

Frivolous Tax Arguments

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Frivolous Tax Arguments

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Frivolous Tax Arguments

Introduction

The Internal Revenue Service (IRS) has issued guidance and tax information identifying numerous frivolous arguments made by taxpayers regarding the filing of their federal income tax returns and raised during various legal proceedings. These “frivolous tax arguments” are generally labeled by the IRS as “contentions”. Various “contentions” are raised not only in judicial proceedings, but also in administrative law proceedings; such as Collection Due Process (CDP) proceedings, Offer-in-Compromise (OIC) cases, Examination/Audit proceedings and other administrative/legal arenas. This presentation is designed to explain and discuss many of the current “frivolous tax arguments” (contentions) as well as the severe “penalties” associated with these illegal positions regarding federal tax matters. The Government has established, through various court proceedings and via the issuance of legal memorandums, revenue rulings and other legal mediums, the illegal status of these “contentions” and has demonstrated that these contentions have no basis for validity in existing law. And most of these contentions, if not all, have been deemed frivolous by the United States Tax Court and other federal courts as well.

One particular court case provided a simple explanation of individuals who make frivolous tax arguments as follows, *“Like moths to a flame, some people find themselves irresistibly drawn to the tax protestor movement’s illusory claim that there is no legal requirement to pay federal income tax. And, like moths, these people sometimes get burned.”*¹

¹ United States v. Sloan, 939 F. 2d 499, 499-500 (7th Cir. 1991)

Frivolous Tax Argument in General: “Contentions”

As stated above, the IRS has classified various “frivolous tax arguments” as “contentions”. For example, some taxpayers assert that they are not required to file federal tax returns because the filing of a tax return is voluntary. However, the legal system has consistently dispelled this notion via judicial proceedings, nonetheless the “moths” keep coming. Some of the most common “contentions” are as follows:

The Voluntary Nature of the Federal Income Tax System

- “The filing of a tax return is voluntary”
- “Payment of a tax return is voluntary”
- “Taxpayers can reduce their federal income tax liability by filing a zero return”
- “The IRS must prepare federal tax returns for a person who fails to file”
- Compliance with an administrative summons issued by the IRS is voluntary”

The Meaning of Income: Taxable Income & Gross Income

- “Wages, tips & other compensation received for personal services are not income”
- “Only foreign-source income is taxable”
- “Federal Reserve Notes are not income”
- “Military retirement pay does not constitute income”

The Meaning of Certain Terms Used via the IRC

- “Taxpayer is not citizen of the United States, and thus is not subject to the federal income tax laws”
- “The United States consists only of the District of Columbia, federal territories, and federal enclaves”
- “Taxpayer is not a person as defined by the IRC, thus is not subject to the federal income tax laws”
- “The only employees subject to federal income are employees of the federal government”

Constitutional Amendment Claims

- “Taxpayers can refuse to pay income taxes on religious or moral grounds by invoking the First Amendment”
- “Federal income taxes constitute a taking of property without due process of law, violating the Fifth Amendment”
- “Taxpayers do not have to file returns or provide financial information because of the protection against self-incrimination found in the Fifth Amendment”
- “Compelled compliance with the federal income tax laws is a form of servitude in violation of the Thirteenth Amendment”
- “The federal income tax laws are unconstitutional because the Sixteenth Amendment to the United States Constitution was not properly ratified”
- The Sixteenth Amendment does not authorize a direct non-apportioned federal income tax on United States citizens”

Fictional Legal Bases

- “The Internal Revenue Service is not an agency of the United States”
- “Taxpayers are not required to file a federal income tax return, because the instructions and regulations associated with the Form 1040 do not display an OMB control number as required by the Paperwork Reduction Act”
- “African Americans can claim a special tax credit as reparations for slavery and other oppressive treatment”
- “Taxpayers are entitled to a refund of the Social Security taxes paid over their lifetime”
- “An un-taxing package or trust provides a way of legally and permanently avoiding federal income taxes”
- “A corporation sole can be established and used for the purpose of avoiding federal income taxes”
- “Taxpayers who did not purchase and use fuel for an off-highway business can claim the fuels tax credit”
- “A Form 1099-OID can be used as a debt payment option or a purported financial instrument to obtain money from the Treasury”

Frivolous Tax Argument in Collection Due Process (CDP) Cases: “Contentions”

As noted above, the IRS has classified and identified numerous “frivolous tax arguments” as general “contentions”. However, the IRS created a separate classification system for “CDP frivolous arguments”. Although frivolous arguments have the same effect on the tax system, the IRS and the Treasury Department believe CDP frivolous arguments carry a different weight regarding federal tax matters. These CDP frivolous tax arguments (contentions) are as follows:

Invalidity of the Assessment

- “A tax assessment is invalid because (1) the taxpayer did not get a copy of the Form 23-C, (2) the Form 23C was not personally signed by the Secretary of the Treasury, or (3) a form other than Form 23C is not a valid record of assessment”
- “A tax assessment is invalid because the assessment was made from a substitute for return prepared pursuant to IRC §6020(b), which is not a valid return”

Invalidity of the Statutory Notice of Deficiency

- “A statutory notice of deficiency is invalid because it was not signed by the Secretary of the Treasury or by someone with delegated authority”
- “A statutory notice of deficiency is invalid because the taxpayer did not file an income tax return”

Invalidity of a Notice of Federal Tax Lien

- “A notice of federal tax lien is invalid because it is unsigned or not signed by the Secretary of the Treasury, or because IRS employees lack the delegated authority to file a notice of federal tax lien”
- “The form or content of a notice of federal tax lien is controlled by or subject to a state or local law, and a notice of federal tax lien that does not comply in form or content with a state or local law is invalid”

Invalidity of a Notice of Federal Tax Lien

- “A collection due process notice (e.g., Letter 1058, LT-11 or Letter 3172) is invalid because it is not signed by the Secretary or his delegate”
- “A collection due process notice is invalid because no certificate of assessment is attached”

Verification Given as Required by IRC §6330(c)(1)

- “Verification requires the *production of certain documents*”

Invalidity of Statutory-Notice & Demand

- “No notice and demand, as required by *IRC §6303*, was ever received by the taxpayer”
- “A *notice & demand* is invalid because (1) it is not signed, (2) it is not on the correct form (such as Form 17), or (3) because no certificate of assessment is attached”

Tax Court Authority

- “The Tax Court *does not have the authority* to decide legal issues”
- “A *notice & demand* is invalid because (1) it is not signed, (2) it is not on the correct form (such as Form 17), or (3) because no certificate of assessment is attached”

Challenges to the Authority of IRS Employees

- “Revenue Officers *are not authorized* to seize property in satisfaction of unpaid taxes”
- “IRS employees *lack credentials*. For example, they have no pocket commission or the wrong color identification badge”

Use of Unauthorized Representatives

- “Taxpayers are entitled to be represented at hearings, such as collection due process hearings, and in court, by *persons without valid powers of attorney*”

No Authority Under IRC §

- “The Secretary has *not authorized an action for the collection of taxes and penalties* or the Attorney General has not directed an action be commenced for the collection of taxes and penalties”

As outlined above, these “contentions” are numerous and are varied in content and illegal basis. However, as the 7th Circuit Court indicated, “the moths keep coming”. Now that we’ve identified a number of the “frivolous arguments” presented to the Courts and the IRS by wayward taxpayers, the next section describes the various penalties, fines & prosecution that may be subject to related to these inappropriate “contentions”.

IRC §6702(c) requires that the list of frivolous arguments noted above (as well as others not identified in this text) be periodically revised and recognized.

Frivolous Tax Argument: Civil Penalties

The IRS has and will continue to challenge the “contentions” of individuals who inappropriately attempt to avoid or evade their federal tax liabilities by making “frivolous tax arguments”. These taxpayers are subject to “additional tax liability”, as well as statutory penalty and interest assessments. Generally, taxpayers fail to file valid returns or they pay federal income tax based upon arguments that state that “wages and other compensation for personal services are exempt from federal income tax”. Those taxpayers that continue to present such arguments are subject to substantial civil and criminal penalties.

