

Part I – 1986 Code

Section 61

Rev. Rul. 2004-34

PURPOSE

The Service is aware that some taxpayers are attempting to reduce their federal income tax liability by filing a return that reports no income and no tax liability (a “zero return”) even though they have taxable income. A taxpayer filing a zero return invariably requests a refund of any taxes withheld by an employer. The Service also is aware that promoters, including return preparers, are advising or recommending that taxpayers take this frivolous position. Some promoters may be marketing a package, kit, or other materials that claim to show taxpayers how they can avoid paying income taxes based on this and other frivolous arguments.

This revenue ruling emphasizes to taxpayers, and to promoters and return preparers who assist taxpayers with these schemes, that a taxpayer cannot avoid income tax by filing a zero return. The zero return position has no merit and is frivolous.

The Service is committed to identifying taxpayers who attempt to avoid or evade their tax obligations by taking frivolous positions, such as the filing of a zero return. 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 Service are processed through its 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 against 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 THE ZERO RETURN POSITION

Proponents of the zero return position file income tax returns that report no income and no tax liability even though these taxpayers have wages, salary or other income. Taxpayers taking this position typically attach to the zero return a Form W-2 or other information return that reports income and income tax withholding and request refunds from the Service of the withheld taxes. These taxpayers typically rely on one or more frivolous arguments to support the position that wage or other income is not

subject to tax. See, e.g., Rev. Rul 2004-31, I.R.B. 2004-12 (March 22, 2004) and Notice 2004-22, I.R.B. 2004-12 (March 22, 2004).

There is no authority under U.S. law that permits a taxpayer that has taxable income to avoid income tax by filing a zero return. The claim that the filing of a zero return will allow a taxpayer to avoid income tax liability, or will permit a refund of any tax withheld by an employer, is frivolous. 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 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 1.6011-1(b) of the Treasury Regulations provides, in relevant part, that each taxpayer should set forth fully and clearly the information required to be included on the return. Section 6012 identifies the persons who are required to file income tax returns.

Courts repeatedly have penalized taxpayers who filed zero returns despite having income sufficient to give rise to a tax liability and have rejected frivolous arguments used by taxpayers to justify a zero return position. See, e.g., Gillett v. United States, 233 F. Supp. 2d 874 (W.D. Mich. 2002) (“Numerous federal courts have upheld the imposition of the \$500 sanction by the IRS pursuant to 26 U.S.C. § 6702(a) [for frivolous returns], where, as here, a tax form is filed stating that an individual had no income, but the attached W-2 forms show wages, tips, or other compensation of greater than zero.”); Hill v. Commissioner, T.C. Memo. 2003-144 (imposing \$15,000 penalty under section 6673 for frivolous “zero return” position); Rayner v. Commissioner, T.C. Memo. 2002-30 (imposing \$5,000 penalty under section 6673 for frivolous “zero return” position).

CIVIL AND CRIMINAL PENALTIES

The Service will disallow any refund claim based on the filing of a zero return and will determine the correct amount of tax due from the taxpayer. The Service also will seek the return of any erroneous refund resulting from a zero return. In addition to liability for tax due plus statutory interest, individuals who claim tax benefits on their returns based on this and other frivolous arguments face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (2) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (3) a \$500 penalty under section 6702 for filing a frivolous return; and (4) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers 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; or (2) 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 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 an understatement of tax; and (3) criminal prosecution under section 7206 for which the penalty is 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

A taxpayer cannot use a zero return to avoid or evade the taxpayer's federal income tax liability. Taxpayers attempting to avoid or evade their federal tax liability by taking frivolous positions will be liable for the actual tax due plus statutory interest. In addition, the Service will determine civil penalties against taxpayers where appropriate, and those taxpayers may also face criminal prosecution. The Service also will determine appropriate 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).