

Part I – 1986 Code

Section 61

Rev. Rul. 2004-31

PURPOSE

The Service is aware that some individuals are attempting to reduce their federal income tax obligations by claiming that they have been “removed” or “redeemed” from the federal tax system. Although the specific arguments made by these individuals vary, some argue that the Government commits a fraud when it attempts to collect debts, including tax debts, and that this purported fraud allows individuals to “chargeback” debts that the Government purportedly owes to these individuals to eliminate any asserted tax liability. “Removal,” “redemption,” and “chargeback” schemes are referred to here collectively as “removal schemes” and “removal arguments.” Some promoters are marketing a package, kit, or other materials that claim to show individuals how they can avoid paying income taxes based on these and other meritless arguments.

This revenue ruling emphasizes to individuals, and to promoters and return preparers who assist individuals with these schemes, that there is no authority under any U.S. law that supports the argument that an individual can be “removed” or “redeemed” from the federal tax system to avoid tax liabilities or that an individual can satisfy debts, including tax liabilities, by making “chargeback” or other similar arguments. Removal and redemption arguments have no merit and are frivolous.

The Service is committed to identifying individuals who attempt to avoid or evade their tax obligations. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions. Frivolous returns and other similar documents submitted to the IRS are processed through the Service’s Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service also determines whether civil or criminal penalties should apply to return preparers, promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether a court injunction should be sought to halt such activities. Other information about frivolous tax positions is available on the Service website at www.irs.gov.

DISCUSSION OF REMOVAL AND REDEMPTION ARGUMENTS AND SCHEMES

Removal arguments and schemes are loosely related and take a variety of different forms. Proponents of removal arguments and schemes typically claim, even though they remain citizens or residents of the U.S., that they are not required to file federal tax returns and pay their tax obligations because they have been removed or redeemed from the federal tax system. As a result of participating in removal schemes, these individuals do not file required returns or pay the income tax that they owe.

In some variations of the removal argument, individuals claim that the Government commits a fraud when it attempts to collect debts, including tax debts, and that this purported fraud allows individuals to “chargeback” debts that the Government purportedly owes to these individuals to eliminate any liability to the Government. In other variations, individuals argue that Federal Reserve notes, or “paper money,” are not legal tender and that the Government has been wrongfully using taxpayers and their labor as security for the Government’s obligations. Other individuals argue that they may reclaim, or “chargeback,” their own value from the Government as a result of the Government’s wrongful conduct and then use that value to pay the individuals’ debts. Participants in removal schemes often attempt to offset, collect or “redeem” their asserted claims against the Government by using or filing liens, bills of exchange, and various Uniform Commercial Code (UCC) forms, or by relying on misinterpretations of federal laws and the Uniform Commercial Code.

Participants in the removal schemes may rely on one or more of the following erroneous arguments, alleged facts or actions to support their frivolous claims: (a) the bankruptcy of the United States occurred contemporaneously with the creation of the Federal Reserve, the start of the Great Depression, the removal of the United States from the gold standard, or the passage of House Joint Resolution 192 (claimed to be a declaration of bankruptcy); (b) the Government’s use of birth certificates of taxpayers as registered securities; (c) the filing of documents with variations on a taxpayer’s name, (e.g., using all capital letters in some documents and standard capitalization in others) creates a “straw man” or “nom de guerre” as the debtor to the Government that replaces the individual who has removed himself from the Government’s jurisdiction; (d) the “redemption” of debts from the Government by filing UCC forms, such as the UCC-1 form; (e) the submission of documents to the U.S. Secretary of the Treasury to establish a fictitious bank account (sometimes referred to as a “Treasury Direct Account”) where the value of charged back debts is located; (f) the practice of “accepting for value” official Government documents and the “charging back” of those documents by responding to them with a “private notice” that may include a “Treasury Direct Account Number,” a “Memory of Account Number” or a “Posted Certified Account Number”; and (g) the use of “Bills of Exchange,” Form UCC-3 and “Sight Drafts” to discharge debts to the Government. This list is not exclusive, however. Participants in removal schemes also make other equally frivolous arguments.

Instead of filing federal income tax returns with the Service, participants in removal schemes frequently send documents and other correspondence to the Service and other Government agencies. Examples of these documents include: improperly filed Forms 1040-ES, Estimated Tax for Individuals, reporting the location of the funds in

a fictitious bank account from which the IRS can collect taxes; improperly filed Fiduciary Tax Returns; improperly filed Forms 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business, reporting that a person or entity has “charged back” after “accepting for value” the Government’s documents; improperly filed Forms W-9, Request for Taxpayer Identification Number and Certification, to obtain a social security or employee identification number of a person or entity to include on the Form 8300; “commercial affidavits” in lieu of tax returns stating that the filer is a secured party and has no income for a particular year; and documents and correspondence to “accept for value” IRS notices of tax liens and levies to have the tax balances paid from the filer’s “Treasury Direct Account.”

