CONTINUING EDUCATION

FRIVOLOUS TAX ARGUMENTS & SCAMS

2 CPE Hours

Course 9000

Self-Study Online
Sequoia CPE

FRIVOLOUS TAX ARGUMENTS AND SCAMS (COURSE #9000I)

COURSE DESCRIPTION

This course discusses various frivolous tax arguments and scams in relation to a federal tax preparer's ethical obligations under IRS Circular 230. Additional information is provided on the civil and criminal penalties that can apply to your clients and the various penalties that can apply to you, the tax preparer, that violates ethical standards and your obligations under Circular 230.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

ASSIGNMENT 1: **SUBJECT**

Frivolous Tax Positions

Study the course materials from pages 1 to 40

Complete the review questions at the end of the course

Answer the exam questions 1 to 10

Objectives:

- To recognize characteristics of common frivolous tax positions
- To identify the penalties and fines that may be assessed in frivolous tax cases
- To identify the current "Dirty Dozen" tax scams

ASSIGNMENT 2:

Complete the Online Exam

NOTICE

Note: Any case studies or examples relating to any disciplinary actions taken by the Board of Accountancy have been taken directly from a BOA source (e.g. website, newsletters, notices) and were published based on the information available at the time of course development. Subsequent events, actions, withdrawals may have occurred since the publication of this course.

Program publication date **11/14/2023**

EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.

- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.

- **LICENSE RENEWAL INFORMATION:** This course (#9000I) qualifies for **2** CPE hours.

- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.

- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

ENJOY YOUR COURSE

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FRIVOLOUS TAX POSITIONS

Course Objectives

After completing this course, you should be able to:

- Recognize characteristics of common frivolous tax positions.
- Identify the penalties and fines that may be assessed in frivolous tax cases.
- Identify the current "Dirty Dozen" tax scams.

I. FRIVOLOUS TAX ARGUMENTS IN GENERAL

A. THE VOLUNTARY NATURE OF THE FEDERAL INCOME TAX SYSTEM

1. Contention: The filing of a tax return is voluntary.

Some taxpayers assert that they are not required to file federal tax returns because the filing of a tax return is voluntary. Proponents of this contention point to the fact that the IRS tells taxpayers in the Form 1040 instruction book that the tax system is voluntary. Additionally, these taxpayers frequently quote *Flora v. United States*, 362 U.S. 145, 176 (1960), for the proposition that "[o]ur system of taxation is based upon voluntary assessment and payment, not upon distraint."

The Law: The word "voluntary," as used in Flora and in IRS publications, refers to our system of allowing taxpayers initially to determine the correct amount of tax and complete the appropriate returns, rather than have the government determine tax for them from the outset. The requirement to file an income tax return is not voluntary and is clearly set forth in sections 6011(a), 6012(a), et seq., and 6072(a) of the Internal Revenue Code. See also Treas. Reg. § 1.6011-1(a).

Any taxpayer who has received more than a statutorily determined amount of gross income in a given tax year is obligated to file a return for that tax year. Failure to file a tax return could subject the non-compliant individual to civil and/or criminal penalties, including fines and imprisonment. In *United States v. Tedder*, 787 F.2d 540, 542 (10th Cir. 1986), the court stated that, "although Treasury regulations establish voluntary compliance as the general method of income tax collection, Congress gave the Secretary of the Treasury the power to enforce the income tax laws through involuntary collection . . . . The IRS' efforts to obtain compliance with the tax laws are entirely proper." The IRS warned taxpayers of the consequences of making this frivolous argument in Rev. Rul. 2007-20, 2007-1 C.B. 863 and in Notice 2010-33, 2010-17 I.R.B. 609.

2. Contention: Payment of federal income tax is voluntary.

In a similar vein, some argue that they are not required to pay federal taxes because the payment of federal taxes is voluntary. Proponents of this position argue that our system of taxation is based upon voluntary assessment and payment. They frequently claim that there is no provision in the Internal

Revenue Code or any other federal statute that requires them to pay or makes them liable for income taxes, and they demand that the IRS show them the law that imposes tax on their income. They argue that, until the IRS can prove to these taxpayers' satisfaction the existence and applicability of the income tax laws, they will not report or pay income taxes. These individuals or groups reflexively dismiss any attempt by the IRS to identify the laws, thereby continuing the cycle. The IRS discussed this frivolous position at length and warned taxpayers of the consequences of asserting it in Rev. Rul. 2007-20, 2007-1 C.B. 863 and in Notice 2010-33, 2010-17 I.R.B. 609.

The Law: The requirement to pay taxes is not voluntary. Section 1 of the Internal Revenue Code clearly imposes a tax on the taxable income of individuals, estates, and trusts, as determined by the tables set forth in that section. (Section 11 imposes a tax on corporations' taxable income.)

Furthermore, the obligation to pay tax is described in section 6151, which requires taxpayers to submit payment with their tax returns. Failure to pay taxes could subject the non-complying individual to criminal penalties, including fines and imprisonment, as well as civil penalties.

In *United States v. Drefke*, 707 F.2d 978, 981 (8th Cir. 1983), the Eighth Circuit Court of Appeals stated, in discussing section 6151, that "when a tax return is required to be filed, the person so required 'shall' pay such taxes to the internal revenue officer with whom the return is filed at the fixed time and place. The sections of the Internal Revenue Code imposed a duty on Drefke to file tax returns and pay the appropriate rate of income tax, a duty which he chose to ignore."

Although courts, in rare instances, have waived *civil penalties* because they have found that a taxpayer relied on an IRS misstatement or wrongful misleading silence with respect to a factual matter, there have been no cases in which the IRS's lack of response to a taxpayer's inquiry has relieved the taxpayer of the duty to pay *tax* due under the law.

3. Contention: Taxpayers can reduce their federal income tax liability by filing a "zero return".

Some taxpayers attempt to reduce their federal income tax liability by filing a tax return that reports no income and no tax liability (a "zero return") even though they have taxable income. Many of these taxpayers also request a refund of any taxes withheld by an employer. These individuals typically attach to the zero return a "corrected" Form W-2 or another information return that reports income and income tax withholding, relying on one or more of the frivolous arguments discussed throughout this outline to support their position.

The Law: A taxpayer that has taxable income cannot legally avoid income tax by filing a zero return. Section 61 provides that gross income includes all income from whatever source derived, including compensation for services. Courts have repeatedly penalized taxpayers for making the frivolous argument that the filing of a zero return can allow a taxpayer to avoid income tax liability or permit a refund of tax withheld by an employer. Courts have also imposed the frivolous return and failure to file penalties because these forms do not evidence an honest and reasonable attempt to satisfy the tax laws or contain sufficient data to calculate the tax liability, which are necessary elements of a valid tax return. See *Beard v. Commissioner*, 82 T.C. 766, 777-79 (1984). Furthermore, including the phrase "nunc pro tunc" or other legal phrase has no legal effect and does not serve to validate a zero return. See Rev. Rul. 2006- 17, 2006-1 C.B. 748; Notice 2010-33, 2010-17 I.R.B. 609.

4. Contention: The IRS must prepare federal tax returns for a person who fails to file.

Proponents of this argument contend that section 6020(b) obligates the IRS to prepare and sign under penalties of perjury a federal tax return for a person who does not file a return. Those who subscribe to this contention claim that they are not required to file a return for themselves.

The Law: Section 6020(b) merely provides the IRS with a mechanism for determining the tax liability of a taxpayer who has failed to file a return. Section 6020(b) does not require the IRS to prepare or sign under penalties of perjury tax returns for persons who do not file, and it does not excuse the taxpayer from civil penalties or criminal liability for failure to file.

5. Contention: Compliance with an administrative summons issued by the IRS is voluntary.

Some summoned parties may assert that they are not required to respond to or comply with an administrative summons issued by the IRS. Proponents of this position argue that a summons thus can be ignored. The Second Circuit's opinion in *Schulz v. IRS*, 413 F.3d 297 (2d Cir. 2005) ("*Schulz II*"), discussed below, is often inappropriately cited to support this proposition.

The Law: A summons is an administrative device with which the IRS can summon persons to appear, testify, and produce documents. The IRS is statutorily authorized to inquire about any person who may be liable to pay any internal revenue tax, and to summon a witness to testify or to produce books, papers, records, or other data that may be relevant or material to an investigation. I.R.C. § 7602; *United States v. Arthur Young & Co.*, 465 U.S. 805, 816 (1984); *United States v. Powell*, 379 U.S. 48 (1964). Sections 7402(b) and 7604(a) of the Internal Revenue Code grant jurisdiction to district courts to enforce a summons, and section 7604(b) governs the general enforcement of summonses by the IRS.

Section 7604(b) allows courts to issue attachments, consistent with the law of contempt, to ensure attendance at an enforcement hearing "[i]f the taxpayer has contumaciously refused to comply with the administrative summons and the [IRS] fears he may flee the jurisdiction." *Powell*, 379 U.S. at 58 n.18; see also *Reisman v. Caplin*, 375 U.S. 440, 448-49 (1964) (noting that section 7604(b) actions are in the nature of contempt proceedings against persons who "wholly made default or contumaciously refused to comply" with an administrative summons issued by the IRS). Under section 7604(b), the courts may also impose contempt sanctions for disobedience of an IRS summons.

Failure to comply with an IRS administrative summons also could subject the non-complying individual to criminal penalties, including fines and imprisonment. I.R.C. § 7210. While the Second Circuit held in *Schulz II* that, for due process reasons, the government must first seek judicial review and enforcement of the underlying summons and to provide an intervening opportunity to comply with a court order of enforcement before seeking sanctions for noncompliance, the court's opinion did not foreclose the availability of prosecution under section 7210.

B. THE MEANING OF INCOME: TAXABLE INCOME AND GROSS INCOME

1. Contention: Wages, tips, and other compensation received for personal services are not income.

This argument asserts that wages, tips, and other compensation received for personal services are not income, arguing there is no taxable gain when a person "exchanges" labor for money. Under this theory, wages are not taxable income because people have basis in their labor equal to the fair market value of the wages they receive; thus, there is no gain to be taxed. A variation of this argument misconstrues section 1341—which deals with computations of tax where a taxpayer restores a substantial amount held under claim of right— to claim a deduction for personal services rendered.

Another similar argument asserts that wages are not subject to taxation where individuals have obtained funds in exchange for their time. Under this theory, wages are not taxable because the Code does not specifically tax "time reimbursement transactions." Some individuals or groups argue that the Sixteenth Amendment to the United States Constitution did not authorize a tax on wages and salaries, but only on gain or profit.

The Law: For federal income tax purposes, "gross income" means all income from whatever source derived and includes compensation for services. I.R.C. § 61. Any income, from whatever source, is presumed to be income under section 61, unless the taxpayer can establish that it is specifically exempted or excluded. See Reese v. United States, 24 F.3d 228, 231 (Fed. Cir. 1994) ("an abiding principle of federal tax law is that, absent an enumerated exception, gross income means all income from whatever source derived."). In Rev. Rul. 2007-19, 2007-1 C.B. 843, and in Notice 2010-33, 2010-17 I.R.B. 609, the IRS advised taxpayers that wages and other compensation received in exchange for personal services are taxable income and warned of the consequences of making frivolous arguments to the contrary.

Section 1341 and the court opinions interpreting it require taxpayers to return funds previously reported as income before they can claim a deduction under claim of right. To have the right to a deduction, the taxpayer should appear to have had an unrestricted right to the income in question, but had to return the money. See *Dominion Resources, Inc. v. United States*, 219 F.3d 359 (4th Cir. 2000). The IRS, in Rev. Rul. 2004-29, 2004-1 C.B. 627, warned taxpayers of the consequences of frivolously claiming the section 1341 deduction when the taxpayer has not repaid an amount previously reported as income.

All compensation for personal services, no matter what the form of payment, must be included in gross income. This includes salary or wages paid in cash, as well as the value of property and other economic benefits received because of services performed or to be performed in the future. Criminal and civil penalties have been imposed against individuals who rely upon this frivolous argument.