Potential Civil Penalties include:

- (1) IRC §6662, “Imposition of Accuracy-Related Penalty on Underpayments”, which is calculated at 20 percent of the proper amount of tax due by the taxpayer
- (2) IRC §6663, Civil Fraud Penalty, which is calculated at 75 percent of the amount of tax the taxpayer should have paid
- (3) **IRC §6702(a)**, “Civil Penalty for Frivolous Tax Return”, which is assessed at \$5,000 per occurrence if a person files what purports to be a return of a tax imposed by this title but which
 - Does not contain information on which the substantial correctness of the self-assessment may be judged, or
 - Contains information that on its face indicates that the self-assessment is substantially incorrect.
- (4) **IRC §6702(b)**, “Penalty for Specified Frivolous Submission”, which is also assessed at \$5,000 for each specified frivolous submission submitted by a taxpayer. The term “specified frivolous submission” means:
 - A specified submission if any portion of such submission is based on a position which the Secretary has identified as frivolous, or
 - That reflects a desire to delay or impede the administration of Federal tax laws.
- (5) IRC §6651, assessed for Failure to File, Failure to Pay, & Fraudulent Failure to File a Tax Return
- (6) IRC §6673, imposes a penalty of up to \$25,000 for frivolous tax arguments raised in the United States Tax Court, and;
- (7) IRC §6682, Penalty for Providing False Information, which is assessed at \$500 for providing false information with respect to federal income tax withholding

Frivolous Tax Argument: Criminal Penalties

Potential Criminal Penalties include:

- (1) IRC §7201-The taxpayer is subject to a significant fine, penalty and/or up to five years in federal prison for attempting to evade or defeat a tax
- (2) IRC §7203-The taxpayer is subject to a significant fine, penalty and/or up to one year in federal prison for willful failure to file a tax return
- (3) IRC §7206(a)-The taxpayer is subject to a significant fine, penalty and/or up to three years in federal prison for making false statements via a tax return, statement, or other document

Frivolous Tax Argument: Practitioner Penalties

Individuals, including tax return preparers and other individuals who promote frivolous arguments as well as individuals who assist taxpayers in claiming various tax benefits based on frivolous arguments, are subject to civil and potentially criminal penalties. Also, pursuant to IRC §7407 & IRC §7408, these individuals may also be enjoined by a court from preparing federal tax returns and/or enjoined from professionally participating in federal tax administrative or judicial proceedings. Potential penalties regarding these type individuals are as follows:

Potential Preparer/Promoter Penalties include:

- (1) IRC §6694-“Understatement of Taxpayer’s Liability by Tax Return Preparer”
IRC §6694(a)-Imposes a penalty which is the greater of \$1,000 or 50% of the income derived (or expected to be derived) by the return preparer for each return or claim based upon an “understatement of tax due to an unreasonable position”;

IRC §6694(b)-Imposes a penalty which is the greater of \$5,000 or 50% of the income derived (or expected to be derived) by the return preparer for each return or claim where the understatement of tax was due to “willful or reckless” conduct
- (2) IRC §6700, “Promoting Abusive Tax Shelters, Etc.”- Imposes a penalty equal to the \$1,000 or if the person establishes that it is lesser, 100 % of the gross income derived (or to be derived) by such person from such activity.
- (3) IRC §6701, “Penalties for Aiding & Abetting Understatement of Tax Liability” Imposes a \$1,000 penalty for aiding and abetting the understatement of tax, and;
- (4) IRC §7206, “ Fraud & False Statements”- Imposes a penalty of not more than \$100,000 (\$500,000 for corporations) and/or imprisonment for up to 3 years for assisting or advising with respect to the preparation of a false return, statement or other document under federal tax law.

Frivolous Positions **“NOTICE 2007-30”**

Purpose

Positions that are the same as or similar to the positions listed in this notice are identified as frivolous for purposes of the penalty for a “frivolous tax return” under section 6702(a) of the Internal Revenue Code and the penalty for a “specific frivolous submission” under section 6702(b). Persons who file a purported return of tax, including an original or amended return, based on one or more of these purported return of tax, including an original or amended return, based on one or more of these positions are subject to a penalty of \$5,000 if the purported return of tax does not contain information on which the substantial correctness of the self-assessed determination of tax may be judged or contains information that on its face indicates the self-assessed determination of tax may be judged or contains information that on its face indicates the self-assessed determination of tax is substantially incorrect. Likewise, persons who submit a “specified submissions” (namely, a request for a collection due process hearing or an application for an installment agreement, offer-in-compromise, or Taxpayer Assistance Order) based on one or more of the positions listed in this notice are subject to a penalty of \$5,000. The penalty may also be applied if the purported return or any portion of the specified submission is not based on a position set forth in this notice, yet reflects a desire to delay or impede the administration of federal tax laws for purposes of section 6702(a)(B) or 6702(b)(2)(A)(ii).

Background

Section 407 of the “*Tax Relief and Health Care Act of 2006*”, Pub. L. No. 109-432, 120 Stat. 2922 (2008), amended section 6702 to increase the amount of the penalty for frivolous tax returns from \$500 to \$5,000 and to impose a penalty of \$5,000 on any person who submits a “specified frivolous submission.” A submission is a “specified frivolous submission” if it is a “specified submission” (defined in section 6702(b)(2)(B) as a request for a hearing under section 6320 or 6330 or an application under section 6159, 7122 or 7811) and any portion of the submission: (i) is based on a position identified by the secretary as frivolous, or (ii) reflects a desire to delay or impede administration of the federal tax laws. Section 6702 was further amended to add a new subsection (c) requiring the secretary to prescribe a list of positions identified as frivolous. This notice contains the prescribed list.

Discussion

Frivolous Positions. Positions that are the same as or similar to the following are frivolous.

1. Compliance with the internal revenue laws is voluntary or optional and not required by law, including arguments that:
 - a. Filing a federal tax or information return or paying tax is voluntary under the law, or similar arguments described as frivolous in Rev. Rul. 2007-20.
 - b. Noting in the Internal Revenue Code imposes a requirement to file a return or pay tax, or that a person is not required to file a tax return or pay a tax unless the Internal Revenue Service responds to the person's questions, correspondence, or a request to identify a provision in the Code requiring the filing of a return or the payment of tax.
 - c. There is no legal requirement to file a federal income tax return because the instructions to Forms 1040, 1040A, or 1040EZ or the Treasury regulations associated with the filing of the forms do not display an OMB control number as required by the Paperwork Reduction Act of 1980, 44 U.S.C. § 3501 *et seq.*, or similar arguments described as frivolous in Rev. Rul. 2006-21.
 - d. Because filing a tax return is not required by law, the Service must prepare a return for a taxpayer who does not file one in order to assess and collect tax.
 - e. A taxpayer has an option under the law to file a document or set of documents in lieu of a return or elect to file a tax return reporting zero taxable income and zero tax liability even if the taxpayer received taxable income during the taxable period for which the return is filed, or similar arguments described as frivolous in Rev. Rul. 2004-34.
 - f. An employer is not legally obligated to withhold income or employment taxes on employees' wages.
 - g. A taxpayer may "untax" himself or herself at any time or revoke the consent to be taxed and thereafter not be subject to internal revenue taxes.
 - h. Only persons who have contracted with the government by applying for a governmental privilege or benefit, such as holding a social security number, are subject to tax, and those who have contracted with the government may choose to revoke the contract at will.
 - i. A taxpayer may lawfully decline to pay taxes if the taxpayer disagrees with the government's use of tax revenues, or similar arguments described as frivolous in Rev. Rul. 2005-20.
 - j. An administrative summons issued by the Service is *per se* invalid and compliance with a summons is not legally required.

2. The Internal Revenue Code is not law (or "positive law") or its provisions are ineffective or inoperative, including the sections imposing an income tax or requiring the filing of tax returns, because the provisions have not been implemented by regulations even though the provisions in question either: (a) do not expressly require the Secretary to issue implementing regulations to become effective, or (b) expressly require implementing regulations which have been issued.

