the amount of Social Security taxes under section 3121 that he paid and get a refund of those taxes.”** Section 3121 does not exclude wages from taxation and does not authorize a refund of Social Security taxes paid.
- **“A taxpayer may sell (or purchase) the right to use dependents in order to increase the amount of EIC claimed.”** A taxpayer may not purchase or sell the right to use additional dependents for purposes of the Earned Income Credit. To be claimed as a dependant, a child must be a qualifying child under the Earned Income Credit rules.

The Service and the federal courts also have repeatedly rejected variations of these arguments as well as numerous other tax avoidance schemes and frivolous arguments used by taxpayers to avoid or evade taxes.

SECTION 3 CIVIL AND CRIMINAL PENALTIES

Civil and criminal penalties may apply to taxpayers who make frivolous arguments. Potentially applicable civil penalties include: (1) the section 6651 additions to tax for failure to file a return, failure to pay the tax owed, and fraudulent failure to file a return; (2) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (3) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (4) a \$500 penalty under section 6702 for filing a frivolous return; and (5) a penalty

of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers who engage in tax-avoidance schemes also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201 for which the penalty is a fine of up to \$100,000 and imprisonment for up to 5 years; and (2) willful failure to file a return under section 7203 for which the penalty is a fine of up to \$25,000 and imprisonment of up to one year; and (3) making false statements on a return under section 7206 for which the penalty is a fine of up to \$100,000 and imprisonment for up to 3 years.

Persons who promote tax-avoidance schemes and those who assist taxpayers in claiming tax benefits based on a tax-avoidance scheme also may face penalties. Potential penalties include: (1) a \$250 penalty for each return prepared by an income tax return preparer who knew or should have known that the taxpayer's argument was frivolous (or \$1,000 for each return where the return preparer's actions were willful, intentional or reckless); (2) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (3) criminal prosecution under section 7206 for which the penalty is a fine of up to \$100,000 and imprisonment for up to 3 years for assisting or advising about the preparation of a false return or other document under the internal revenue laws. Promoters and others who assist taxpayers in engaging in these schemes also may be enjoined from doing so under section 7408.

SECTION 4 ADDITIONAL INFORMATION

Other information about frivolous tax positions is available on the Service website at www.irs.gov.

This notice was authored by the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this notice, contact that office on (202) 622-7800 (not a toll-free call).