Though a handful of taxpayers who were criminally charged with violations of the internal revenue laws have avoided conviction, taxpayers should not mistake those few cases as indicative that frivolous positions that fail to yield criminal convictions are legitimate or that because one taxpayer escaped conviction, taxpayers are protected from sanctions resulting from noncompliance. While a few defendants have prevailed, the vast majority are convicted. Furthermore, even if a taxpayer is acquitted of criminal charges of noncompliance with federal tax laws, the IRS may pursue any underlying tax liability and is not barred from determining civil penalties. See *Helvering v. Mitchell*, 303 U.S. 391 (1938); *Price v. Commissioner*, T.C. Memo. 1996-204, 71 T.C.M. (CCH) 2884 (1996).

2. Contention: Only foreign-source income is taxable.

Some individuals and groups maintain that there is no federal statute imposing a tax on income derived from sources within the United States by citizens or residents of the United States. They argue instead that federal income taxes are excise taxes imposed only on nonresident aliens and foreign corporations for the privilege of receiving income from sources within the United States. The premise for this argument is a misreading of sections 861, *et seq.*, and 911, *et seq.*, as well as the regulations under those sections. These frivolous assertions are contrary to well-established legal precedent.

The Law: As stated above, for federal income tax purposes, “gross income” means all income from whatever source derived and includes compensation for services. I.R.C. § 61. Further, Treas. Reg. § 1.1-1(b) provides, “[i]n general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States.” Sections 861 and 911 define the sources of income (U.S. versus non-U.S. source income) for such purposes as the prevention of double taxation of income that is subject to tax by more than one country. These sections neither specify whether income is taxable nor determine or define gross income.

The IRS has warned taxpayers of the consequences of making these frivolous arguments. Rev. Rul. 2004-28, 2004-1 C.B. 624 (discussing section 911); Rev. Rul. 2004-30, 2004-1 C.B. 622 (discussing section 861); Notice 2010-33, 2010-17 I.R.B. 609.

Some groups and individuals have adopted a variation of this argument and argue that income derived within the United States is actually foreign earned income and then they claim the foreign earned income exclusion. This contention has been rejected as frivolous by the courts.

3. Contention: Federal Reserve Notes are not income.

Proponents of this contention assert that Federal Reserve Notes currently used in the United States are not valid currency and cannot be taxed because Federal Reserve Notes are not gold or silver and may not be exchanged for gold or silver. This argument misinterprets Article I, Section 10 of the United States Constitution. The courts have rejected this argument on numerous occasions.

The Law: Congress is empowered “[t]o coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures.” U.S. Const. Art. I, § 8, cl. 5. Article I, Section 10 of the Constitution prohibits the states from declaring as legal tender anything other than gold or silver, but does not limit Congress’s power to declare the form of legal tender. See 31 U.S.C. § 5103; 12 U.S.C. § 411. In an opinion affirming a conviction for willfully failing to file a return and rejecting the argument that Federal Reserve Notes are not subject to taxation, the court stated that “Congress has declared federal reserve notes legal tender . . . and federal reserve notes are taxable dollars.” United States v. Rifen, 577 F.2d 1111, 1112 (8th Cir. 1978).

4. Contention: Military retirement pay does not constitute income.

Eligible, retired United States military personnel may receive military retirement pay (MRP) from the agency responsible for disbursing these payments, the Defense Finance and Accounting Service (DFAS). Some individuals argue that MRP does not constitute income for federal income tax purposes.

The Law: The Internal Revenue Code defines gross income as "all income from whatever source derived, including . . . pensions." I.R.C. § 61(a)(11). Military retirement pay is pension income within the meaning of section 61. *Wheeler v. Commissioner*, 127 T.C. 200, 205 n.11 (2006); see also *Eatinger v. Commissioner*, T.C. Memo. 1990-310.

C. THE MEANING OF CERTAIN TERMS USED IN THE INTERNAL REVENUE CODE

1. Contention: Taxpayer is not a "citizen" of the United States and thus is not subject to the federal income tax laws.

Some individuals argue that they have rejected citizenship in the United States in favor of state citizenship; therefore, they are relieved of their federal income tax obligations. A variation of this argument is that a person is a free born citizen of a particular state and thus was never a citizen of the United States. The underlying theme of these arguments is the same: the person is not a United States citizen and is not subject to federal tax laws because only United States citizens are subject to these laws.

The Law: 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. 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. The IRS has warned taxpayers of the consequences of making this frivolous argument. Rev. Rul. 2007-22, 2007-1 C.B. 866; Notice 2010-33, 2010-17 I.R.B. 609.

In a variation of this argument, taxpayers argue that although they are citizens of the United States, for the purposes of the Internal Revenue Code they are non-resident aliens and are subject to taxation only on income that is connected with the conduct of a trade or business. The 11th Circuit rejected this contention as frivolous.

2. Contention: The "United States" consists only of the District of Columbia, federal territories, and federal enclaves.

Some individuals and groups argue that the United States consists only of the District of Columbia, federal territories (e.g., Puerto Rico, Guam, etc.), and federal enclaves (e.g., American Indian reservations, military bases, etc.) and does not include the "sovereign" states. According to this argument, if a taxpayer does not live within the "United States," as so defined, he is not subject to the federal tax laws.

The Law: The Internal Revenue Code imposes a federal income tax upon all United States citizens and residents, not just those who reside in the District of Columbia, federal territories, and federal enclaves.

The Supreme Court has "recognized that the sixteenth amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation, not just in federal enclaves." *Taliaferro v. Freeman,* 595 F. App'x 961, 963 (11th Cir. 2014). Courts have uniformly rejected this frivolous contention, and the IRS has warned taxpayers of the consequences of making this frivolous argument. Rev. Rul. 2006-18, 2006-1 C.B. 743; Notice 2010-33, 2010-17 I.R.B. 609.

3. Contention: Taxpayer is not a "person" as defined by the Internal Revenue Code, thus is not subject to the federal income tax laws.

Some individuals and groups maintain that they are not a "person" as defined by the Internal Revenue Code, and thus not subject to the federal income tax laws. This argument is based on a tortured misreading of the Code. In a variation of this argument, some individuals and groups argue that IRS correspondences addressed to taxpayers in all capital letters are not valid. Proponents of this argument claim there is a legal distinction under state law that entities such as corporations are legally addressed in this manner and since taxpayers are not "fictional legal entities," the correspondence is not valid.

The Law: The Internal Revenue Code clearly 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" within the meaning of the Internal Revenue Code have been uniformly rejected. A similar argument with respect to the term "individual" has also been rejected. The IRS has warned taxpayers of the consequences of making this frivolous argument. Rev. Rul. 2007-22, 2007-1 C.B. 866; Notice 2010-33, 2010-17 I.R.B. 609.

4. Contention: The only "employees" subject to federal income tax are employees of the federal government.

This contention asserts that the federal government can tax only employees of the federal government; therefore, employees in the private sector are immune from federal income tax liability. This argument is based on a misinterpretation of section 3401, which imposes responsibilities on employers to withhold tax from "wages." That section establishes the general rule that "wages" include all remuneration for services performed by an employee for his employer. Section 3401(c) goes on to state that the term "employee" includes "an officer, employee, or elected official of the United States, a State, or any political subdivision thereof . . . ."

The Law: Section 3401(c) defines "employee" and states that the term "includes an officer, employee or elected official of the United States . . . ." This language does not address how other employees' wages are subject to withholding or taxation. Section 7701(c) states that the use of the word "includes" "shall not be deemed to exclude other things otherwise within the meaning of the term defined." Thus, the word "includes" as used in the definition of "employee" is a term of enlargement, not of limitation. It makes federal employees and officials a part of the definition of "employee," which generally includes private citizens. The IRS has warned taxpayers of the consequences of making this frivolous argument. Rev. Rul. 2006-18, 2006-1 C.B. 743.

D. CONSTITUTIONAL AMENDMENT CLAIMS

1. Contention: Taxpayers can refuse to pay income taxes on religious or moral grounds by invoking the First Amendment.

Some individuals or groups claim that taxpayers may refuse to pay federal income taxes based on their religious or moral beliefs or on an objection to using taxes to fund certain government programs. In support of this frivolous position, these persons mistakenly invoke the First Amendment and, often, the Religious Freedom Restoration Act ("RFRA").

The Law: The First Amendment to the United States Constitution provides that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." The First Amendment, however, does not provide a right to refuse to pay income taxes on religious or moral grounds or because taxes are used to fund government programs opposed by the taxpayer. Likewise, it is well settled that RFRA does not afford a right to avoid payment of taxes for religious reasons. The First Amendment does not protect commercial speech or speech that aids or incites taxpayers to unlawfully refuse to pay federal income taxes, including speech that promotes abusive tax avoidance schemes.

2. Contention: IRS summonses violate the Fourth Amendment protections against search and seizure.

Some individuals or groups assert that summonses sent by the IRS to taxpayers and to third parties are per se violations of the Fourth Amendment's prohibition against warrantless search and seizure and are therefore unconstitutional.

The Law: The Fourth Amendment to the United States Constitution provides the "right of the people to be secure in their persons, houses, papers, and effects" and prohibits "unreasonable searches and seizures. . . ." The United States Supreme Court has held repeatedly that "the Fourth Amendment does not prohibit the obtaining of information revealed to a third party." *United States v. Miller*, 425 U.S. 435 (1976). The Fourth Amendment also provides that "no Warrants shall issue" unless there is "probable cause." The United States Supreme Court has ruled that the IRS "need not meet any standard of probable cause to obtain enforcement of [IRS] summons." *United States v. Powell*, 379 U.S. 48, 52 (1964). Where the enforcement of an IRS summons is challenged, the IRS bears the initial burden of showing "good faith compliance with summons requirements," which may "be demonstrated by the affidavit of the IRS agent." *United States v. Norwood*, 420 F.3d 888 (8th Cir. 2005).

3. Contention: Federal income taxes constitute a "taking" of property without due process of law, violating the Fifth Amendment.

Some individuals or groups assert that the collection of federal income taxes constitutes a "taking" of property without due process of law, in violation of the Fifth Amendment. Thus, any attempt by the IRS to collect federal income taxes owed by a taxpayer is unconstitutional.

The Law: The Fifth Amendment to the United States Constitution provides that a person shall not be "deprived of life, liberty, or property, without due process of law . . . ." The United States Supreme Court stated that "it is . . . well settled that [the Fifth Amendment] is not a limitation upon the taxing power conferred upon Congress by the Constitution; in other words, that the Constitution does not conflict with itself by conferring, upon the one hand, a taxing power, and taking the same power away, on the other, by the limitations of the due process clause." *Brushaber v. Union Pacific R.R.*, 240 U.S. 1, 24 (1916). Further, the Supreme Court has upheld the constitutionality of the summary administrative procedures contained in the Internal Revenue Code against due process challenges on the basis that a post-collection remedy (e.g., a tax refund suit) exists and is sufficient to satisfy the requirements of constitutional due process. *Phillips v. Commissioner*, 283 U.S. 589, 595-97 (1931).

The Internal Revenue Code provides methods to ensure due process to taxpayers: (1) the "refund method," set forth in section 7422(e) and 28 U.S.C. §§ 1341 and 1346(a), in which a taxpayer must pay the full amount of the tax and then sue for a refund in a federal district court or in the United States Court of Federal Claims; and (2) the "deficiency method," set forth in section 6213(a), in which a taxpayer may, without paying the contested tax, petition the United States Tax Court to redetermine a tax deficiency asserted by the IRS. Courts have found that both methods provide constitutional due process.

In Rev. Rul. 2005-19 2005-1 C.B. 819 and in Notice 2010-33, 2010-17 I.R.B. 609, the IRS discussed this frivolous argument in more detail and warned taxpayers of the consequences of attempting to pursue a claim on these grounds.

4. Contention: Taxpayers do not have to file returns or provide financial information because of the protection against self-incrimination found in the Fifth Amendment.

Some individuals or groups claim that taxpayers may refuse to file federal income tax returns, or may submit tax returns on which they refuse to provide any financial information, because they believe that their Fifth Amendment privilege against self-incrimination will be violated.

The Law: There is no constitutional right to refuse to file an income tax return on the ground that it violates the Fifth Amendment privilege against self-incrimination. As the Supreme Court has stated, a taxpayer cannot "draw a conjurer's circle around the whole matter by his own declaration that to write any word upon the government blank would bring him into danger of the law." *United States v. Sullivan*, 274 U.S. 259, 264 (1927). The failure to comply with the filing and reporting requirements of the federal tax laws will not be excused based upon blanket assertions of the constitutional privilege against compelled self-incrimination under the Fifth Amendment.