3. A taxpayer's income is excluded from taxation when the taxpayer rejects or renounces United States citizenship because the taxpayer is a citizen exclusively of a state (sometimes characterized as a "natural-born citizen" of a "sovereign state"), that is claimed to be a separate country or otherwise not subject to the laws of the United States. This position includes the argument that the United States does not include all or a part of the physical territory of the 50 States and instead consists of only places such as the District of Columbia, Commonwealths and Territories (*e.g.*, Puerto Rico), and Federal enclaves (*e.g.* Native American reservations and military installations), or similar arguments described as frivolous in 'Rev. Rul. 2004-28 or Rev. Rul. 2007-22.
4. Wages, tips, and other compensation received for the performance of personal services are not taxable income or are offset by an equivalent deduction for the personal services rendered, including an argument that a taxpayer has a "claim of right" to exclude the cost or value of the taxpayer's labor from income or that taxpayers have a basis in their labor equal to the fair market value of the wages they receive, or similar arguments described as frivolous in Rev. Rul. 2004-29 or Rev. Rul. 2007-19.
5. United States citizens and residents are not subject to tax on their wages or other income derived from sources within the United States, as only foreign-based income or income received by nonresident aliens and foreign corporations from sources within the United States is taxable, and similar arguments described as frivolous in Rev Rul. 2004-30.
6. A taxpayer has been removed or redeemed from the federal tax system though the taxpayer remains a United States citizen or resident or similar arguments described as frivolous in Rev. Rul. 2004-31.
7. Only certain types of taxpayers are subject to income and employment taxes, such as employees of the federal government, corporations, nonresident aliens, or residents of the District of Columbia or the federal territories, or similar arguments described as frivolous in Rev. Rul. 2006-18.
8. Only certain types of income are taxable, for example, income that results from the sale of alcohol, tobacco, or firearms or from transactions or activities that take place in interstate commerce.
9. Federal income taxes are unconstitutional or a taxpayer has a constitutional right not to comply with the federal tax laws for one of the following reasons:
 - a. The First Amendment permits a taxpayer to refuse to pay taxes based on religious or moral beliefs.
 - b. A taxpayer may withhold payment of taxes or the filing of a tax return until the Service or other government entity responds to a First Amendment petition for redress or grievances.
 - c. Mandatory compliance with, or enforcement of, the tax laws invades a taxpayer's right to privacy under the Fourth Amendment.
 - d. The requirement to file a tax return is an unreasonable search and seizure contrary to the Fourth Amendment.

- e. Income taxation, tax withholding due process of law or just compensation in violation of the Fifth Amendment.
 - f. The Fifth Amendment privilege against self-incrimination grants taxpayers the right not to file returns or the right to withhold all financial information from the Service.
 - g. Mandatory or compelled compliance with the internal revenue laws is a form of involuntary servitude prohibited by the Thirteenth Amendment.
 - h. Individuals may not be taxed unless they are “citizens” within the meaning of the Fourteenth Amendment.
 - i. The Sixteenth Amendment was not ratified, has no effect, contradicts the Constitution as originally ratified, lacks an enabling clause, or does not authorize a non-apportioned, direct income tax.
 - j. Taxation of income attributed to a trust, which is a form of contract, violates the constitutional prohibition against impairment of contracts.
 - k. Similar constitutional arguments described as frivolous in Rev. Bul. 2005-19.
10. A taxpayer is not a “person” within the meaning of section 7701(a)(14) or other provisions of the Internal Revenue Code, or similar arguments described as frivolous in Rev. Rul. 2007-22.
 11. Federal Reserve Notes are not taxable income when paid to a taxpayer because they are not gold or silver and may not be redeemed for gold or silver.
 12. In a transaction using gold or silver coins, the value of the coins is excluded from income or the amount realized in the transaction is the face value of the coins and not their fair market value for purposes of determining taxable income.
 13. A taxpayer with a home-based business may deduct as business expenses the costs of maintaining the taxpayer’s household along with personal expenses, or similar arguments described as frivolous by Rev. Bul. 2004-32.
 14. A “reparations” tax credit exists, including arguments that African-American taxpayers may claim a tax credit on their federal income tax returns as reparations for slavery or other historical mistreatment, that Native Americans are entitled to an analogous credit (or are exempt from federal income tax on the basis of a treaty), or similar arguments described as frivolous in Rev. Rul. 2004-33 or Rev. Rul. 2006-20.
 15. A Native American or other taxpayer who is not an employer engaged in a trade or business may nevertheless claim (for example, in an amount exceeding all reported income) the Indian Employment Credit under section 45A, which explicitly requires, among other criteria, that the taxpayer be an employer engaged in a trade or business to claim the credit.
 16. A taxpayer’s wages are excluded from social security taxes if the taxpayer waives the right to receive social security benefits, or a taxpayer is entitled to a refund of, or may claim a charitable-contribution deduction for, the social security taxes that the taxpayer has paid, or similar arguments described as frivolous in Rev. Rul. 2005-17.

17. Taxpayers may reduce or eliminate their federal tax liability by altering a tax return, including striking out the penalty-of-perjury declaration, or attaching documents to the return, such as a disclaimer of liability, or similar arguments described as frivolous in Rev. Rul. 2005-18.
18. A taxpayer is not obligated to pay income tax because the government has created an entity separate and distinct from the taxpayer - a “straw man” - that is distinguishable from the taxpayer by some variation of the taxpayer’s name, and any tax obligations are exclusively those of the “straw man,” or similar arguments described as frivolous in Rev. Rul. 2005-21.
19. Inserting the phrase “nunc pro tunc” on a return or other document filed with or submitted to the Service has a legal effect, such as reducing a taxpayer’s tax liability, or similar arguments described as frivolous in Rev. Rul. 2006-17.
20. A taxpayer may avoid tax on income by attributing the income to a trust, including the argument that a taxpayer can put all of the taxpayer’s assets into a trust to avoid income tax while still retaining substantial powers of ownership and control over those assets or that a taxpayer may claim an expense deduction for the income attributed to a trust, or similar arguments described as frivolous in Rev. Rul. 2006-19.
21. A taxpayer may lawfully avoid income tax by sending income offshore, including depositing income into a foreign bank account.
22. By purchasing equipment and services for an inflated price (which may or may not have been actually paid), a taxpayer can use the section 44 Disabled Access Credit to reduce tax or generate a refund irrespective of whether the taxpayer is a small business that purchased the equipment or services to comply with the requirements of the Americans with Disabilities Act.
23. A taxpayer is allowed to buy or sell the right to claim a child as a qualifying child for purposes of the Earned Income Tax Credit.
24. An IRS Form 23C, *Assessment Certificate - Summary Record of Assessments*, is an invalid record of assessment for purposes of section 6203 and Treas. Reg. § 301.6203-1, the Form 23C must be personally signed by the Secretary of the Treasury for an assessment to be valid, the Service must provide a copy of the Form 23C to a taxpayer if requested before taking collection action, or similar arguments described as frivolous in Rev. Rul. 207-21.
25. A tax assessment is invalid because the assessment was made from a section 6020(b) substitute for return, which is not a valid return.
26. A statutory notice of deficiency is invalid because the taxpayer to whom the notice was sent did not file an income tax return reporting the deficiency or because the statutory notice of deficiency was unsigned or not signed by the Secretary of the Treasury or by someone with delegated authority.