There is no authority under any U.S. law that supports the claim that individuals may avoid their federal income tax obligations based on removal arguments such as those described in this revenue ruling. Similarly, there is no authority under any U.S. law that supports the claim that requiring payment of a debt owed to the Government by commercially acceptable means amounts to a fraud by the Government. Section 61 of the Internal Revenue Code provides that gross income includes all income from whatever source derived, including compensation for services. Adjustments to income, deductions, and credits must be claimed in accordance with the provisions of the Internal Revenue Code and the Treasury regulations thereunder and other applicable federal law. Section 6011 provides that any person liable for any tax imposed by the Internal Revenue Code shall make a return when required by Treasury regulations, and that returns must be in accordance with Treasury regulations and IRS forms. Section 6012 identifies the persons who are required to file income tax returns. Section 6151, except as specifically provided, requires that taxpayers pay their tax when the return is due. Section 6311 requires payment of taxes by commercially acceptable means as prescribed by Treasury Regulations.

Courts repeatedly have rejected removal arguments and other similar arguments as frivolous and have penalized taxpayers who make these types of arguments. See, e.g., United States v. Sloan, 939 F.2d 499, 500 (7th Cir. 1991) (affirming criminal conviction for tax evasion and rejecting “wholly defective” arguments that the federal tax laws did not apply to taxpayer because he was a “freeborn, natural individual, a citizen of the State of Indiana, and a ‘master’ - not – ‘servant’ of his Government”); United States v. Condo, 741 F.2d 238, 239 (9th Cir. 1984) (affirming criminal conviction for tax fraud and rejecting as “frivolous” the argument that Federal Reserve Notes are not valid currency, cannot be taxed, and are merely “debts”); United States v. Rickman, 638 F.2d 182, 184 (10th Cir. 1980) (affirming criminal conviction for willfully failing to file a return and rejecting the taxpayer’s argument that “the Federal Reserve Notes in which he was paid were not lawful money within the meaning of Art. 1, § 8, United States Constitution”).

Although individuals who rely on these removal arguments generally do not file federal income tax returns with the Service, some individuals also are relying on removal or similar frivolous arguments to claim that they can reduce or eliminate their

tax by filing tax returns in which they report zero income and tax liability. See Rev. Rul. 2004-34, I.R.B. 2004-12 (3/22/2004), for a discussion of this frivolous position.

CIVIL AND CRIMINAL PENALTIES

The Service will challenge the claims of individuals who attempt to avoid or evade their federal tax liability by refusing to file returns and pay tax on the basis that they have been removed or redeemed from the federal tax system. In addition to liability for the tax due plus statutory interest, individuals who fail to file and pay tax or who claim refunds based on this or any other frivolous arguments face substantial civil and criminal penalties. Potential civil penalties include: (1) the section 6651(f) penalty for fraudulent failure to file, which is up to 75 percent of the amount of taxes the taxpayer should have reported on the return ; (2) the section 6651(a)(1) penalty for failure to file, which is equal to up to 25 percent of the amount of taxes the taxpayer should have reported on the return; (3) the section 6651(a)(2) penalty for failure to pay, which is equal to .5 percent of the tax for each month or fraction of a month the tax remains unpaid, not to exceed a total of 25 percent; and; (4) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Individuals relying on this scheme 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; (2) willful failure to make a return or pay tax under section 7203 for which the penalty is up to \$25,000 and imprisonment of up to 1 year, or (3) making false statements 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 this scheme and those who assist taxpayers in claiming tax benefits based on this scheme also may face penalties. Potential penalties include: (1) a \$250 penalty under section 6694 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.

HOLDING

Individuals may not avoid or evade their tax liability by refusing to file returns and pay tax on the basis that they have been removed or redeemed from the federal tax system or by claiming that they can "chargeback" their debts to the Government. Arguments that individuals may be removed or redeemed from the federal tax system or may "chargeback" their debts to the Government have no merit and are frivolous.

Individuals who attempt to reduce their federal tax liability by taking frivolous positions based on these arguments will be liable for the actual tax due plus statutory interest. In addition, the Service will determine civil penalties against individuals where appropriate, and those individuals may also face criminal prosecution. The Service also will determine appropriate civil penalties against persons who prepare frivolous returns or promote frivolous positions, and those persons may also face criminal prosecution. Promoters and others who assist taxpayers in engaging in these schemes also may be enjoined from doing so under section 7408.

DRAFTING INFORMATION

This revenue ruling was authored by the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact that office on (202) 622-4940 (not a toll-free call).