The IRS has discussed this frivolous argument in more detail and warned taxpayers of the consequences of attempting to pursue a claim on these grounds. Rev. Rul. 2005-19, 2005-1 C.B. 819; Notice 2010-33, 2010-17 I.R.B. 609.

5. Contention: Compelled compliance with the federal income tax laws is a form of servitude in violation of the Thirteenth Amendment.

This argument asserts that being compelled to comply with federal tax laws is a form of servitude in violation of the Thirteenth Amendment.

The Law: The Thirteenth Amendment to the United States Constitution prohibits slavery within the United States as well as imposing involuntary servitude, except as punishment for a crime of which a person shall have been duly convicted. "If the requirements of the tax laws were to be classed as servitude, they would not be the kind of involuntary servitude referred to in the Thirteenth Amendment." *Porth v. Brodrick*, 214 F.2d 925, 926 (10th Cir. 1954) (per curiam). Courts have consistently found arguments that taxation constitutes a form of involuntary servitude to be frivolous.

In Rev. Rul. 2005-19, 2005-1 C.B. 819 and in Notice 2010-33, 2010-17 I.R.B. 609, the IRS discussed this frivolous argument in more detail and warned taxpayers of the consequences of attempting to pursue a claim on these grounds.

6. Contention: The federal income tax laws are unconstitutional because the Sixteenth Amendment to the United States Constitution was not properly ratified.

This argument is based on the premise that all federal income tax laws are unconstitutional because the Sixteenth Amendment was not officially ratified or because the State of Ohio was not properly a state at the time of ratification. Proponents mistakenly believe that courts have refused to address this issue.

The Law: The Sixteenth Amendment provides that Congress shall have the power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration. The Sixteenth Amendment was ratified by forty states, including Ohio (which became a state in 1803); see *Bowman v. United States*, 920 F. Supp. 623 n.1 (E.D. Pa. 1995) (discussing the 1953 joint Congressional resolution that confirmed Ohio's status as a state retroactive to 1803), and issued by proclamation in 1913. Shortly thereafter, two other states also ratified the Amendment. Under Article V of the Constitution, only three-fourths of the states are needed to ratify an Amendment. There were enough states ratifying the Sixteenth Amendment even without Ohio to complete the number needed for ratification. Furthermore, after the Sixteenth Amendment was ratified, the Supreme Court upheld the constitutionality of the income tax laws. *Brushaber v. Union Pacific R.R.*, 240 U.S. 1 (1916). Since then, courts have consistently upheld the constitutionality of the federal income tax.

In Rev. Rul. 2005-19, 2005-1 C.B. 819, and in Notice 2010-33, 2010-17 I.R.B. 609, the IRS discussed this frivolous argument in more detail and warned taxpayers of the consequences of attempting to pursue a claim on these grounds.

7. Contention: The Sixteenth Amendment does not authorize a direct non-apportioned federal income tax on United States citizens.

Some individuals and groups assert that the Sixteenth Amendment does not authorize a direct non-apportioned income tax and, thus, U.S. citizens and residents are not subject to federal income tax laws.

The Law: The constitutionality of the Sixteenth Amendment has invariably been upheld when challenged. Numerous courts have both implicitly and explicitly recognized that the Sixteenth Amendment authorizes a non-apportioned direct income tax on United States citizens and that the federal tax laws are valid as applied. In Notice 2010-33, 2010-17 I.R.B. 609, the IRS warned taxpayers of the consequences of attempting to pursue a claim on these grounds.

E. FICTIONAL LEGAL BASES

1. Contention: The Internal Revenue Service is not an agency of the United States.

Some argue that the IRS is not an agency of the United States but rather a private corporation, because it was not created by positive law (i.e., an act of Congress) and that, therefore, the IRS does not have the authority to enforce the Internal Revenue Code.

The Law: Constitutional and statutory authority establishes that the IRS is an agency of the United States. Indeed, the Supreme Court has stated, "[T]he Internal Revenue Service is organized to carry out the broad responsibilities of the Secretary of the Treasury under § 7801(a) of the 1954 Code for the administration and enforcement of the internal revenue laws." *Donaldson v. United States*, 400 U.S. 517, 534 (1971).

Pursuant to section 7801, the Secretary of the Treasury has full authority to administer and enforce the internal revenue laws and has the power to create an agency to enforce such laws. Based upon this legislative grant, the IRS was created. Thus, the IRS is a body established by "positive law" because it was created through a congressionally mandated power. Moreover, section 7803(a) explicitly provides that there shall be a Commissioner of Internal Revenue who shall administer and supervise the execution and application of the internal revenue laws.

The IRS warned taxpayers of the consequences of attempting to pursue a claim on these grounds in Notice 2010-33, 2010-17 I.R.B. 609.

2. Contention: 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.

Some individuals and groups claim that taxpayers are not required to file tax returns because of the Paperwork Reduction Act of 1980, 44 U.S.C. § 3501, *et seq.* ("PRA"). The PRA was enacted to limit federal agencies' information requests that burden the public. The "public protection" provision of the PRA provides that no person shall be subject to any penalty for failing to maintain or provide information to any agency if the information collection request involved does not display a current control number assigned by the Office of Management and Budget [OMB] Director. 44 U.S.C. § 3512. Advocates of this contention claim that they cannot be penalized for failing to file Form 1040, because the instructions and regulations associated with the Form 1040 do not display any OMB control number.

The Law: Courts have uniformly rejected this argument on multiple grounds. Some have simply noted that the PRA applies to the forms themselves, not to the instruction booklets, and because the Form 1040 has a control number, there is no PRA violation. Others have held that Congress created the duty to file returns in section 6012(a), and "Congress did not enact the PRA's public protection provision to allow OMB to abrogate any duty imposed by Congress." *United States v. Neff*, 954 F.2d 698, 699 (11th Cir. 1992). The IRS has warned taxpayers of the consequences of making this frivolous argument. Rev. Rul. 2006-21, 2006-1 C.B. 745; Notice 2010-33, 2010-17 I.R.B. 609.

One variation of this theory is that taxpayers are not required to comply with requests at a Collection Due Process (CDP) hearing to fill out and submit Form 443-A Collection Information Statement for Wage

Earners and Self–Employed Individuals because the Form 443-A does not display an OMB control number as required by the Paperwork Reduction Act (PRA).

The Law: *Pitts v. Commissioner*, T.C. Memo 2010-101, 9 T.C.M. (CCH) 1406 (2010). The Court held that 44 U.S.C. section 3518(c)(1)(B)(ii) excludes administrative hearings—such as CDP hearings that evaluate the propriety of a specific collection action against a specific taxpayer—from the reach of the PRA. The lack of a control number on Form 433–A did not relieve Mr. Pitts from the obligation to submit the form and does not relieve him of the consequences of his failure to do so.

3. Contention: African Americans can claim a special tax credit as reparations for slavery and other oppressive treatment.

Proponents of this contention assert that African Americans can claim a so-called "Black Tax Credit" on their federal income tax returns as reparations for slavery and other oppressive treatment suffered by African Americans. A similar frivolous argument has been made that Native Americans are entitled to a credit on their federal income tax returns as a form of reparations for past oppressive treatment.

The Law: No provision in the Internal Revenue Code allows taxpayers to claim a "Black Tax Credit" or a credit for Native American reparations. It is a well settled principle of law that deductions and credits are a matter of legislative grace. See *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). Unless specifically provided for in the Internal Revenue Code, no deduction or credit is allowed. The IRS has warned taxpayers of the consequences of claiming refunds or other tax benefits based on frivolous reparations tax credits. Rev. Rul. 2004-33, 2004-1 C.B. 628; Notice 2010-33, 2010-17 I.R.B. 609. And in Rev. Rul. 2006-20, 2006-1 C.B. 746, and Notice 2010-33, 2010-17 I.R.B. 609, the IRS warned taxpayers about the frivolous nature of claiming an exemption for Native Americans from federal income tax liability based upon an unspecified "Native American Treaty".

Persons who claim refunds based on the slavery reparation tax credit or assist others in doing so are subject to prosecution for violation of federal tax laws. Furthermore, the United States has a cause of action for injunctive relief against a party suspected of violating the tax laws. Sections 7407 and 7408 provide for injunctive relief against income tax preparers and promoters of abusive tax shelters, respectively, in these types of cases.

4. Contention: Taxpayers are entitled to a refund of the Social Security taxes paid over their lifetime.

Proponents of this contention encourage individuals to file claims for refund of the Social Security taxes paid during their lifetime on the basis that the claimants have sought to waive all rights to their Social Security benefits. Or they encourage taxpayers to claim a charitable contribution deduction for their "gift" of these benefits or of the Social Security taxes to the United States.

The Law: No provision in the Internal Revenue Code, or any other provision of law, allows for a refund of Social Security taxes paid on the grounds asserted above. Nor may a person claim a charitable contribution deduction based upon the purported waiver of future Social Security benefits. *Crouch v. Commissioner*, T.C. Memo. 1990-309, 59 T.C.M. (CCH) 938 (1990).

The IRS has discussed this frivolous argument in more detail and warned taxpayers of the consequences of attempting to pursue a claim on these grounds. Rev. Rul. 2005-17 2005-1 C.B. 823; Notice 2010-33, 2010-17 I.R.B. 609.

5. Contention: An "untaxing" package or trust provides a way of legally and permanently avoiding the obligation to file federal income tax returns and pay federal income taxes.

Advocates of this idea believe that an "untaxing" package or trust provides a way of legally and permanently "untaxing" oneself so that a person is no longer required to file federal income tax returns and pay federal income taxes. Promoters who sell such tax-evasion plans and supposedly teach individuals how to remove themselves from the federal tax system rely on many of the above-described frivolous arguments, such as the claim that payment of federal income taxes is voluntary, that there is no requirement for a person to file federal income tax returns, and that there are legal ways not to pay federal income taxes.

The Law: The underlying claims for these "untaxing" packages are frivolous, as specified above. Furthermore, in Rev. Rul. 2006-19, 2006-1 C.B. 749, the IRS warned that taxpayers may not eliminate their federal income tax liability by attributing income to a trust and claiming expense deductions related to that trust.

Promoters of these "untaxing" schemes as well as willful taxpayers have been subjected to criminal penalties for their actions. Taxpayers who have purchased and followed these "untaxing" plans have also been subjected to civil penalties for failure to timely file a federal income tax return and failure to pay federal income taxes. Those who promote, advise on, or assist with these schemes can be enjoined from further carrying out this conduct or may be denied the ability to practice before the IRS.

6. Contention: A "corporation sole" can be established and used for the purpose of avoiding federal income taxes.

Advocates of this idea believe they can reduce their federal tax liability by taking the position that the taxpayer's income belongs to a "corporation sole" (these have also been referred to as "ministerial trusts"), an entity created for the purpose of avoiding taxes. A valid corporation sole is a corporate form that enables religious leaders to hold property and conduct business for the religious entity. Participants in this scheme apply for incorporation under the pretext of being an official of a church or other religious organization. Participants contend that their income is exempt from taxation because the income allegedly belongs to the corporation sole, which is claimed to be a tax exempt organization described in section 501(c)(3).

The Law: A valid corporation sole enables a bona fide religious leader, such as a bishop or other authorized religious official, to incorporate under state law, in his capacity as a religious official. See, e.g., *Berry v. Society of Saint Pius X*, 69 Cal. App. 4th 354 (1999). A corporation sole may own property and enter into contracts as a natural person, but only for the purposes of the religious entity and not for the individual office holder's personal benefit. A legitimate corporation sole is designed to ensure continuity of ownership of property dedicated to the benefit of a legitimate religious organization.

A taxpayer cannot avoid income tax or other financial responsibilities by purporting to be a religious leader and forming a corporation sole for tax avoidance purposes. The claims that such a corporation sole is described in section 501(c)(3) and that assignment of income and transfer of assets to such an entity will exempt an individual from income tax are meritless. Courts have repeatedly rejected similar arguments as frivolous, imposed penalties for making such arguments, and upheld criminal tax evasion convictions against those making or promoting the use of such arguments.

The IRS discussed this frivolous argument in more detail and warned taxpayers of the consequences of attempting to use this scheme in Rev. Rul. 2004-27, 2004-1 C.B. 625 and in Notice 2010-33, 2010-17 I.R.B. 609.