27. A Notice of Federal Tax Lien is invalid because it is not signed by a particular official (such as by the Secretary of the Treasury), or because it was filed by someone without delegated authority.
28. The form or content of a Notice of Federal Tax Lien is controlled by or subject to a state or local law, and a Notice of Federal Tax Lien that does not comply in form or content with a state or local law is invalid.
29. A collection due process notice under section 6320 or 6330 is invalid if it is not signed by the Secretary of the Treasury or other particular official, or if no certificate of assessment is attached.
30. Verification under section 6330 that the requirements of any applicable law or administrative procedure have been met may only be based on one or more particular forms or documents (which must be in a certain format), such as a summary record of assessment, or that the particular forms or documents or the ones on which verification was actually determined must be provided to a taxpayer at a collection due process hearing.
31. A Notice and Demand is invalid because it was not signed, was not on the correct form (*e.g.*, a Form 17), or was not accompanied by a certificate of assessment when mailed.
32. The United States Tax Court is an illegitimate court or does not, for any purported constitutional or other reason, have the authority to hear and decide matters within its jurisdiction.
33. Federal courts may not enforce the internal revenue laws because their jurisdiction is limited to admiralty or maritime cases or issues.
34. Revenue Officers are not authorized to issue levies or Notices of Federal Tax Lien or to seize property in satisfaction of unpaid taxes.
35. A Service employee lacks the authority to carry out the employee's duties because the employee does not possess a certain type of identification or credential, for example, a pocket commission or a badge, or it is not in the correct form or on the right medium.
36. A person may represent a taxpayer before the Service or in court proceedings even if the person does not have a power of attorney from the taxpayer, has not been enrolled to practice before the Service, or has not been admitted to practice before the court.
37. A civil action to collect unpaid taxes or penalties must be personally authorized by the Secretary of the Treasury and the Attorney General.
38. A taxpayer's income is not taxable if the taxpayer assigns or attributes the income to a religious organization (a "corporation sole" or trust) claimed to be tax-exempt under section 501(c)3, or similar arguments described as frivolous in Rev. Rul. 2004-27.

39. The Service is not an agency of the United States government but rather a private-sector corporation or an agency of a state or territory without authority to administer the internal revenue laws.
40. Any position described as frivolous in any revenue ruling or other published guidance in existence when the return adopting the position is filed with or the specified submission adopting the position is submitted to the Service.

Returns or submissions that contain positions not listed above, which on their face have no basis for validity in existing law, or which have been deemed frivolous in a published opinion of the United States Tax Court or other court of competent jurisdiction, may be determined to reflect a desire to delay or impede the administration of federal tax laws and thereby subject to the \$5,000 penalty.

IRS Revenue Rulings-Frivolous Tax Arguments

Revenue Rulings provide “guidance” and “clarification” of specific tax matters regarding federal tax matters and are considered “official pronouncements” of the IRS. More importantly, Revenue Rulings also represent the IRS’s “interpretation” of federal tax law. However, Revenue Rulings *are not* a direct extension of the lawmaking powers of Congress; accordingly Revenue Rulings do not carry the same authority as Treasury Regulations, and Revenue Rulings are limited to a given set of facts and circumstances of their transactions. However, Revenue Rulings include the Government’s “basis & analysis” of the law with respect to the subject of the Rev. Rul. With respect to “frivolous tax arguments”, and for the purposes of this presentation, we will focus on four major/relative Revenue Rulings concerning these critical tax issues as follows:

Revenue Rulings (Rev. Rul.)

- Rev. Rul.-2007-19
- Rev. Rul.-2007-20
- Rev. Rul.-2007-21
- Rev. Rul.-2007-22

The Rev. Rul’s referenced above address four specific “frivolous tax arguments as follows:

- Frivolous tax arguments asserting the position that “*wages are not taxable income*”.
- Frivolous tax arguments asserting the position that the “*filing returns and the payment of federal income taxes are voluntary*”.
- Also, the frivolous that “the IRS must provide taxpayers with a summary record of assessment made on a *Form 23C, Assessment Certificate-Summary Record of Assessments*, before overdue taxes may be collected”, and;
- The frivolous tax position that “income is not subject to taxation when the taxpayer declares that *he is not a United States citizen* because he is a citizen of an individual state or claims he is not a person as defined by the Internal Revenue Code”.

REV. RUL. 2007-19

Purpose

The Internal Revenue Service (Service) is aware that some taxpayers are attempting to reduce or eliminate their federal income tax liability by claiming that compensation received in exchange for personal services is not taxable income. These taxpayers often attempt to avoid their federal income tax liability by failing to file federal income tax returns or by failing to report all income from wages or other compensation on their federal income tax return. They often furnish Forms W-4, *Employee's Withholding Allowance Certificate*, on which they claim excessive withholding allowances or claim complete exemption from withholding. In addition, they often claim deductions from gross income for personal, living and family expenditures in order to reduce the tax liability related to wages or other compensation.

The Service is aware that some promoters and return preparers are advising or recommending that taxpayers take these or other meritless positions. This revenue ruling emphasizes to taxpayers, promoters and return preparers that wages and other compensation received in exchange for personal services are taxable income subject to federal income tax. Any argument that such compensation is not taxable income has no merit and is frivolous.

The Service is committed to identifying taxpayers who attempt to avoid their federal tax obligations by taking frivolous positions. 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 the Service's Frivolous Return Program. As part of this program, the Service determines whether taxpayers who have taken frivolous positions have filed all required tax returns; computes the correct amount of tax and interest due; and determines whether civil or 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 an injunction should be sought to halt these activities.

Issues

Whether Taxpayer A may avoid federal income tax liability by maintaining that the Internal Revenue Code does not tax wages or other compensation received in exchange for personal services.

Facts

Taxpayer A receives wages in exchange for personal services. Taxpayer A then does one or more of the following: (1) furnishes a Form W-4 to the employer on which Taxpayer A claims excessive withholding allowances a or claims complete exemption from withholding; (2) fails to file a federal income tax return; (3) fails to report the wages on the federal tax return; (4) claims a refund for any withheld income tax; or (5) claims deductions for personal, living and family expenditures to offset the wages reported on the federal income tax return. Taxpayer A claims that compensation received for personal services is not subject to federal income tax.

Arguments that wages are not subject to federal income tax many forms including, but not limited to, the following:

- 1, A tax on wages is a direct tax subject to the provisions in Article I, Section 2, Clause 3 of the Constitution that requires that direct taxes be apportioned among the states by population.
2. Money received in exchange for personal labor constitutes an equal, nontaxable exchange of property.
3. Taxable income from wages or other compensation for personal services can only be determined after deduction of the cost of providing the labor.

Laws and Analysis

1. Article 1, Section 2, Clause 3 of the United States Constitution states that “direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective number ..” This statement has been used to support the argument that there is a constitutional impediment to the imposition of a direct tax on an individual’s wages. The Sixteenth Amendment to the Constitution, ratified in 1913, provides that “[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”

The Sixteenth Amendment has been reviewed by the Supreme Court and upheld. *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1 (1916). Thus, the imposition of income tax on wages, without apportionment among the states, is authorized. See, e.g., *Funk v. Commissioner*, 687 F.2d 264 (8th Cir. 1982); *Abrams v Commissioner*, 82 T.C. 403 (1984).

Section 61(a) of the Internal Revenue Code defines gross income as income from whatever source derived, including (but not limited to) “compensation for services, including fees, commissions, fringe benefits, and similar items.” I.R.C. § 61 (a)(1). Courts consistently have upheld the determination that wages fall within section 61(a)(1)’s definition of compensation and accordingly, constitute taxable income. See, e.g., *Ledford v. United States*, 297 F. 3d 1378 (Fed. Cir. 2002); *United States v. Connor*, 898 F.2d 942 (3d Cir. 1990); *Casper v. Commissioner*, 805 F.2d 902 (10th Cir. 1986); *Connor v. Commissioner*, 770 F.2d 17 (2d Cir. 1985); *Lovell v. United States*, 755 F.2d 517 (7th Cir. 1984); *Perkins v. Commissioner*, 746 F.2d 1187 (6th Cir. 1984); *Funk v. Commissioner*, 687 F.2d 264 (8th Cir. 1982); *Lonsdale v. Commissioner*, 661 F.2d 71 (5th Cir. 1981); *Rowlee v. Commissioner*, 80 T.C. 1111 (1983)

In *United States v. Connor*, 898 F.2d at 943, the Third Circuit noted that “[e]very court which has ever considered the issue has unequivocally rejected the argument that wages are not income.” All income received by a taxpayer is income under section 61 unless it is specifically exempted or excluded. See *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429-30 (1955) (“Congress applied no laminations as to the source of taxable receipts, nor restrictive labels as to the intention of “Congress to tax all gains except those specifically exempted.”)

