

Part III - Administrative, Procedural, and Miscellaneous

Frivolous Arguments to Avoid When Filing a Return or Claim for Refund

Notice 2005-30

SECTION 1. INTRODUCTION.

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

Many abusive tax-avoidance schemes are based on frivolous arguments that the Service and the courts have repeatedly rejected. These schemes are often 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 some of the most common frivolous arguments used by these abusive 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 documents submitted to the Service are processed through its Frivolous Return Program. The Service also reviews

other documents that make frivolous arguments to determine whether the individuals who submit these documents 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 abusive 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 and consider taking other appropriate action against persons who promote these schemes and who prepare frivolous returns based on those schemes.

SECTION 2. COMMON FRIVOLOUS ARGUMENTS.

This section sets out some of the most common frivolous arguments used by taxpayers to avoid or evade tax.

- ***“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, from whatever source derived, must file returns and pay tax. No law, including the Internal Revenue Code, permits a taxpayer who has received wages or other income to file a return with zero income and zero tax liability. If a taxpayer has received income subject to federal tax, a return showing only zeroes for income and tax liability is not a valid return. Further, inclusion of the phrase “nunc pro tunc” or other legal jargon on an income tax return does not serve to validate an otherwise improper return.
- ***“A taxpayer may avoid income tax by referring to a separate ‘straw man’ entity created by the use of the taxpayer’s name in all capital letters in government documents.”*** No authority supports the claim that individuals may avoid their federal income tax obligations based on “straw man” arguments. The use of all uppercase letters when including an individual’s name in government documents has no significance whatsoever.
- ***“Wages are not taxable income, pursuant to section 1001, because***

taxpayers have basis in their labor equal to the fair market value of the wages they receive; thus, there is no gain to be taxed. All compensation received, no matter what the form of payment, must be included in gross income under section 61. This includes salary or wages paid in cash, as well as the value of property and other economic benefits received from services performed or to be performed in the future. Section 1001 governs gain or loss on the disposition of property, and has no application to compensation for services.

- ***“The 16th Amendment is invalid because it contradicts the original Constitution, was not properly ratified, and lacks an enabling clause.”*** The Sixteenth Amendment to the U.S. Constitution, which authorizes the income tax, was properly ratified by the states and is valid. Further, the argument that the Sixteenth Amendment is invalid due to the lack of an enabling clause is without merit because Congress has the power to lay and collect taxes pursuant to Article 1, Section 8, Clause 18 of the Constitution.
- ***“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 from gross income the value of his labor.
- ***“Only income from a foreign source is taxable under section 861.”*** Sections 861 through 865 do not exclude income from taxable income. 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 any one of the 50 States (e.g., New York, California) of the United States or of the District of Columbia is also a citizen of the United States and is subject to federal tax.
- ***“Residents of States, such as New York or California, are residents of a foreign country and therefore not subject to U.S. income tax.”*** Under its specific conditions and limitations, section 911 permits a taxpayer to elect to exclude income from U.S. taxable income only when the taxpayer earns income abroad and resides outside the geographic boundaries of the United States. For purposes of section 911, States (e.g., New York or California), the District of Columbia, and Commonwealths and Territories of the United States (e.g., Johnston Atoll) 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 financial arrangement (such as a foreign bank or brokerage account, or a credit card issued by a foreign bank) to avoid his federal tax obligations. 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.” A corporation sole may be used only by a legitimate 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 for federal tax purposes and is subject to tax on the income from those assets.
- **“A taxpayer can deduct amounts 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 legitimate profit-seeking trade or business. Promoters of home-based business schemes improperly encourage taxpayers to claim household expenses as business expense deductions when the purported home-based business is not a legitimate trade or business.
- **“Nothing in the Internal Revenue Code imposes a requirement to file a return.”** Section 6011 expressly authorizes the Service to require, by Treasury regulation, the filing of tax 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 income tax 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 minimum gross income requirements. The word “voluntary,” as used in IRS publications and elsewhere, refers to the fact that the U.S. tax system is a voluntary compliance system. This means only that taxpayers themselves determine the correct amount of tax and complete the appropriate returns, rather than have the government do this for them as is done in some other countries. This system of self-reporting does not make the filing of tax

returns or the payment of tax voluntary. For those who do not comply with this system and fail to self-report their tax liability, the tax law authorizes various enforced 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 Service.
- **“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 the grounds that the taxpayer does not agree with the Government’s past or possible future use of the taxes collected.
- **“A taxpayer can escape income taxes or the tax system by submitting 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 taxpayers to submit a document or series of documents to remove themselves 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.
- **“A taxpayer can avoid tax by filing a return with an altered penalties of perjury statement.”** Alterations to an income tax return or to the penalties of perjury statement may nullify a return.
- **“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 section 44 Disabled Access Credit, which is limited to expenses for specific medical equipment needed to make a business accessible to disabled individuals, may only be claimed for amounts actually paid by a taxpayer running a legitimate business. Promoters of this scheme improperly offer to sell equipment or services at 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.

- ***“Under section 3121 taxpayers can deduct the amount of Social Security taxes paid or get a refund of those taxes.”*** The Internal Revenue Code imposes Social Security tax on wages as defined in section 3121. Aside from the narrow exception for a religious exemption under section 3127, a taxpayer may not exclude wages from Social Security taxation on the basis that the taxpayer is waiving the right to receive Social Security benefits, and the Code does not authorize a deduction for, or refund of, Social Security taxes paid.
- ***“A taxpayer may sell (or purchase) the right to claim a child as a qualifying child for purposes of the EIC.”*** A taxpayer may not purchase or sell the right to claim a child as a qualifying child for purposes of the earned income credit (EIC). In order to claim a child as a qualifying child for purposes of the EIC, the child must meet specific relationship, residency and age requirements.

The Service and the courts have repeatedly rejected these arguments and variations on them, and have rejected 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 income tax 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 take frivolous positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which the penalty is a significant fine and imprisonment for up to 5 years; (2) willful failure to file a return under section 7203, for which the penalty is a fine of up to \$25,000 and imprisonment for up to one year; and (3) making false statements on a return, statement, or other document under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years.

Persons, including return preparers, who promote frivolous positions and those who assist taxpayers in claiming tax benefits based on frivolous positions may face penalties and may be enjoined by a court pursuant to sections 7407 and 7408. Potential penalties include: (1) a \$250 penalty under section 6694 for each return or claim for refund prepared by an income tax return preparer who knew or should have known that the taxpayer's position was frivolous (or \$1,000 for each return or claim for refund if the return preparer's actions were willful, intentional or reckless); (2) a penalty under section 6700 for promoting abusive tax shelters; (3) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (4) criminal prosecution under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years for assisting or advising about the preparation of a false return, statement or other document under the internal revenue laws.

SECTION 4. EFFECT ON OTHER DOCUMENTS.

Notice 2004-22 is modified and superseded.

SECTION 5. ADDITIONAL INFORMATION.

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

The principal author of this notice is the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact that office at (202) 622-7800 (not a toll-free call).