7. Contention: Taxpayers who did not purchase and use fuel for an off-highway business can claim the fuels tax credit.

Proponents of this idea assert that taxpayers can claim the section 6421 fuels tax credit without regard to whether they qualify for the credit through the purchase and use of gasoline for an off-highway business. In addition, certain purveyors of fraudulent tax schemes have claimed on behalf of clients (usually on IRS Form 4136, Credit for Federal Tax Paid on Fuels) the tax credit under section 6427 for nontaxable uses of fuel when the taxpayers clearly are not entitled to the credit based on the facts, such as the taxpayers' occupation and income level, type of motor vehicle and how it is used, and the volume of fuel claimed.

The Law: These claims are frivolous. Section 6421(a) allows a tax credit for gasoline purchased and used in an off-highway business. Similarly, section 6427 provides a tax credit to certain purchasers of undyed diesel fuel used in an off-highway business. The diesel fuel credit is allowable both for off-highway business use or any use other than in a registered diesel-powered highway vehicle (e.g., in a private home for personal heating purposes). The circumstances in which the credits are available are specific and limited.

The principal requirement is that the fuel be used in an off-highway business. Off-highway business use is the use of fuel in a trade or business or in an income-producing activity other than as a fuel in a vehicle registered for use on public highways. IRS Publication 225 (2008), *Farmer's Tax Guide* , gives as examples of the off-highway business use of fuels: (1) use in stationary machines like generators, compressors, power saws, and similar equipment; (2) use in forklifts, bulldozers, and earthmovers; and (3) use in cleaning. Also, Publication 510 (2008), Excise Taxes, explains that, with some exceptions, a highway vehicle is one "designed to carry a load over a public highway," including federal, state, county, and city roads and streets. Passenger cars, motorcycles, buses, highway trucks, tractor trailers, etc., generally are highway vehicles. Taxpayers are claiming fuels tax credits without regard to these requirements and often in absurdly large amounts that cannot possibly be for the quantity of fuel expended for off-highway purposes. Notice 2010-33, 2010-17 I.R.B. 609, lists such positions as frivolous.

8. Contention: A Form 1099-OID can be used as a debt payment option or the form or a purported financial instrument may be used to obtain money from the Treasury.

Advocates of this contention encourage individuals to use a Form 1099-OID, Original Issue Discount, or a bogus financial instrument such as a bonded promissory note as what purports to be a debt payment method for credit cards or mortgage debt. This scheme has evolved somewhat from an earlier frivolous position under which a secret bank account (sometimes referred to as a “straw man” account) was supposedly created at the Treasury Department for each U.S. citizen that individuals could use to pay tax and non-tax debts and claim withholding credits. Those who put forth this theory often argue that the proper way to redeem or draw on the account is to use some form of made-up financial instrument. This has frequently involved what looks like a check drawn on the United States Treasury or other similar paper instruments, e.g., bonded promissory notes.

One variation of this theory claims that each citizen has a “private side” and a “public side.” This theory contends that the government owns each person’s public side or “straw man” by holding title to each citizen’s birth certificate. By filing UCC–1 financing statements and their birth certificates in a state that accepts such filings, followers of this theory believe they can “redeem” their birth certificates. Redemption theorists view the redeemed birth certificate as an asset on which they place a value of up to $2 million and assert the U.S. Treasury Department acts as a clearinghouse for the funds. Under this theory, they then create money orders and sight drafts drawn on their “Treasury Direct Accounts.” Courts have characterized this theory as “implausible,” “clearly nonsense,” “convoluted,” and “peculiar.”

Another variation of the “redemption theory” asserts that persons can draw on the secret or “straw man” Treasury account by sending a Form 1099-OID to a creditor and the creditor can present the form to the Treasury Department and receive full payment of the debt. The proponents of this theory appear to assert that the Form 1099-OID permits them to access their secret Treasury Account for an amount equal to the face amount of the Form 1099-OID in the form of a tax refund.

Proponents of this theory also argue that they have sold or transferred their debt or obligation to the person to whom they issued the Form 1099- OID in a transaction subject to sections 1271 through 1275 and that the debt or obligation is transferred with a discount of the full face amount. The issuer of the Form 1099-OID then treats the face amount of the Form 1099-OID as “other income” on the individual’s return. The “other income” amount, however, is not included in the taxable income line.

Persons asserting this theory often significantly overstate withholding and claim an excessive refund in an amount close or identical to the inflated withholding.

The Law: As the instructions to the Form 1099-OID indicate, the purpose of the form is to report the original issue discount of holders of OID obligations, like certificates of deposit, time deposits, bonds, debentures, bonus saving plans, and Treasury inflation-indexed securities, having a term of more than one year. OID is simply the excess of the stated redemption of the deposit, bond, or other financial obligation at maturity over its issue price. Under section 1272, OID is taxable as interest over the life of the obligation and must be included in the holder’s gross income each taxable year that the obligation is held. Certain obligations are excepted, including United States savings bonds and short-term (less than one year) and tax-exempt obligations.

The Form 1099-OID is in no way a financial instrument. It is not a legitimate method of payment of any public or private debt, and it is not a means to withdraw or redeem money from the Treasury. Furthermore, as the federal Court of Appeals for the Sixth Circuit stated in *United States v. Anderson*, 353 F.3d 490, 500 (6th Cir. 2003), the Treasury Department does not maintain depository accounts against which an individual can draw a check, draft, or any other financial instrument. The notion of secret accounts assigned to each citizen is pure fantasy.

In addition to potential civil and criminal tax penalties for misuse of the Form 1099-OID, persons who fraudulently use false or fictitious instruments may be guilty of federal criminal offenses, such as under sections 287 and 514(a) of title 18.

The IRS warned taxpayers of the consequences of making such frivolous arguments in Rev. Rul. 2005-21, 2005-1 C.B. 822 (discussing the "straw man" theory) and Rev. Rul. 2004-31, 2004-1 C.B. 617 (discussing the commercial redemption theory).

There are variations of this frivolous argument where certain individuals or groups may claim false withholding or tax payments on an income tax return or purported return using another document from the Form 1099 series of information returns or a Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*. When such a taxpayer uses the Form 2439, the form is prepared to show false amounts of tax payments allegedly made for the taxpayer by a Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT).

II. FRIVOLOUS ARGUMENTS IN COLLECTION DUE PROCESS CASES

A. INVALIDITY OF THE ASSESSMENT

1. Contention: A tax assessment is invalid because the taxpayer did not get a copy of the Form 23C, the Form 23C was not personally signed by the Secretary of the Treasury, or a form other than Form 23C is not a valid record of assessment.

The Law: Tax assessments are formally recorded on a record of assessment. I.R.C. § 6203. The assessment is made by an assessment officer signing the summary record of assessment. Treas. Reg. § 301.6203-1. The summary record of assessment must "provide identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment." Id. The date of the assessment is the date the summary record is signed. Id. There is no requirement in the statute or regulation that the assessment be recorded on a specific form, that the Secretary of the Treasury personally sign it, or that the taxpayer be provided with a copy of the record of assessment before the IRS takes collection action.

The IRS has refuted the frivolous argument that before the IRS may collect overdue taxes, the IRS must provide taxpayers with a summary record of assessment made on a Form 23-C, *Assessment Certificate – Summary Record of Assessments*, or on another particular form in Rev. Rul. 2007-21, 2007-1 C.B. 865..

2. Contention: A tax assessment is invalid because the assessment was made from a substitute for return prepared pursuant to section 6020(b), which is not a valid return.

The Law: Section 6020(b)(1) provides that "[i]f any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefore, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise." Section 6020(b)(2) further provides that any return prepared pursuant to section 6020(b)(1) shall be prima facie good and sufficient for all legal purposes. See also Treas. Reg. § 301.6020-1.

B. INVALIDITY OF THE STATUTORY NOTICE OF DEFICIENCY

1. Contention: A statutory notice of deficiency is invalid because it was not signed by the Secretary of the Treasury or by someone with delegated authority.

The Law: There is no statutory requirement that, to be valid, a notice of deficiency must be signed by the Secretary of the Treasury or his delegate. The Secretary is authorized to send notices of deficiency to taxpayers. I.R.C. § 6212(a). "Secretary" includes the Secretary of the Treasury or his delegate. I.R.C. § 7701(a)(11)(B). "Delegate," as used with respect to the Secretary of the Treasury, means any officer, employee, or agency of the Treasury Department duly authorized by the Secretary directly, or indirectly by redelegation of authority, to perform a certain function. I.R.C. § 7701(a)(12)(A)(i). Thus, the authority to sign notices of deficiency may be delegated to any IRS officer, employee, or agency of the Treasury Department duly authorized by the Secretary directly, or indirectly by redelegation of authority.

2. Contention: A statutory notice of deficiency is invalid because the taxpayer did not file an income tax return.

The Law: Section 6211(a) defines "deficiency" as the amount by which the tax imposed by subtitle A (income taxes) or B (estate and gift taxes) or chapter 41, 42, 43, 44 (excise taxes) exceeds the excess of the sum of the amount shown as the tax by the taxpayer upon his return (if a return was made and amount was shown thereon) plus amounts previously assessed (or collected without assessment) as a deficiency, over the amount of rebates, as defined in section 6211(b)(2). In accordance with this definition, a taxpayer's failure to report tax on a return does not prevent the IRS from determining a deficiency in his federal tax and issuing a notice of deficiency under section 6212(a).

C. INVALIDITY OF NOTICE OF FEDERAL TAX LIEN

1. Contention: 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 Law: The form and content of the notice of federal tax lien is controlled by federal law. The form and content of the notice of federal tax lien shall be prescribed by the Secretary and shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien. I.R.C. § 6323(f)(3). The notice of federal tax lien must be filed on a Form 668, Notice of Federal Tax Lien Under Internal Revenue Laws, and must identify the taxpayer, the tax liability giving rise to the lien, and the date the assessment arose. Treas. Reg. § 301.6323(f)-1(d). There is no statutory or regulatory requirement that a notice of federal tax lien, to be valid, must be signed by anyone or, if it is signed, that it must be signed by the Secretary of the Treasury.

"The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary." I.R.C. § 6323(a). "Secretary" is defined to include the Secretary of the Treasury or his delegate and the term "delegate," as used with respect to the Secretary of the Treasury, is defined to mean any officer, employee, or agency of the Treasury Department duly authorized by the Secretary directly, or indirectly by redelegation of authority, to perform a certain function. I.R.C. §§ 7701(a)(11)(B) and 7701(a)(12)(A)(i). Treasury Order 150-10 delegates to the Commissioner the Secretary's authority to enforce and administer the internal revenue laws. Delegation Order 5-4, Rev. 2 delegates to IRS personnel the Commissioner's authority with respect to notices of federal tax lien.

2. Contention: 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.

The Law: The form and content of the notice of federal tax lien is controlled by federal law. the form and content of the notice of federal tax lien shall be prescribed by the Secretary and shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien. I.R.C.§ 6323(f)(3). The notice of federal tax lien must be filed on a Form 668, Notice of Federal Tax Lien Under Internal Revenue Laws, and must identify the taxpayer, the tax liability giving rise to the lien, and the date the assessment arose. Treas. Reg. § 301.6323(f)-1(d).

D. INVALIDITY OF COLLECTION DUE PROCESS NOTICE

1. Contention: 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.

The Law: The Secretary shall notify a taxpayer in writing of the filing of a notice of federal tax lien, pursuant to section 6323, advising the taxpayer of the right to request a collection due process hearing. I.R.C. § 6320(a)(1). No levy may be made on any property or rights to property of any person unless the Secretary has notified such person of his or her right to a collection due process hearing before levy. I.R.C. § 6330(a)(1). There is no requirement for a signature on the collection due process notice in the statute or regulations.

2. Contention: A collection due process notice is invalid because no certificate of assessment is attached.

The Law: Sections 6320(a)(3) and 6330(a)(3) list the information required to be included with the collection due process notice, such as the amount of unpaid tax, the right of the person to request a collection due process hearing, administrative appeals available, and the provisions of the Internal Revenue Code and procedures pertaining to the notice of federal tax lien or levy. See also Treas. Reg. §§ 301.6320-1(a)(2), Q&A A10 and 301.6330-1(a)(3), Q&A A6. There is no requirement in the statute or regulations that a certificate of assessment be attached to the collection due process notice.