2. Some taxpayers claim that the payment of wages or other compensation in exchange for personal labor in a nontaxable exchange of property. These taxpayers sometimes rely on sections 83 or 1001 of the Internal Revenue Code to support this argument. Section 83 provides for the determination of the amount to be included in gross income and the timing of the inclusion when property is transferred to an employee or independent contractor in connection with the performance of services. Section 1001 provides for the determination of the amount and timing of the recognition of gain or loss from the sale or other disposition of property.

Courts have universally rejected the argument that labor is property that can be exchanged for wages or other compensation in a nontaxable transaction. *See Casper v. Commissioner*, 805 F.2d at 905; *Funk v. Commissioner*, 687 F.2d at 265. Courts recognize a distinction between selling labor and selling or exchanging property. *See Reading v. Commissioner*, 70 T.C. 730, 733-34 (1978), *aff'd*, 614 F.2d 159 (8th Cir. 1980). Further, the courts have concluded that a taxpayer has no tax basis in one's labor and, therefore, the full amount of the wages or other compensation received represents gain which may be taxed as income. *See, e.g., Casper*, 805 F.2d at 905; *Abrams*, 82 T.C. at 407; *Reading*, 70 T.C. at 733-34.

3. A related argument is that income from the sale of labor cannot be determined until the taxpayer's investment in that labor has been recovered. This argument has been repeatedly rejected. *See Rowlee*, 80 T.C. at 1120; *Reading*, 70 T.C. at 733-34. In *Reading*, the Tax Court examined the contention that gain must be realized for there to be income, analyzing the distinction recognized under federal tax law between producing a physical product and providing services. The court flatly rejected the idea that living expenses constitute the cost of "goods" sold for providing labor or services. *Reading*, 70 T.C. at 733-34. Thus, the court concluded that the gain from the sale of labor is the entire amount received and upheld the disallowance of deductions for personal living expenses. Courts have uniformly rejected arguments that wages and other compensation for personal services are not taxable income. Accordingly, raising these arguments, justifies the imposition of sanctions. *See Ledford v. United States*, 297 F.3d at 1381-83 (Fed. Cir. 2002); *Casper v. Commission*, 805 F.2d at 906; *Connor v. Commissioner*, 770 F.2d at 20.

Holding

1. Wages fall within the definition of income set forth in section 61(a)(1) of the Internal Revenue Code. Taxpayer A's wages and other compensation for services are income subject to federal income tax and must be reported on Taxpayer A's federal income tax return.
2. The payment of wages and other compensation for personal services is not an equal exchange of property. The full amount of wages received by Taxpayer A is subject to federal income tax and must be reported on Taxpayer A's federal income tax return.
3. Wages and other compensation received by Taxpayer A in exchange for personal services are subject to federal income tax without reduction of Taxpayer A's personal living expenses.

REV. RUL. 2007-20

Purpose

The Internal Revenue Service (Service) is aware that some taxpayers assert that compliance with the internal revenue laws is purely voluntary, specifically, that they are not required to file federal tax returns or pay federal tax because the filing of a tax return or the payment of tax is a matter of choice. Taxpayers who take this position argue that the Form 1040 Series instructions provide that filing a return and paying tax are voluntary and not mandatory. Often quoting from the Supreme Court's opinion in *Flora v. United States*, 362 U.S. 145, 176 (1960), they claim that "[o]ur system of taxation is based upon voluntary assessment and payment not upon distraint." Some of these taxpayers also contend that section 6020(b) of the Internal Revenue Code requires the Service to prepare a federal tax return for any person who does not file a return, which, according to these taxpayers, means that they are not required to file a return.

This revenue ruling emphasizes to taxpayers, promoters, and return preparers that the requirements to file a tax return and pay the tax that is due are not optional. Any position to the contrary has no merit and is frivolous.

The Service is committed to identifying taxpayers who attempt to avoid their federal tax obligations by taking frivolous positions. 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 the Service’s Frivolous Return Program. As part of this program, the Service determines whether taxpayers who have taken frivolous positions have filed all required tax returns, computes the correct amount of tax and interest due, and determines whether civil or 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 an injunction should be sought to halt these activities.

Issue

Whether filing a tax return or paying tax is voluntary.

Facts

Taxpayer A claims that he is not required to file a federal income tax return or pay income taxes because filing a return and paying tax are “voluntary” activities that he can legitimately opt not to do. Taxpayer A further claims that if a tax return is required, the Service must prepare it for the taxpayer.

Law and Analysis

Effective tax administration relies on taxpayers willingly complying with the tax laws, but taxpayers do not have the rights to choose whether the laws apply to them. References to a “voluntary” tax system in *Flora, supra*, and in Service publications, mean a system that allows taxpayers to determine, in the first instance, the correct amount of their tax and to report their liability on appropriate returns, rather than having the government make the determinations for them. See *Hibbs v. Winn*, 542 U.S. 88, 100 n.3 (2004) (“[T]he taxpayer, not the taxing authority, is the *first* party to make the relevant calculation of income taxes owed.”) (Emphasis added). “Voluntary” in context does not mean that taxpayers may opt out of the system. As stated in *United States v. Schiff*, 876 F.2d 272, 275 (2d Cir. 1989):

To the extent that income taxes are said to be “voluntary,” . . . they are only voluntary in that one files the returns and pays the taxes without the IRS first telling each individual the amount due and then forcing payment of that amount. The payment of income taxes is not optional, however, . . . and the average citizen knows that the payment of income taxes is legally required.

See also United States v. Middleton, 246 F.3d 825, 840-41 (6th Cir. 2001); *United States v. Raymond*, 228 F.3d 804, 812-13 (7th Cir. 2000); *United States v. Gerads*, 999 F.2d 1255, 1256 (8th Cir. 1993); *Wilcox v. Commissioner*, 848 F.2d 1007, 1008 (9th Cir. 1988); *United States v. Teddler*, 787 F.3d 540, 642 (10th Cir. 1986); *Moore v. Commissioner*, 722 F.2d 193m 196 (5th Cir. 1984); *Woods v. Commissioner*, 91 T.C. 88, 90 (1988).

Any suggestion that taxpayers may elect not to file returns or pay tax ignores the laws that affirmatively and unambiguously establish these requirements. Specifically, the requirement to pay income taxes is clearly established in section 1 of the Internal Revenue Code, which imposes a tax on the taxable income of individuals, estates, and trusts as determined by the tables set forth in that section, and section 11, which imposes a tax on the taxable income of corporations. The requirement to file an income tax return is explicitly stated in sections 6011(a), 6012(a), and 6072(a) and corresponding Treasury Regulations. In addition, section 6151 requires taxpayers to submit payment of their taxes with their tax returns. Under these provisions of the Code, any taxpayer who has received more than a statutory determined amount of gross income during the tax year is required to file a return for the year and pay tax on the income.

Underscoring the fallacy of any position that filing a tax return or paying tax is voluntary is the existence of civil and criminal penalties for failing to file or pay. *See Helvering v. Mitchell*, 303 U.S. 391, 399 (1938) (“In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts . . . [on an] annual taxpayers claim, reporting and paying taxes were optional, penalties for noncompliance would not exist and would not be routinely imposed and upheld.

Section 6651(a) imposes an addition to tax for failure to file a required tax return or pay tax unless the failure is due to reasonable cause and not willful neglect. Section 7203 imposes a criminal penalty (in addition to the civil penalty) for willfully failing to file a return or pay tax.

Finally, the Service is not obligated to make returns for taxpayers who fail to do so. Section 6020(b) merely provides the Service with a mechanism for determining the tax liability of a taxpayer who has not filed a return. Section 6020(b) does not require the Service to prepare a tax return in any case, and it does not excuse a taxpayer from the requirements to file and pay or from liability for unpaid taxes, plus civil and criminal penalties for the failure to file or pay.