E. VERIFICATION GIVEN AS REQUIRED BY I.R.C. § 6330(C)(1)

1. Contention: Verification requires the production of certain documents.

The Law: At a collection due process hearing, the appeals officer is required to obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met.

I.R.C. §§ 6320(c) and 6330(c)(1). Appeals must obtain verification from the IRS office collecting the tax. Treas. Reg. §§ 301.6320-1(e)(1) and 301.6330-1(e)(1). Neither the statutes nor the regulations require the appeals officer to rely upon a particular document (e.g., the summary record of assessment) to satisfy the verification requirement. Sections 6320(c) and 6330(c)(1) also do not require the Appeals Officer to give the taxpayer a copy of the verification upon which the Appeals Officer relied. See also Treas. Reg. §§ 301.6320-1(e)(1) and 301.6330-1(e)(1). There is no requirement in the statute or regulations that the taxpayer be provided with any documents as a part of the verification process. As a matter of practice, however, the taxpayer will be provided with a transcript of account such as a Form 4340 or MFTRA-X computer transcript. Transcripts such as the Form 4340 or MFTRA-X, which identify the taxpayer, the character of the liability assessed, the taxable period and the amount of the assessment, are sufficient to show the validity of an assessment, absent a showing of irregularity.

F. INVALIDITY OF STATUTORY NOTICE AND DEMAND

1. Contention: A notice and demand is invalid because it is not signed, it is not on the correct form (such as Form 17), or because no certificate of assessment is attached.

The Law: The Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. I.R.C. § 6303(a). This notice is to be left at the dwelling or usual place of business of such person, or shall be mailed to such person's last known address. Seealso Treas. Reg. § 301.6303-1(a) (failure to give notice within 60 days does not invalidate notice). Notice and demand is sufficient for purposes of section 6303 as long as it states the amount due and makes demand for payment. There is no requirement in the statute or regulation that the notice and demand be made on a specific form, have a signature, or include any specific attachments.

At a collection due process hearing, an Appeals Officer may rely upon a computer transcript to verify that notice and demand for payment has been sent to a taxpayer in accordance with section 6303. For example, the entry in a Form 4340 showing "notice of balance due" can establish proper issuance of a section 6303 notice and demand.

G. TAX COURT AUTHORITY

1. Contention: The Tax Court does not have the authority to decide legal issues.

The Law: The United States Tax Court is a federal court of record established by Congress under Article I of the United States Constitution. Congress created the Tax Court to provide a judicial forum in which affected persons could dispute tax deficiencies before paying the disputed amount. The Tax Court's jurisdiction includes the authority to hear tax disputes concerning notices of deficiency, notices of transferee liability, certain types of declaratory judgment, readjustment and adjustment of partnership items, administrative costs, worker classification, relief from joint and several liability on a joint return, and to review collection due process actions and the IRS's failure to abate interest.

Section 7441 provides that "[t]here is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. The members of the Tax Court shall be the chief judge and the judges of the Tax Court." Section 7442 provides that "[t]he Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by Chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926." Seealso I.R.C. §§ 7443-7448.

H. CHALLENGES TO THE AUTHORITY OF IRS EMPLOYEES

1. Contention: Revenue Officers are not authorized to seize property in satisfaction of unpaid taxes.

The Law: "If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax ... by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax." I.R.C. § 6331(a). The term "levy" includes the power of distraint and seizure by any means. I.R.C. § 6331(b). In any case in which the Secretary may levy upon property or property rights, he may also seize and sell such property or property rights. I.R.C. § 6331(b).

Section 7701(a)(11)(B) defines "Secretary" to include the Secretary of the Treasury or his delegate. Section 7701(a)(12)(A)(i) defines the term "delegate," as used with respect to the Secretary of the Treasury, to mean any officer, employee, or agency of the Treasury Department duly authorized by the Secretary directly, or indirectly by redelegation of authority, to perform a certain function. Treasury Order 150-10 delegates to the Commissioner the Secretary's authority to enforce and administer the internal revenue laws. See also Treas. Reg. § 301.6331-1(a)(1) (district director is authorized to levy); see, e.g., Delegation Order 5-3 (formerly D.O. 191 Rev. 3) (redelegation of authority with respect to levies to revenue officers and other IRS employees).

2. Contention: IRS employees lack credentials. For example, they have no pocket commission or the wrong color identification badge.

The Law: The authority of IRS employees is derived from Internal Code provisions, Treasury Regulations, and other redelegations of authority (such as delegation orders). See the previous discussion on the authority of revenue officers to seize property. The authority of IRS employees is not contingent upon such criteria as possession of a pocket commission or a specific type of identification badge.

3. Contention: Certain employees in the IRS Office of Appeals are not authorized to conduct collection due process hearings.

The Law: Hearings must be conducted by an officer or employee in the Internal Revenue Service Office of Appeals who has had no prior involvement with respect to the same unpaid tax. I.R.C. §§ 6320(b)(3) and 6330(b)(3). The statute does not specify that any particular category or officer conduct the hearing.

I. USE OF UNAUTHORIZED REPRESENTATIVES

1. Contention: Taxpayers are entitled to be represented at hearings, such as collection due process hearings, and in court, by persons without valid powers of attorney.

The Law: Section 500 of Title 5 of the United States Code authorizes (subject to some limitations) an attorney in good standing of the bar of the highest court of a State to represent a person before an agency upon filing with the agency a written declaration that they are currently qualified and authorized to represent the person on whose behalf they act. It also authorizes (subject to some limitations) an individual who is duly qualified to practice as a certified public accountant to represent a person before the IRS upon filing a written declaration that they are currently qualified and authorized to represent the particular person on whose behalf they act. Section 330 of Title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department and, after notice and an opportunity for a proceeding, to suspend or disbar from practice before the Treasury Department those representatives who are incompetent, disreputable, or who violate regulations prescribed under section 330. Pursuant to section 330, the Secretary, in Circular No. 230 (31 CFR part 10), published regulations that authorize the Office of Professional Responsibility to act on matters related to practitioner conduct and discipline, including disciplinary proceedings and sanctions. The regulations provide that only certain practitioners are entitled to represent taxpayers before the IRS. Attorneys and non-attorneys are entitled to practice before the United States Tax Court only upon application and admission to practice, pursuant to Tax Court Rule of Practice and Procedure 200.

J. AUTHORIZATION UNDER I.R.C. § 7401 IS REQUIRED IN A COLLECTION DUE PROCESS CASE

1. Contention: 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.

The Law: Section 7401 provides that "[n]o civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Secretary authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced.

Section 7401 does not apply in collection due process cases. The issue in a collection due process case is whether to sustain a levy or proposed levy or a notice of federal tax lien filing. These are administrative collection actions authorized under I.R.C. §§ 6323 and 6331, not "civil actions" for purposes of section 7401.

III. PENALTIES FOR PURSUING FRIVOLOUS TAX ARGUMENTS

Those who act on frivolous positions risk a variety of civil and criminal penalties. Those who adopt these positions may face harsher consequences than those who merely promote them. "Like moths to a flame, some people find themselves irresistibly drawn to the tax protester movement's illusory claim that there is no legal requirement to pay federal income tax. And, like moths, these people sometimes get burned." *United States v. Sloan*, 939 F.2d 499, 499–500 (7th Cir. 1991).

Taxpayers who rely on frivolous arguments to avoid filing returns may be subject to an addition to tax under section 6651(a)(1) for failing to file a return. Additionally, taxpayers who rely on frivolous arguments to avoid paying taxes may be subject to additions to tax under sections 6651(a)(2) and 6654 for failing to pay taxes.

Taxpayers filing returns with frivolous positions may be subject to the accuracy-related penalty under section 6662 (twenty percent of the underpayment attributable to negligence or disregard of rules or regulations), the civil fraud penalty under section 6663 (seventy-five percent of the underpayment attributable to fraud) and the erroneous claim for refund penalty under section 6676 (twenty percent of the excessive amount). Additionally, late filed returns setting forth frivolous positions may be subject to an addition to tax under section 6651(f) for fraudulent failure to timely file an income tax return (triple the amount of the standard failure to file addition to tax under section 6651(a)(1)). See *Mason v. Commissioner*, T.C. Memo. 2004-247, 88 T.C.M. (CCH) 398 (2004) (stating that frivolous arguments "may be indicative of fraud if made in conjunction with affirmative acts designed to evade paying federal income tax").

The Tax Relief Health Care Act of 2006 amended section 6702 to allow imposition of a $5,000 penalty for frivolous tax returns and for specified frivolous submissions other than returns, if the purported returns or specified submissions are either based upon a position identified as frivolous by the IRS in a published list or reflect a desire to delay or impede tax administration. Pub. L. No. 109-432, § 407(a), 120 Stat. 2922 (2006). The term "specified submission" means: a request for a hearing under section 6320 (relating to notice and opportunity for hearing on filing of a notice of lien), a request for hearing under section 6330 (relating to notice and opportunity for hearing before levy), an application under section 6159 (relating to agreements for payment of tax liability in installments), an application under section 7122 (relating to compromises), or an application under section 7811 (relating to taxpayer assistance orders). This amendment is effective for frivolous returns or specified frivolous submissions made after March 15, 2007, the release date of Notice 2007-30, 2007-1 C.B. 883, which identified the list of frivolous positions (last updated by Notice 2010-33, 2010-17 I.R.B. 609).

Section 6673(a) allows the Tax Court to impose a penalty of up to $25,000 when it appears that:

- a taxpayer instituted or maintained a proceeding primarily for delay,
- a taxpayer's position in such proceeding is frivolous or groundless, or
- a taxpayer unreasonably failed to pursue administrative remedies.

Courts provide a forum for litigation of taxpayers' bona fide disputes with the IRS. The courts' ability to perform that function is impeded when a taxpayer files a petition for some other reason, such as to defy the law or to delay the inevitable. Consequently, Congress gave courts discretion to impose penalties on taxpayers who engage in such conduct, to deter frivolous litigation and to induce taxpayers to conform their conduct to settled principles of law before pursuing litigation. A court may impose a section 6673 penalty on its own, even if the IRS does not make a motion for sanctions. *Leyshon v. Commissioner*, T.C. Memo 2015-104, 109 T.C.M. (CCH) 1535 (2015). "The purpose of § 6673 . . . is to induce litigants to conform their behavior to the governing rules regardless of their subjective beliefs. Groundless litigation diverts the time and energies of judges from more serious claims; it imposes needless costs on other litigants. Once the legal system has resolved a claim, judges and lawyers must move on to other things. They cannot endlessly rehear stale arguments. . . . [T]here is no constitutional right to bring frivolous suits . . . . People who wish to express displeasure with taxes must choose other forums, and there are many available." *Coleman v. Commissioner*, 791 F.2d 68, 72 (7th Cir. 1986) (emphasis in original). A penalty under section 6673 may be assessed against the taxpayer even when the taxpayer relied on the advice of an attorney. *Best v. Commissioner*, T.C. Memo. 2014-72, 107 T.C.M. (CCH) 1376 (2014).

Taxpayers who appeal a decision on frivolous grounds may be subject to sanctions under Rule 38 of the Federal Rules of Appellate Procedure. Sanctions may include single or double costs and damages to appellee. Courts have "sounded a cautionary note to those who would persistently raise arguments against the income tax which have been put to rest for years. The full range of sanctions in Rule 38 hereafter shall be summoned in response to a totally frivolous appeal." *Crain v. Commissioner*, 737 F.2d 1417, 1418 (5th Cir. 1984).

A tax return preparer, as defined by section 7701(a)(36), who prepares any return or claim of refund with respect to which any part of an understatement of liability is due to an unreasonable position, including any frivolous position discussed in this outline, and who knew or reasonably should have known of the position, may be required to pay a penalty equal to the greater of $1,000 or 50 percent of the income derived by the tax return preparer with respect to preparing the return or claim for refund. I.R.C. § 6694(a). The minimum penalty amount increases to the greater of $5,000 or 75 percent of the income derived by the tax return preparer with respect to preparing the return or claim for refund for willful or reckless conduct of the tax return preparer. I.R.C. § 6694(b). The IRS may impose a penalty of $1,000 for aiding or assisting in the preparation or presentation of any portion of a return with knowledge that it will result in an understatement of tax liability. I.R.C. § 6701(a).

Taxpayers who rely on frivolous arguments may also face criminal prosecution. These taxpayers may be convicted of a felony for attempting to evade or defeat tax. I.R.C. § 7201. Section 7201 provides as a penalty a fine of up to $100,000 ($500,000 in the case of a corporation) and imprisonment for up to 5 years. Similarly, taxpayers may be convicted of a felony for willfully making and signing under penalties of perjury any return, statement, or other document that the person does not believe to be true and correct as to every material matter. I.R.C. § 7206(1). The penalty for violating section 7206 is a fine of up to $100,000 ($500,000 in the case of a corporation) and imprisonment for up to 3 years. Any individual found guilty of either offense may be subject to an increased fine of up to $250,000. 18 U.S.C. § 3571(b)(3).

Persons who promote frivolous arguments and those who assist taxpayers in claiming tax benefits based on frivolous arguments may be prosecuted for a criminal felony for which the penalty is up to $100,000 ($500,000 in the case of a corporation) and imprisonment for up to 3 years for assisting with or advising about the preparation or presentation of a false return or other document under the internal revenue laws. I.R.C. § 7206(2). Any individual found guilty of a felony under section 7206 may be subject to an increased fine of up to $250,000. 18 U.S.C. § 3571(b)(3).

IV. IRS DIRTY DOZEN TAX SCAMS FOR 2023

In an effort to help taxpayers from becoming victims of tax fraudsters, the IRS publishes an annual list of the "Dirty Dozen" which are common tax scams for which taxpayers and tax professionals should be aware.

1. Employee Retention Credit (ERC) claims

While many eligible employers claimed and have already received the ERC, some third parties continue to widely advertise their services targeting taxpayers who may not be eligible for the ERC. Unfortunately, these advertisements, along with the increased prevalence of websites touting how easy it is to qualify for the ERC, lend an air of legitimacy to abusive claims for refund.

Tax professionals have reported receiving undue pressure from clients to participate and claim the ERC, even when the tax professional believes the client is not entitled to the credit. The IRS encourages the tax professional community to continue to advise clients not to file ERC claims when the tax professional believes they do not qualify.

The IRS has been warning about this scheme since last fall, but there continue to be attempts to claim the ERC during the 2023 tax filing season.

Third party promoters of the ERC often don't accurately explain eligibility for, and computation of, the credit. They may make broad arguments suggesting that all employers are eligible without evaluating an employer's individual circumstances. For example, only recovery startup businesses are eligible for the ERC in the fourth quarter of 2021, but these third-party promoters fail to explain this limitation. In addition, some third parties do not inform employers that they cannot claim the ERC on wages that were reported as payroll costs in obtaining Paycheck Protection Program loan forgiveness.

Additionally, some of these advertisements exist solely to collect the taxpayer's personally identifiable information in exchange for false promises. The scammers then use the information to conduct identity theft.

Properly claiming the ERC

Eligible taxpayers can claim the ERC on an original or amended employment tax return for qualified wages paid between March 13, 2020, and Dec. 31, 2021. However, to be eligible, employers must have:

- Sustained a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel or group meetings because of COVID-19 during 2020 or the first three quarters of 2021,
- Experienced a significant decline in gross receipts during 2020 or a decline in gross receipts during the first three quarters of 2021, or
- Qualified as a recovery startup business for the third or fourth quarters of 2021.

2. Phishing and smishing

Taxpayers and tax professionals should be alert to fake communications posing as legitimate organizations in the tax and financial community, including the IRS and states. These messages arrive in the form of an unsolicited text or email to lure unsuspecting victims to provide valuable personal and financial information that can lead to identity theft. There are two main types:

- ***Phishing*** is an email sent by fraudsters claiming to come from the IRS or another legitimate organization, including state tax organizations or a financial firm. The email lures the victims into the scam by a variety of ruses such as enticing victims with a phony tax refund or frightening them with false legal/criminal charges for tax fraud.
- ***Smishing*** is a text or smartphone SMS message that uses the same technique as phishing. Scammers often use alarming language like, "Your account has now been put on hold," or "Unusual Activity Report" with a bogus "Solutions" link to restore the recipient's account. Unexpected tax refunds are another potential target for scam artists.

The IRS initiates most contacts through regular mail and will never initiate contact with taxpayers by email, text, or social media regarding a bill or tax refund.

Never click on any unsolicited communication claiming to be the IRS as it may surreptitiously load malware. It may also be a way for malicious hackers to load ransomware that keeps the legitimate user from accessing their system and files.

The IRS also warns taxpayers to be wary of messages that appear to be from friends or family but that are possibly stolen or compromised email or text accounts from someone they know. This remains a popular way to target individuals and tax preparers for a variety of scams. Individuals should verify the identity of the sender by using another communication method; for instance, calling a number they independently know to be accurate, not the number provided in the email or text.

3. Online account help from third-party scammers

In this scam targeting individuals, swindlers pose as a "helpful" third party and offer to help create a taxpayer's IRS Online Account at IRS.gov. People should remember they can set these accounts up themselves. But third parties making these offers will try to steal a taxpayer's personal information this way. Taxpayers can and should establish their own Online Account through IRS.gov.

These scammers often ask for the taxpayer's personal information including address, Social Security number or Individual Taxpayer Identification number (ITIN), and photo identification. The criminal then sells this valuable information to other criminals. They can also use the sensitive information to file fraudulent tax returns, obtain loans, and open credit accounts.

The IRS urges people to watch out for these "helpful" criminals. The only place individuals should go to create an IRS Online Account is IRS.gov. People should not use third-party assistance, other than the approved IRS authentication process through IRS.gov, to create their own IRS online account.

4. False Fuel Tax Credit claims

Improper credits continue to be an important area of focus for the IRS. The fuel tax credit is meant for off-highway business and farming use and, as such, is not available to most taxpayers. However, unscrupulous tax return preparers and promoters are enticing taxpayers to inflate their refunds by erroneously claiming the credit. The IRS has seen an increase in the promotion of filing certain refundable credits using Form 4136, *Credit for Federal Tax Paid on Fuels*.

In this scam, a third party convinces a taxpayer to fraudulently claim the credit with promises of a windfall refund. But the promoters are focused on their own gain, taking advantage of the taxpayer with inflated fees, refund fraud, and identity theft.

Taxpayers contemplating participating in any questionable tax scheme such as this should be aware the IRS has increased its compliance efforts related to falsely claiming these credits. IRS processing systems, including new identity theft screening filters, are now stopping a significant number of suspicious fuel tax credit refund claims.

Before taking the bait on a dubious credit claim, taxpayers should seek advice from a legitimate source. Returns filed by individuals and tax preparers who knowingly claim a credit to which they are not entitled may face fines and even be subject to federal criminal prosecution and imprisonment.

5. Fake charities

Bogus charities are a perennial problem that gets bigger whenever a crisis or natural disaster strikes. Scammers set up these fake organizations to take advantage of the public's generosity. They seek money and personal information, which can be used to further exploit victims through identity theft.

Taxpayers who give money or goods to a charity might be able to claim a deduction on their federal tax return if they itemize deductions, but charitable donations only count if they go to a qualified tax-exempt organization recognized by the IRS.

Fake charity promoters may use emails to solicit donations or alter or "spoof" their caller ID to make it look like a real charity is calling on the phone. They often target seniors and groups with limited English proficiency.

Here are some tips to protect against fake charity scams:

- **Don't give in to pressure.** Scammers often use a tactic focused on an urgent need to pressure people into making an immediate payment. Legitimate charities are happy to get a donation at any time; so, people should feel no rush. Donors are encouraged to take time to do their own research.

- **Verify first.** Scammers frequently use names that sound like well-known charities to confuse people. Potential donors should ask the fundraiser for the charity's exact name, website, and mailing address so they can independently confirm it.

- **Be wary about how a donation is requested.** Taxpayers should never work with charities that ask for donations by giving numbers from a gift card or by wiring money. That's a scam. It's safest to pay by credit card or check — and only after verifying the charity is real.

- **Don't give more than needed.** Scammers are on the hunt for both money and personal information. Taxpayers should treat personal information like cash and not hand it out to just anyone. They should never give out Social Security numbers, credit card numbers, or PIN numbers, and they should give bank or credit card numbers only after they've confirmed the charity is real.

6. Unscrupulous tax return preparers

Most tax return preparers provide outstanding and professional service. Unfortunately, there are also some unethical tax preparers that should be avoided at all costs.

A major red flag or bad sign is when the tax preparer is unwilling to sign the dotted line. Avoid these "ghost" preparers, who will prepare a tax return but refuse to sign or include their IRS Preparer Tax Identification Number (PTIN) as required by law.

Not signing the return could mean the preparer may be looking to make a quick profit by promising a big refund or charging fees based on the size of the refund. This leaves the taxpayer vulnerable and on the hook for any misinformation on the return. Taxpayers should never sign a blank or incomplete return.

Shady tax preparers may:

- Ask for a cash only payment without providing a receipt.

- Invent false income to try to get their clients more tax credits.

- Claim fake deductions to boost the size of the refund.

- Direct refunds into their bank account, not the taxpayer's account.

7. Social media: Fraudulent form filing and bad advice

Social media can connect people and information from all over the world. Unfortunately, sometimes people provide bad advice that can lure good taxpayers into trouble. The IRS warns taxpayers to be wary of trusting internet advice, whether it's a fraudulent tactic promoted by scammers or it's patently false tax-related scheme trending across popular social media platforms.

The IRS is aware of various filing season hashtags and social media topics leading to inaccurate and potentially fraudulent information. The central theme involves people trying to use legitimate tax forms for the wrong reason. Here are just two of the recent schemes circulating online:

Form 8944 fraud

A recent example of bad advice circulating on social media that could lead to fraudulent form filing involves Form 8944, *Preparer e-file Hardship Waiver Request*. There are wildly inaccurate suggestions being made about this form. Posts claim that Form 8944 can be used by taxpayers to receive a refund from the IRS, even if the taxpayer has a balance due. This is false information. Form 8944 is for tax professional use only.

While Form 8944 is a legitimate IRS tax form, it's intended for a targeted group of tax return preparers who are requesting a waiver so they can file tax returns on paper instead of electronically. It is not in any way a form the average taxpayer can use to avoid tax bills. Taxpayers who intentionally file forms with false or fraudulent information can face serious consequences, including potentially civil and criminal penalties.

Form W-2 fraud

This scheme, which is circulating on social media, encourages people to use tax software to manually fill out Form W-2, *Wage and Tax Statement*, and include false income information. In this W-2 scheme, scam artists suggest people make up large income and withholding figures as well as the employer its coming from. Scam artists then instruct people to file the bogus tax return electronically in hopes of getting a substantial refund.

The IRS, along with the Security Summit partners in the tax industry and the states, are actively watching for this scheme. In addition, the IRS works with payroll companies and large employers – as well as the Social Security Administration – to verify W-2 information.

8. Spearphishing and cybersecurity for tax professionals

Phishing is a term given to emails or text messages designed to get users to provide personal information, either directly or by clicking on a link or attachment. Spearphishing is a tailored phishing attempt to a specific organization or business.

The IRS is warning tax professionals about spearphishing because there is greater potential for harm if the tax preparer has a data breach. A successful spearphishing attack can ultimately steal client data and the tax preparer's identity, allowing the thief to file fraudulent returns.

A taxpayer becoming a victim of tax-related identity theft is certainly an issue with spearphishing, but criminals seeking tax preparer credentials or access to their client's tax-related information increases the potential number of victims.

Spearphishing begins with a suspicious email – one that may appear as a tax preparation application or another e-service or platform. Some scammers will even use the IRS logo and claim something like "Action Required: Your account has now been put on hold." Often these emails stress urgency and will ask tax pros or businesses to click on links to input or verify information.

How to side-step spearphishing:

- Never click suspicious links.
- Double check the requests with the original sender.
- Be vigilant year-round, not just during filing season.

Client impersonation: Spearphishing aimed at tax pros

The IRS and its Security Summit partners continue to see spearphishing attempts that impersonate a new potential client, known as the “New Client” scam. If the tax preparer responds, the scammer sends a malicious attachment or URL that ultimately enables them to gain access to sensitive client information on the tax preparer’s computer systems.