Holding(s)

Taxpayer A must file income tax returns if the income threshold is met and must pay the correct amount of income taxes owed. Compliance with the internal revenue laws, including filing tax returns and paying tax, is not optional. Further, the Service's authority to prepare a return under section 6030(b) does not relieve a taxpayer of the obligation to file a tax return or pay tax. Any claim by Taxpayer A that one may lawfully opt not to file a return or pay tax is frivolous. The Service will challenge the claim of individuals who improperly attempt to avoid or evade their federal tax liability.

Civil and Criminal Penalties

The position described above - that the law permits a taxpayer to choose not to file an income tax return or pay income taxes because these acts are voluntary - is a frivolous position for purposes of section 6702(c). The Service will challenge the claims of individuals who attempt to improperly avoid or evade their federal tax liability. In addition to liability for the tax due plus statutory interest, taxpayers who fail to file valid returns or pay taxes, face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6682 accuracy-related penalties, which are generally equal to 20 percent of the amount of tax the taxpayer should have paid; (2) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of tax the taxpayer should have paid; (3) the section 6702(a) penalty of \$5,000 for filing a document that purports to be a return and that contains a frivolous position or suggests a desire by the taxpayer to delay or impede the administration of federal tax laws; (4) the section 6702(b) penalty of \$5,000 for submitting a "specified frivolous submission"; (5) 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; (6) the section 6673 penalty of up to \$25,000 if the taxpayer makes frivolous arguments in the United States Tax Court, and (7) the section 6682 penalty of \$500 for providing false information with respect to withholding.

Taxpayers relying on this frivolous position also may face criminal prosecution under: (1) section 7201 for attempting to evade or defeat tax, the penalty for which is a significant fine and imprisonment for up to 5 years; (2) section 7203 for willful failure to file a return, the penalty for which is a significant fine and imprisonment for up to a year; (3) section 7206 for making false statements on a return, statement, or other document, the penalty for which is a significant fine and imprisonment for up to 3 years; and (4) other federal laws as applicable.

Persons, including return preparers, who promote this frivolous positions and those who assist taxpayers in claiming tax benefits based on frivolous positions may face civil and criminal penalties and also 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; (4) criminal prosecution under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years, for assisting with or advising on the preparation of a false return, statement, or other document under the internal revenue laws; and (5) other federal laws as applicable.

REV. RUL. 2007-21

Purpose

The Internal Revenue Service (Service) is aware that some taxpayers are claiming that, before the Service may collect overdue taxes, the Service must provide taxpayers with a summary record of assessment made on a Form 23C, "Assessment Certificate-Summary Record of Assessment," that is signed by an authorized employee or officer. If a Form 23C is not provided, these taxpayers claim that the assessment is invalid, and, consequently, that the Service may not collect any taxes due.

The revenue ruling emphasizes to taxpayers, promoters, and return preparers that, although an assessment is recorded on a summary record of assessment, such as the Form 23C or its computer-generated equivalent, the Revenue Accounting Control System (RACS) Report 006, there is no legal requirement that a summary record of assessment be provided to a taxpayer before the Service may proceed with collection activity. Further, if a taxpayer requests proof that an assessment was made, the Service is not required to provide any particular form or information in any particular format to the taxpayer so long as the Service provides the information required by Treasury Regulation § 301.6203-1 to the taxpayer. Any position to the contrary has no merit and is frivolous.

Facts

Taxpayer A argues in a request for a collection due process hearing under section 6330 or 6320 of the Internal Revenue Code that, pursuant to section 6203 and Treasury Regulations § 301.6201-1, the Service must first provide the taxpayer with a summary record of assessment of taxes due before collection action may commence. Taxpayer A further argues that the record provided must include a Form 23C signed by an authorized Service official. In response, the Service provides Taxpayer A with a record of assessment on a Form 4340 (“Certificate of Assessments and Payments”), MFTRA-X (“Master File Transcript”), or other similar document. Taxpayer A asserts these forms do not meet the legal requirements and until the Service produces a valid summary record of assessment, the Service is prohibited from collection the assessment liability. According to Taxpayer A, the Appeals Officer conducting the collection due process hearing, in verifying under section 6330(c)(1) that the Service has complied with applicable law and procedure, may not rely on anything other than the Form 23C to determine, for purposes of the section 6330(c)(1) requirement, that a valid assessment was made.

Law and Analysis

Section 6203 states that an assessment of tax (including interest, additions to tax, and assessable penalties) “shall be made by recording the liability of the taxpayer in the office of the Secretary in accordance with rules or regulations prescribed by the Secretary.” The section also states that, when requested by taxpayer, “the Secretary shall furnish the taxpayer a copy of the record of assessment.” Treasury Regulation § 301.6203-1 specifies that an assessment is made “by an assessment officer signing the summary record of assessment,” which “through support records” must include the “identification of the taxpayer, the character of the liability assessment, the taxable period, if applicable, and the amount of the assessment.” Under the regulation, if a taxpayer requests a copy of the record of assessment, the Service will give the taxpayer “a copy of the pertinent parts of the assessment which set forth the name of the taxpayer, the date of assessment, the character of the liability assessed, the taxable period, if applicable, and the amount assessed.” The date of the assessment is the date the summary record is signed.

There is no requirement in the statute or regulation that the assessment be recorded on a specific form or that the taxpayer be provided with a certain form as a record of assessment.

Until its transition to computerized recordkeeping, the Service generally used Form 23C for the summary record of assessment, but it now uses, except in unusual circumstances, a computer-generated summary record of assessment known as the RACS Report 006. Both forms have been recognized as summary records of assessment within the meaning of section 6203. *See March v. Internal Revenue Service*, 335 F.3d 1186, 1188 (10th Cir. 2003). In *Roberts v. Commissioner*, 329 F.3d 1224, 1228 (11th Cir. 2003), the taxpayer argued that an assessment was invalid because the Service did not use Form 23C but instead used RACS Report 006. The court held that there was nothing in the law to show that the use of the RACS report was not in compliance with the statute and the regulation. The RACS report and the Form 23C are both signed by an assessment officer. The RACS report, like the Form 23C, provides when coupled with “supporting records,” the information set forth in Treasury Regulation § 301.6203-1.

In response to a taxpayer’s request under section 6203 and the regulation for “a copy of the record of assessment, the Service is not required to provide any particular form or document and may choose among documents that contain the items of information listed in the regulation. Instead of a RACS report 006, which does not break out individual taxpayer information, the Service may provide Form 4340, “Certificate of Assessments and Payments,” or a MFTRA-X transcript (literal or plain-language transcript) of the taxpayer’s account, either of which sets forth all of the information required by the regulation, because each identifies the taxpayer, states the character of the assessment, and the date of assessment. *See Goodman v. United States*, 185 Fed. Appx. 725, 728 (10th Cir. 2006); *Roberts*, 329 F.3d at 1228; *Carillo v. Commissioner*, T.C. Memo. 2005-290; *Michael v. Commissioner*, T.C. Memo. 2003-26. In addition, an Appeals Officer is not required to obtain a Form 23C or other particular document in a collection due process hearing and may rely on a Form 4340 or MFTRA-X transcript to verify the validity of the assessment for purposes of section 6330(c)(1). *See Nestor v. Commissioner*, 118 T.C. 162 (2002); *Perez v. Commissioner*, T.C. Memo. 2002-74.

Holding

The Service is not required to provide Taxpayer A with a summary record of assessment before collecting any taxes due. An assessment is not invalid, and collection is not precluded, because the Service has not provided a summary record of assessment to the taxpayer.

Additionally, Taxpayer A's claim that the Service must produce a Form 23C or other record of assessment as proof of assessment is frivolous. If a taxpayer requests a copy of the record of assessment, the Service may produce the information in any form or format, provided the summary produced contains the information required by Treasury Regulation § 301.6203-1. Acceptable copies of the record of assessment include, but are not limited to, Form 4340 and MFTRA-X transcripts. Further, the Form 4340, MFTRA-X transcript, or other similar documents may be used in a collection due process proceeding to verify the validity of an assessment under section 6330(c)(1).

The Service will challenge the claims of individuals who improperly attempt to avoid or evade their federal tax liability.

Civil and Criminal Penalties

The position described above, that the Service must provide a taxpayer with a summary record of assessment, such as a Form 23C, before collection or must provide a Form 23C in any collection proceeding is a frivolous position under section 6702. The Service will challenge the claims of individuals who attempt to improperly avoid or evade their federal tax liability. In addition to liability for the tax due plus statutory interest, taxpayers who insist upon receiving a Form 23C before complying with their tax obligations face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6702(b) \$5,000 penalty for submitting a "specified frivolous submission"; (2) the section 6651(a)(3) addition to tax for failure to pay the tax owed; and (3) the section 6673 penalty of up to \$25,000 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on this frivolous position also may face criminal prosecution under section 7201 for attempting to evade or defeat tax, the penalty for which is a significant fine and imprisonment for up to 5 years, or prosecution under other federal laws as applicable.

REV. RUL. 2007-22

Purpose

The Internal Revenue Service (Service) is aware that some taxpayers are claiming that they are not subject to federal income tax, or that their income is excluded from taxation, because: 1) the taxpayers have declared that they have rejected or renounced United States citizenship because the taxpayers are citizens exclusively of a State (sometimes characterized as a “natural-born citizen” of a “sovereign state”); or 2) the taxpayers claim they are not persons as identified by the Internal Revenue Code. These taxpayers claim they are not persons as identified by the Internal Revenue Code. These taxpayers often furnish Forms W-4, *Employee’s Withholding Allowance Certificate* to their employers on which the taxpayers claim excessive withholding allowances or claim complete exception from withholding. Based on these Forms W-4, federal income taxes are not withheld from wages paid. Alternatively, these taxpayers attempt to avoid their federal income tax liability by submitting a Form 4852, *Substitute for Form W-2, Wage and Tax Statement*, or Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* to the Internal Revenue Service with a zero on the line for the amount of wages received. These taxpayers often either fail to file returns, or file returns showing no income and claiming a refund for any withheld income taxes. The Service is also aware that some promoters, including return preparers, market a book, package, kit, or other materials that claim to show taxpayers how they can avoid paying income taxes based on these and other meritless arguments.

This revenue ruling emphasizes to taxpayers, promoters and return preparers that all U.S. citizens and residents are subject to federal income tax. Any argument that a taxpayer’s income is excluded from taxation because: 1) the taxpayer has rejected or renounced United States citizenship because the taxpayer is a citizen exclusively of a State (sometimes characterized as a “natural-born citizen” of a “sovereign state”); or 2) the taxpayer is not a person as defined by the Internal Revenue Code and is, therefore, not subject to federal tax, has no merit and is frivolous.

The Service is committed to identifying taxpayers who attempt to avoid their federal tax obligations by taking frivolous positions. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions.

Issues

1. Whether a taxpayer may avoid federal income tax liability by maintaining that he/she is not a citizen of the United States and thus, is not subject to the federal income tax law.
2. Whether a taxpayer may avoid federal income tax liability by claiming the taxpayer is not a “person” as defined by the Internal Revenue Code and, thus, is not subject to the federal income tax laws.

Facts

Taxpayer A claims to be exempt from federal income tax because, as a “sovereign citizen” of Taxpayer A’s state of residence, Taxpayer A is not a citizen or resident of the United States and is not subject to federal tax laws.

Taxpayer B claims that the Fourteenth Amendment, providing, “all persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside,” applies only to freed slaves and their descendants, and that all other persons are solely citizens of their state of residence.

Taxpayer C claims not to be a United States citizen or a person subject to tax because Taxpayer C has not requested, obtained, or exercised any privilege from an agency of government.

Taxpayer D claims not to be a “person” or a “taxpayer” as defined by the Internal Revenue Code because Taxpayer D is a freeborn and natural individual and not subject to the jurisdiction of the United States.

The taxpayer often furnishes a Form W-4, *Employee’s Withholding Allowance Certificate*, to the employer on which the taxpayer claims excessive withholding allowances or claims complete exemption from withholding. Based on this Form W-4, federal income taxes are not withheld from wages paid. Alternatively, the taxpayer prepares a Form 4852 (Substitute for Form W-2) showing no wages received. The taxpayer either fails to file a return, or files a return reporting zero income and claiming a refund for all taxes withheld. The taxpayer then contends the taxpayer is not covered by the federal tax laws and is not subject to federal income tax because the taxpayer is not a citizen of the United States, or the taxpayer is not a person as defined by the Internal Revenue Code.

Law and Analysis:

1. Citizenship

The Fourteenth Amendment to the United States Constitution defines the basis for United States citizenship, stating that “[a]ll persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside.” The Fourteenth Amendment, therefore, establishes simultaneous state and federal citizenship. *See United States v. Cruikshank*, 92 U.S. 542, 549 (1875) (“The same person may be at the same time a citizen of the United States and a citizen of a State. . . .”); *In re Slaughter-House Cases*, 83 U.S. (16 Wall.) 36, 74 (1873) (A man “must reside within the State to make him a citizen of it, but it is only necessary that he should be born or naturalized in the United States to be a citizen of the Union”). The Fourteenth Amendment’s granting of citizenship applies to all persons born or naturalized in the United States, regardless of race. *See, e.g., Bell v. State of Maryland*, 378 U.S. 226, 249 (1964) (Douglas, J., concurring) (“The Fourteenth Amendment also makes every person who is born here a citizen; and there is no second or third or fourth class of citizenship”).

Section 7701(a)(9) of the Internal Revenue Code states that “[t]he term ‘United States’ when used in a geographical sense includes only the States and the District of Columbia.” Claims that individuals are not citizens of the United States but are solely citizens of a sovereign state and not subject to federal taxation have been uniformly rejected by the courts. *See, e.g., United States v. Hilgefjord*, 7 F.3d 1340, 1342 (7th Cir. 1993); (“The defendant in this case apparently holds a sincere belief that he is a citizen of the mythical “Indiana State Republic” and for that reason is an alien beyond the jurisdictional reach of federal courts. This belief is, of course, incorrect”); *United States v. Gerads*, 999 F.2d 1255, 1256 (8th Cir. 1993); (“[We] reject appellants’ contention that they are not citizens of the United States, but rather “Free Citizens of the Republic of Minnesota” and, consequently, not subject to taxation.”); *O’Driscoll v. Internal Revenue Service*, 1991 U.S. Dist. LEXIS 9829, *5-6 (E.D. Penn. 1991); (“Despite plaintiff’s linguistic gymnastics, he is a citizen of both the United States and Pennsylvania, and liable for federal taxes”).

Similarly, the individual states are part of the United States and income earned within them is fully subject to United States taxation. *See, e.g., Solomon v. Commissioner*, T.C. Memo. 1993-509 (responding to argument that all of the petitioner’s income was earned outside of the United States, the court held that “petitioner attempts to argue an absurd proposition, essentially that the State of Illinois is not part of the United States”).

2. Definition of Person

The Internal Revenue Code defines “person” and sets forth which persons are subject to federal taxes. Section 7701(a)(14) defines “taxpayer” as “any person” subject to any internal revenue tax, and section 7701(a)(1) defines “person” to include an individual, trust, estate, partnership, or corporation.

Arguments that an individual is not a “person” and sets forth which persons are subject to federal taxes. Section 7701(a)(14) defines “taxpayer” as “any person” subject to any internal revenue tax, and section 7701(a)(1) defines “person” to include an individual, trust, estate, partnership, or corporation.