Bogus requests for W-2s: Spearphishing aimed at businesses

The IRS wants to warn businesses about another specific spearphishing scam that targets employees in payroll or accounting departments. These employees might get an email that looks like it comes from an official source requesting W-2s for all employees. The payroll department might accidentally reply with these important documents, which would provide scammers with W-2 data on employees that can be used to commit fraud.

The IRS recommends using a two-person review process when receiving these types of requests for W-2s. The IRS also recommends any requests for payroll be submitted through an official process, like the employer’s Human Resources portal.

9. Offer in Compromise mills

An Offer in Compromise (OIC) is when the taxpayer works with the IRS to settle a tax debt for less than the full amount owed. It is an option for those unable to pay the full tax liability or if doing so creates a financial hardship. The IRS takes in consideration each unique set of facts and circumstances. This agreement can happen directly between the taxpayer and the IRS without a third party.

An Offer in Compromise “mill” will usually make outlandish claims, frequently in radio and TV ads, about how they can settle a person’s tax debt for cheap. In reality, the promoter fees are often excessive, and taxpayers pay the OIC mill to get the same deal they could have received on their own by working directly with the IRS. This takes unnecessary money out of the taxpayer’s wallet.

In addition, not every taxpayer will qualify for an OIC. Some promoters knowingly advise indebted taxpayers to file an OIC application even though the promoters know the person will not qualify, costing honest taxpayers money and time.

The IRS urges people to take a few minutes to review information on IRS.gov to see if they might be a good candidate for the OIC program – and avoid costly promoters. As a first step, a taxpayer can check their OIC eligibility for free using the IRS’s Offer in Compromise Pre-Qualifier tool. And the IRS reminds taxpayers about the First Time Penalty Abatement policy, where taxpayers can go directly to the IRS for administrative relief from a penalty that would otherwise be added to their tax debt.

10. Schemes aimed at high-income filers

Charitable Remainder Annuity Trust (CRAT)

Charitable Remainder Trusts are irrevocable trusts that let individuals donate assets to charity and draw annual income for life or for a specific time period. The IRS examines charitable remainder trusts to ensure they correctly report trust income and distributions to beneficiaries, file required tax documents and follow applicable laws and rules. A charitable remainder annuity trust (CRAT) pays a specific dollar amount each year.

Unfortunately, these trusts are sometimes misused by promoters, advisors, and taxpayers to try to eliminate ordinary income and/or capital gain on the sale of property. In abusive transactions of this type, property with a fair market value in excess of its basis is transferred to a CRAT. Taxpayers may wrongly claim the transfer of the property to the CRAT results in an increase in basis to fair market value as if the property had been sold to the trust. The CRAT then sells the property but does not recognize gain due to the claimed step-up in basis. Next, the CRAT purchases a single premium immediate annuity (SPIA) with the proceeds from the sale of the property.

By misapplying the rules under sections 72 and 664, the taxpayer, or beneficiary, treats the remaining payment as an excluded portion representing a return of investment for which no tax is due.

Monetized Installment Sales

In these potentially abusive transactions, promoters find taxpayers seeking to defer the recognition of gain upon the sale of appreciated property. They facilitate a purported monetized installment sale for the taxpayer in exchange for a fee. These installment sales occur when an intermediary purchases appreciated property from a seller in exchange for an installment note. The notes typically provide for payments of interest only, with principal being paid at the end of the term. In these arrangements, the seller gets the lion's share of the proceeds, but improperly delays the recognition of gain on the appreciated property until the final payment on the installment note, often years later.

These are examples of potentially abusive arrangements that taxpayers should avoid, many of which are now advertised online. The IRS recommends that taxpayers considering these types of arrangements carefully review the legal requirements underlying them and consult with competent, independent, qualified advisors before engaging or claiming any purported tax benefit.

Where appropriate, the IRS may assert accuracy-related penalties ranging from 20% to 40% of an underpayment of tax, or a civil fraud penalty of 75% of any underpayment of tax related to transactions like those listed here. However, this is not an exclusive list of transactions the IRS is scrutinizing, and taxpayers and practitioners should always be wary of participating in transactions that seem "too good to be true."

11. Bogus tax avoidance strategies

Micro-captive insurance arrangements

Also called a small captive, a micro-captive is an insurance company whose owners elect to be taxed on the captive's investment income only. Abusive micro-captives involve schemes that lack many of the attributes of legitimate insurance. These structures often include implausible risks, failure to match genuine business needs and in many cases, unnecessary duplication of the taxpayer's commercial coverages. In addition, the "premiums" paid under these arrangements are often excessive, reflecting non-arm's length pricing.

Abusive micro-captive transactions continue to be a high-priority enforcement area for the IRS. The IRS has won all micro-captive Tax Court and appellate court cases decided on their merits since 2017.

Syndicated conservation easements

A conservation easement is a restriction on the use of real property. Generally, taxpayers may claim a charitable contribution deduction for the fair market value of a conservation easement transferred to a charity if the transfer meets the requirements of Internal Revenue Code section 170.

Syndicated conservation easements are arrangements that make the Dirty Dozen list again in 2023. In abusive arrangements, promoters are syndicating conservation easement transactions that purport to give an investor the opportunity to claim charitable contribution deductions and corresponding tax savings that significantly exceed the amount the investor invested. These abusive arrangements, which generate high fees for promoters, attempt to game the tax system with grossly inflated tax deductions.

As part of the Consolidated Appropriations Act of 2023, Congress amended section 170 to curb certain abusive conservation easement transactions. The IRS is committed to ensuring compliance with the conservation easement deduction law as amended in the 2023 legislation and will continue to scrutinize transactions that are “too good to be true.”

12. Schemes with international elements

Offshore accounts & digital assets

International tax compliance remains a high priority for the IRS. The IRS continues to scrutinize taxpayers attempting to hide assets in offshore accounts and accounts holding digital assets, such as cryptocurrency. The IRS reminds U.S. persons that they are taxable on their worldwide income, unless they can establish there is a statutory or treaty exemption.

The IRS continues to identify individuals who attempt to conceal income in offshore banks, brokerage accounts, digital asset accounts, and nominee entities. The IRS scrutinizes structured transactions, private annuities, employee leasing schemes, foreign trusts, the use of nominee ownership, and other arrangements used to conceal taxable income, beneficial owners, and assets. To complement its enforcement investigations, the IRS requires individuals holding foreign assets and third parties to report to the IRS on foreign assets, foreign accounts, foreign entities, and digital assets. Reporting requirements carry penalties for failure to file.

Asset protection professionals and unscrupulous promoters continue to lure U.S. persons into placing their assets in offshore accounts and structures, saying they are out of reach of the IRS. Similarly, unscrupulous promoters recommend digital assets as being untraceable and undiscoverable by the IRS. These assertions are not true. The IRS can identify and track anonymous transactions of foreign financial accounts as well as digital assets.

Many of these schemes are promoted and advertised online, but all these schemes have one thing in common - they promise tax savings that are too good to be true and will likely cause legal harm to taxpayers.

Maltese individual retirement arrangements misusing treaty

These arrangements involve U.S. citizens or residents who attempt to avoid U.S. tax by contributing to foreign individual retirement arrangements in Malta (or potentially other host countries). The participants in these transactions typically lack any local connection to the host country, and unlike U.S. law for individual retirement arrangements, the host country's laws allow for contributions in a form other than cash and do not limit the amount of contributions by reference to employment or self-employment activities. By improperly asserting the foreign arrangement as a "pension fund" for U.S. tax treaty purposes, the U.S. taxpayer misconstrues the relevant treaty provisions and improperly claims an exemption from U.S. income tax on gains and earnings in, and distributions from, the foreign individual retirement arrangement.

Puerto Rican and other foreign captive insurance

In these transactions, U.S. business owners of closely held entities participate in a purported insurance arrangement with a Puerto Rican or other foreign corporation in which the U.S. business owner has a financial interest. The U.S. business owner (or a related entity) claims a deduction for amounts paid as premiums for "insurance coverage" provided by a fronting carrier, which reinsures the "coverage" with the Puerto Rican or other foreign corporation. Despite being labeled as insurance, these arrangements lack many of the attributes of legitimate insurance. Like the micro-captives described previously, the characteristics of the purported insurance arrangements typically will include one or more of the following: implausible risks covered (or duplicative coverage of risks already covered by commercial insurance), excessive premiums indicative of non-arm's length pricing, and a lack of business purpose for entering the arrangement.

The IRS warns anyone thinking about using one of these schemes – or similar ones – that the agency continues to improve investigation and enforcement in these areas by utilizing new and evolving data analytic tools and enhanced document matching.

Whether anchored offshore or in the U.S., abusive transactions and schemes remain a high priority for the IRS. The IRS Office of Chief Counsel continues to hire additional attorneys to help the agency combat abusive arrangements, including syndicated conservation easements, micro-captive transactions, and others.

The IRS also created the Office of Fraud Enforcement (OFE) and Office of Promoter Investigations (OPI) to coordinate service-wide enforcement activities against taxpayers committing tax fraud and promoters marketing and selling abusive tax avoidance transactions and schemes to effectuate tax evasion.

V. SUMMARY OF PREPARER PENALTIES RELATED TO FRIVOLOUS TAX RETURN POSITIONS

IRC § 6694 – Understatement of taxpayer's liability by tax return preparer.

IRC § 6694(a) – Understatement due to unreasonable positions. The penalty is $1,000 or 50% (whichever is greater) of the tax preparer's income to prepare the tax return or claim.

IRC § 6694(b) – Understatement due to willful or reckless conduct. The penalty is $5,000 or 75% (whichever is greater) of the tax preparer's income to prepare the tax return or claim.

IRC § 6695 – Other assessable penalties with respect to the preparation of tax returns for other persons.

IRC § 6695(a) – Failure to furnish copy to taxpayer. For returns filed in calendar year 2023, the penalty is $55 for each failure of a tax preparer to give a copy of a tax return or refund claim to a taxpayer and the maximum penalty cannot be greater than $28,000. For returns filed in calendar year 2024, the penalty is $60 for each failure and the maximum penalty cannot be greater than $30,000.

IRC § 6695(b) – Failure to sign return. For returns filed in calendar year 2023, the penalty is $55 for each failure of a tax preparer to sign a tax return or refund claim and the maximum penalty cannot be greater than $28,000. For returns filed in calendar year 2024, the penalty is $60 for each failure and the maximum penalty cannot be greater than $30,000.

IRC § 6695(c) – Failure to furnish identifying number. For returns filed in calendar year 2023, the penalty is $55 for each failure of a tax preparer to include a preparer tax identifying number (PTIN) on a tax return or claim and the maximum penalty cannot be greater than $28,000. For returns filed in calendar year 2024, the penalty is $60 for each failure and the maximum penalty cannot be greater than $30,000.

IRC § 6695(d) – Failure to retain copy or list. For returns filed in calendar year 2023, the penalty is $55 for each failure of a tax preparer to keep a copy or list of a tax return or claim they prepared and the maximum penalty cannot be greater than $28,000. For returns filed in calendar year 2024, the penalty is $60 for each failure and the maximum penalty cannot be greater than $30,000.

IRC § 6695(e) – Failure to file correct information returns. For returns filed in calendar year 2023, the penalty is $55 for each failure of a tax preparer to include correct information on tax returns and the maximum penalty cannot be greater than $28,000. For returns filed in calendar year 2024, the penalty is $60 for each failure and the maximum penalty cannot be greater than $30,000.

IRC § 6695(f) – Negotiation of check. Penalty in calendar year 2023 is $560 for a tax preparer who endorses or negotiates any check payable to another person. The penalty for returns filed in calendar year 2024 is $600.00.

IRC § 6695(g) – Failure to be diligent in determining eligibility for certain tax benefits. Penalty in calendar year 2023 is $560 for each failure of a tax preparer to determine a taxpayer's eligibility for the head of household filing status and the following credits:

- Any dependent credit including the Additional Child Tax Credit and Child Tax Credit
- American Opportunity Credit
- Earned Income Tax Credit
- Lifetime Learning Credit

The penalty for returns filed in calendar year 2024 is $600.00.

IRC § 6700 – Promoting abusive tax shelters.