Arguments that an individual is not a “person” within the meaning of the Internal Revenue Code have been uniformly rejected by the courts as have arguments with respect to the term “individual.” *See, e.g., United States v. Dawes*, 874 F.2d 746, 750-51 (10th Cir. 1989), *overruled on other grounds*, 895 F.2d 1577 (10th Cir. 1990) (“The contention that appellants are not taxpayers because they are ‘free born, white, preamble, sovereign, natural, individual common law ‘de jure’ citizens of Kansas’ is frivolous. Individuals are ‘persons’ under the Internal Revenue Code and thus subject to 26 U.S.C. § 7203.”); *United States v. Studley*, 783 F.2d 934, 937 n.3 (9th Cir. 1986) (in “this argument has been consistently and thoroughly rejected by every branch of the government for decades. Indeed advancement of such utterly meritless arguments is now the basis for serious sanctions imposed on civil litigants who raise them”).

Courts have also uniformly rejected claims that a taxpayer is not a person subject to tax because the taxpayer did not request, obtain, or exercise any privileges of citizenship. *See, e.g., Lovell v. United States*, 755 F.2d 517, 510 (7th Cir. 1984) (“All individuals, natural and unnatural, must pay federal income tax on their wages, regardless of whether they received any ‘privileges’ from the government”).

Holding

1. The Fourteenth Amendment of the United States Constitution establishes simultaneous state and federal citizenship. Therefore, an individual cannot reject citizenship in the United States in favor of states citizenship, or otherwise claim not to be a citizen of the United States for the purpose of avoiding federal tax liability. Furthermore, income earned within a state of the United States by a United States citizen or resident is taxable under federal tax laws. Accordingly, Taxpayer A and Taxpayer B are subject to federal income tax liability because they are citizens of the United States and citizens of the state in which they reside.

2. The term “person” as used by the Internal Revenue Code includes natural persons and individuals. Moreover, a taxpayer need not request, obtain, or exercise a privilege from an agency of the government to be a “person” within the meaning of the Internal Revenue Code. Therefore, Taxpayer C and Taxpayer D are subject to federal income tax liability.

Civil and Criminal Penalties

The Service will challenge the claims of individuals who improperly attempt to avoid or evade their federal tax liability. In addition to liability for the tax due plus statutory interest, taxpayers who fail to file valid returns or pay tax based on arguments that they are not citizens or persons as contemplated by the Internal Revenue Code and, thus are not subject to federal tax face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6662 accuracy-related penalties, which are generally equal to 20 percent of the amount of tax the taxpayer should have paid; (2) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of tax the taxpayer should have paid; (3) the section 6702(a) penalty of \$5,000 for a “frivolous tax return”, (4) the section 6702(b) penalty of \$5,000 for submitting a “specified frivolous admission”; (5) 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; (6) the section 6673 penalty of up to \$25,000 if the taxpayer makes frivolous arguments in the United States Tax Court; and (7) the section 6682 penalty of \$500 for providing false information with respect to withholding.

Taxpayers relying on these frivolous positions also may face criminal prosecution under: (1) section 7201 for attempting to evade or defeat tax, the penalty for which is a significant fine and imprisonment for up to 5 years; (2) section 7203 for willful failure to file a return the penalty for which is a significant fine and imprisonment for up to 1 year; (3) section 7206 for making false statements on a return, statement, or other document, the penalty for which is a significant fine and imprisonment for up to 3 years or (4) other provisions of federal law.

Persons, including return preparers, who promote these frivolous positions and those who assist taxpayers in climbing tax benefits based on frivolous positions may face civil and criminal penalties and also 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.

Practitioner Pointer:

Revenue Rulings are generally authorized by the "Office of Associate Chief Counsel" (Procedure & Administration) Administrative Provisions and Judicial Practice Division. Additional information can be obtained regarding these and other Revenue Rulings, by contacting this office at (202) 622-7960.

HOW TO REPORT SUSPECTED TAX FRAUD ACTIVITY

If a practitioner suspects a “tax fraud activity” has occurred, the practitioner should report such activity to the IRS via Form 3949-A, *Information Referral*. Form 3949-A can be accessed via the IRS website at irs.gov. A taxpayer or tax practitioner is not required utilize Form 3949-A, and they are allowed to prepare a letter (in lieu of Form 3949-A) which should detail any alleged fraudulent activity should be addressed and remitted to the following address:

- Internal Revenue Service, Fresno, CA 93888.

The letter or Form 3949-A, should provide the following:

- Specific information regarding the person or persons suspected of the fraudulent activity,
- The specific fraudulent activity being reported
- How you (or the taxpayer) became aware of the activity
- Also, if known, when the alleged fraudulent activity occurred
- The amount of any money and/or funds involved, and
- Any other information that might be relevant to the IRS investigation.

The person reporting the incident is not required to identify themselves; however the IRS has stated that doing so would be extremely helpful and that your identify would be kept “confidential” if you did in-fact disclose your identity. Also, “Whistleblowers” (yes including you) may provide information and submit allegations of fraud to the IRS. In doing so, the “Whistleblower” may qualify for an award. The reporting individual generally is required to prepare & file Form 211, “*Application for Award for Original Information*”. Also refer to Notice 2008-4, “Claims Submitted to the IRS Whistleblower Office pursuant to IRC §7623”.

Statistical Data - Abusive Return Preparers

	<u>FY</u> <u>2011</u>	<u>FY</u> <u>2010</u>	<u>FY</u> <u>2009</u>
Investigations Initiated	371	397	224
Prosecution Recommendations	233	202	129
Indictments/Information	176	182	149
Convictions	163	145	115
Sentenced	163	132	136
Incarceration Rate*	87.1%	88.6%	85.3%
Avg. Months to Serve	25	24	24

* Incarceration includes confinement to a federal prison, halfway house, home detention, or a combination thereof.

* Data Source: Criminal Investigation Management Information System.

RELEVANT JUDICIAL DECISIONS & COURT CASES

The following court cases are relevant to “frivolous tax arguments” and are discussed via your Power Point Presentation in detail, and will be discussed in detail accordingly as time permits.

- A. Wnuck v. Commissioner, 136, T.C. 489 (2011)**
- B. Helvering v. Commissioner, 303, U. S., 391, 399 (1938)**
- C. United States v. Tedder, 787, F .2d, 540, 542 (10th Cir. 1986)**
- D. Schiff v. United States. 919, F .2d, 830, 832 (2d. Cir. 1990)**
- E. Stewart v. Commissioner, T. C. Memo, 2005-212, 90 T.C.M**
- F. United States v. Becker, 58-1, U.S.T.C.**
- G. Commissioner v. Glenshaw Glass, Co., 348, U. S. 426, 429-30 (1955)**
- H. Stelly v. Commissioner, 761 F .2d, 1113, 1115-16 (5th Cir. 1985)**
- I. Callahan v. Commissioner, 334, F. App’x, 754 (7th Cir. 2009)**
- J. United States v. Hilgeford, 7 F .3d, 1340, 1342 (7th Cir. 1993)**
- K. United States v. Ambort, 405, F .3d, 1109 (10th Cir. 2005)**
- L. Takaba v. Commissioner, 119 T.C. 285, 295 (2002)**
- M. United States v. Hilgeford, 7 F .3d, 1340, 1342 (7th Cir. 1993)**
- N. Smith v. Commissioner, T.C. Memo 2000-290, 80-T.C.M.**
- O. Montero v. Commissioner, 354 F. App’x 173 (5th Cir. 2009)**
- P. Jenkins v. Commissioner, 483 F .3d, 90, 92 (2d. Cir. 2007)**
- Q. United States v. Schiff, 612 F .2d 73, 83 (2d. Cir. 1979)**
- R. Wolcott v. Commissioner, 103 AFTR 2d 2009-1300 (6th Cir. 2008)**
- S. United States v. Foster, 2002 U. S. Dist. LEXIS 3092, 2002-1 U.S.T.C**
- T. Osband v. Commissioner, T. C. Memo 2013-188, 106 T.C. M 124 (Aug. 19, 2013)**
- U. Williams v. United States, U.S. Court of Federal Claims, 2013-2 U.S.T.C.**