Applies to people who organize or sell abusive tax shelters. The IRS calculates the penalty differently depending on the conduct:

- **False statements about the tax benefits of the transaction:** Penalty is 50% of the gross income the person made for the activity
- **Provides a gross valuation overstatement:** Penalty is $1,000 or 100% (whichever is less) of the gross income the person made for the activity for each entity or arrangement (treated as a separate activity) and participation in each sale

IRC § 6701 – Penalties for aiding and abetting understatement of tax liability.

The penalty is $1,000 ($10,000 for a corporate tax return) for helping underestimate a person's tax liability on their tax return. The IRS may assess this penalty only once for documents relating to the same taxpayer for a single tax period or event.

IRC § 6713 – Disclosure or use of information by preparers of returns.

Applies to disclosures or uses made on or after July 1, 2019.

The penalty is $250 for each unauthorized disclosure or use of information given to a tax preparer to prepare a tax return. The maximum penalty assessed cannot be greater than $10,000 in a calendar year.

If an unauthorized disclosure or use of information is connected to an identity theft crime, the penalty is $1,000 for each use or disclosure. The maximum penalty assessed cannot be greater than $50,000 in a calendar year.

IRC § 7206 – Fraud and false statements.

Applies to people who commit fraud or make false statements on tax returns. People assessed this penalty are charged with a felony crime and may be:

- Fined up to $100,000 ($500,000 in the case of a corporation)
- Imprisoned up to 3 years
- Required to pay for the costs of prosecution

This penalty also applies to fraudulent and false activities in connection with offers in compromise or a closing agreement.

IRC § 7207 – Fraudulent returns, statements, or other documents.

It may apply to people who prepare fraudulent returns, statements or other documents. People assessed this penalty are charged with a misdemeanor crime and may be:

- Fined up to $10,000 ($50,000 in the case of a corporation)
- Imprisoned up to 1 year

IRC § 7216 – Knowing or reckless disclosure or use of information by preparers of returns.

Applies to tax preparers who knowingly or recklessly disclose information given to them to prepare a tax return or use the information for any purpose other than to prepare a return. Tax preparers assessed this penalty are charged with a misdemeanor crime and may be:

- Fined up to $1,000
- Imprisoned up to 1 year
- Required to pay for the costs of prosecution

RC § 7408 – Action to enjoin specified conduct related to tax shelters and reportable transactions

The U.S. government may sue in federal district court to stop a person's unlawful conduct regarding tax shelters and reportable transactions. The conduct may include violations in Circular 230 and other laws about practicing before the IRS.

VI. CONCLUSION

The IRS is very serious about combating frivolous tax return positions and prosecuting abusive tax return preparers. IRS Circular 230 outlines the ethical responsibilities that govern all tax preparers. Significant penalties apply to practitioners that prepare tax returns with frivolous tax positions.

TEST YOUR KNOWLEDGE

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). They are included as an additional tool to enhance your learning experience and do not need to be submitted in order to receive CPE credit.

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.	**Which of the following is correct regarding the filing of tax returns:** **A.** filing is voluntary **B.** filing is mandatory for any taxpayer who has received any gross income **C.** filing is mandatory for any taxpayer who has received more than a statutorily determined amount of gross income **D.** filing is mandatory only if the taxpayer has dependents
2.	**Which of the following is correct regarding “zero returns”:** **A.** a “zero return” simply refers to a tax return in which a refund is given to the taxpayer **B.** “zero returns” are acceptable for Federal tax returns, but not state tax returns **C.** “zero returns” are only acceptable if “nunc pro tunc” is written on the return **D.** “zero returns” are frequently submitted with “corrected” W-2 forms
3.	**Which of the following is correct regarding income taxes and the First Amendment of the Constitution:** **A.** taxpayers have a legal right to refuse to pay taxes based on religious grounds, which is protected by the First Amendment **B.** the First Amendment protects speech that aids taxpayers to unlawfully refuse to pay federal income taxes **C.** the First Amendment allows taxpayers to not pay taxes that will go towards programs that the taxpayer morally objects to **D.** the First Amendment offers no legal protection for refusing to pay legitimate federal income tax

4.	**Which of the following is correct regarding the Sixteenth Amendment of the Constitution:** **A.** federal income tax laws are unconstitutional because the Sixteenth Amendment was never properly ratified **B.** courts have found that the Sixteenth Amendment does not authorize a direct non-apportioned federal income tax on U.S. citizens **C.** the Supreme Court has upheld the constitutionality of the Sixteenth Amendment's income tax laws **D.** the Sixteenth Amendment was ratified by all fifty states
5.	**The use of unsolicited text messages to lure unsuspecting victims to provide valuable personal and financial information that can lead to identity theft is referred to as which of the following:** **A.** spearphishing **B.** ghosting **C.** smishing **D.** flexing
6.	**Under IRC § 6713, which of the following is the maximum annual penalty that can be assessed for an unauthorized disclosure or use of information that is connected to an identity theft crime:** **A.** $1,000 **B.** $10,000 **C.** $25,000 **D.** $50,000

SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.	**A.** Incorrect. Filing a tax return is not voluntary. **B.** Incorrect. A tax return is not required if the gross income is less than the statutorily determined amount. **C.** **CORRECT**. Failure to file a tax return could subject the noncomplying individual to criminal penalties, including fines and imprisonment, as well as civil penalties. **D.** Incorrect. Whether or not a taxpayer has dependents does not change the requirements for filing a tax return. *(See page 1 of the course material.)*
2.	**A.** Incorrect. A "zero return" refers to the misguided belief that taxpayers can reduce their federal income tax liability by filing a tax return that reports no income and no tax liability even though they have taxable income. **B.** Incorrect. "Zero returns" are acceptable by neither the Federal government nor any state government. **C.** Incorrect. The inclusion of "nunc pro tunc," or any legal phrase, does not validate the concept of the "zero return." **D.** **CORRECT**. Taxpayers who file "zero returns" typically attach "corrected" W-2 forms that report income and income tax withholding, typically using other frivolous tax arguments as the basis for the correction. *(See page 2 of the course material.)*
3.	**A.** Incorrect. The First Amendment offers no legal protection for individuals who want to refuse to pay taxes based on a moral objection. **B.** Incorrect. The First Amendment does not protect speech that aids or incites taxpayers to unlawfully refuse to pay federal income taxes. **C.** Incorrect. The First Amendment does not provide a right to refuse to pay income taxes on religious or moral grounds or because taxes are used to fund government programs opposed by the taxpayer. **D.** **CORRECT**. The First Amendment offers taxpayers no legal cover for refusing to pay taxes based on a religious or moral objection. *(See page 8 of the course material.)*

4.	**A.** Incorrect. Multiple courts have ruled that the Sixteenth Amendment was properly ratified and is constitutional. **B.** Incorrect. Numerous courts have both implicitly and explicitly recognized that the Sixteenth Amendment authorizes a non-apportioned direct income tax on U.S. citizens and that the federal tax laws are valid as applied. **C.** **CORRECT**. The Supreme Court ruled in *Brushaber v. Union Pacific R.R.* that the Sixteenth Amendment's income tax laws are constitutional. **D.** Incorrect. The Sixteenth Amendment was ratified by 40 states, not all 50. *(See page 10 of the course material.)*
5.	**A.** Incorrect. The term "spearphishing" is used to describe a tailored phishing attempt to a specific organization or business. **B.** Incorrect. The term "ghosting" is not used by the IRS to describe unsolicited text messages sent to lure unsuspecting victims to provide valuable personal and financial information. **C.** **CORRECT**. According to the IRS, taxpayers and tax professionals should be alert to fake communications from those posing as legitimate organizations in the tax and financial community. These messages arrive in the form of an unsolicited text (smishing) or email (phishing) to lure unsuspecting victims to provide valuable personal and financial information that can lead to identity theft. **D.** Incorrect. "Flexing" is not the term used to describe unsolicited texts sent in order to lure unsuspecting victims to provide valuable personal and financial information that can lead to identity theft. *(See page 25 of the course material.)*
6.	**A.** Incorrect. If the unauthorized disclosure or use of information is connected to an identity theft crime, the penalty is $1,000 for each use. However, the maximum annual penalty is capped at $50,000. **B.** Incorrect. The maximum annual penalty can be higher than $10,000. **C.** Incorrect. The maximum penalty for the year cannot be more than $50,000, not $25,000. **D.** **CORRECT**. According to IRC § 6713, the maximum penalty assessed cannot be greater than $50,000 in a calendar year. *(See page 34 of the course material.)*

GLOSSARY

"Dirty Dozen" tax schemes: A list put out each year by the IRS identifying the top twelve tax schemes for that year.

Frivolous tax positions: A tax position that is knowingly advanced in bad faith and is patently improper.

Identity theft: The fraudulent acquisition and use of a person's private identifying information, usually for financial gain.

Phishing: The fraudulent practice of sending emails purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords and credit card numbers.

Phone scams: Scammers make unsolicited calls claiming to be IRS officials. They demand that the victim pay a bogus tax bill. They con the victim into sending cash, usually through a prepaid debit card or wire transfer. They may also leave "urgent" callback requests through phone "robo-calls," or via a phishing email.

Spearphishing: An email scam that attempts to steal a tax professional's software preparation credentials. The thieves try to steal client data and tax preparers' identities in an attempt to file fraudulent tax returns for refunds.

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FRIVOLOUS TAX ARGUMENTS AND SCAMS (COURSE #9000I)
FINAL EXAM COPY

The following exam will not be graded. It is attached only for your convenience while you read the course text. To access the exam to be submitted for grading, go to your account and select Take Exam.

1. **Which of the following is considered income for federal income tax purposes:**
   - **A.** tips received for personal service
   - **B.** income derived from sources within the United Sates
   - **C.** Federal Reserve Notes
   - **D.** all of the above

2. **Which of the following Amendments refutes the notion that taxpayers are not "citizens" of the United States and thus are not subject to federal income tax laws:**
   - **A.** the 7th Amendment
   - **B.** the 11th Amendment
   - **C.** the 14th Amendment
   - **D.** the 21st Amendment

3. **Which of the following is correct regarding the Internal Revenue Service:**
   - **A.** the IRS is technically a private corporation
   - **B.** the IRS is a body established by "positive law"
   - **C.** the IRS does not have the authority to enforce Internal Revenue Code
   - **D.** the Supreme Court has never decided the issue of whether or not the IRS has the power to enforce internal revenue laws

4. **Which of the following is correct regarding a "corporation sole":**
   - **A.** another name for a corporation sole is a managerial trust
   - **B.** a corporation sole is not valid under any circumstances
   - **C.** a corporation sole enables religious leaders to hold property and conduct business for the religious entity
   - **D.** a corporation sole may own property and enter into contracts for the individual office holder's personal benefit

5. **Which of the following is correct regarding frivolous tax arguments:**
   - **A.** frivolous tax arguments can result in civil penalties only
   - **B.** only a tax preparer can be held accountable for filing a tax return based on a frivolous tax argument
   - **C.** the penalty for filing a frivolous tax return is a maximum fine of $50,000
   - **D.** under section 6676, a penalty of 20 percent of the excessive amount can be assigned to erroneous refund claims

6. **Which of the following IRS Dirty Dozen subjects is meant for off-highway business and farming use and, as such, is not available to most taxpayers:**
   - **A.** the employee retention credit
   - **B.** the fuel tax credit
   - **C.** charitable remainder annuity trusts
   - **D.** micro-captive insurance arrangements

7. Tax preparers who will prepare a tax return but refuse to sign or include their IRS Preparer Tax Identification Number (PTIN) as required by law are referred to as which of the following:

A. lone wolf preparers

B. ghost preparers

C. clandestine preparers

D. phantom preparers

8. According to the IRS, which of the following is a potential tax scam aimed at high-income filers:

A. monetized installment sales

B. micro-captive insurance arrangements

C. syndicated conservation easements

D. Puerto Rican and foreign captive insurance

9. As part of the Consolidated Appropriations Act of 2023, Congress amended Internal Revenue Code section 170 to curb certain abusive ___________________ transactions.

A. micro-captive insurance

B. charitable remainder annuity trust

C. conservation easement

D. monetized installment sale

10. Which of the following represents the maximum fine allowed under IRC § 7206 for a corporation that is found guilty of fraud and making false statements on tax returns:

A. $5,000

B. $50,000

C. $100,000

D. $500,000