Frivolous Tax Arguments and Scams

Course #5001

Accounting

2 Credit Hours

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FRIVOLOUS TAX ARGUMENTS AND SCAMS (COURSE #5001A)

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. Abusive tax preparer statistics are used to reinforce the examples of ethical violations by tax return preparers.

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	SUBJECT
1	**Frivolous Tax Positions**

Study the course materials from pages 1 to 46

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	SUBJECT
2	**Complete the Online Exam**

Program publication date 4/25/18

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 (#5001A) 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

Chapter Objectives

After completing this chapter, 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. Such an estoppel argument does not, however, apply to a legal matter such as whether there is legal authority to collect taxes. See, e.g., McKay v. Commissioner, 102 T.C. 465 (1994).

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, reling 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. The IRS warned taxpayers of the consequences of making this frivolous argument in Rev. Rul. 2004-34, 2004-1 C.B. 619.

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." United States v. Collins, 920 F.2d 619, 629 (10th Cir. 1990) (citing Brushaber v. Union Pac. R.R., 240 U.S. 1, 12-19 (1916)). 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." <u>United States v. Miller</u>, 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." <u>United States v. Powell</u>, 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." <u>United States v. Norwood</u>, 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 compy 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". Rev. Rul. 2004-1 C.B.

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. See also 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." See also 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 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 court's discretion to impose penalties on taxpayers who engage in such conduct, in order to deter frivolous litigation and to induce taxpayers to conform their conduct to settled principles of law before pursuing litigation. Courts 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 claims 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 $5,000 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. BEWARE OF IRS' 2018 "DIRTY DOZEN" TAX SCAMS

1. 2018 SEES NEW PHISHING SCHEMES

The IRS continues to see a steady onslaught of new and evolving phishing schemes as scam artists work to victimize taxpayers during filing season.

In a recent twist to a phishing scam, the IRS has seen thousands of taxpayers victimized by an unusual scheme that involves their own bank accounts. After stealing client data from tax professionals and filing fraudulent tax returns, the criminals use taxpayers' real bank accounts to direct deposit refunds. Thieves are then using various tactics to reclaim the refund from the taxpayers, including falsely claiming to be from a collection agency or representing the IRS. Phone calls, emails and web sites are used to make the scheme more elaborate. Versions of the scam may continue to evolve. The IRS encourages taxpayers to review some basic tips if they see an unexpected deposit in their bank account.

In addition, the IRS has seen email schemes in recent weeks targeting tax professionals, payroll professionals, human resources personnel and schools, as well as individual taxpayers.

In these email schemes, criminals pose as a person or organization the taxpayer trusts or recognizes. They may hack an email account and send mass emails under another person's name. Or they may pose as a bank, credit card company, tax software provider or government agency. Criminals go to great lengths to create websites that appear legitimate but contain phony log-in pages. These criminals hope victims will "take the bait" and provide money, passwords, Social Security numbers and other information that can lead to identity theft.

Fake emails and websites also can infect a taxpayer's computer with malware without the user knowing it. The malware gives the criminal access to the device, enabling them to access all sensitive files or even track keyboard strokes, exposing login information.

For those participating in these schemes, such activity can lead to significant penalties and possible criminal prosecution. IRS Criminal Investigation works closely with the Department of Justice to shutdown scams and prosecute the criminals behind them.

2. PHONE SCAMS

Con artists make unsolicited calls claiming to be IRS officials. They demand that the victim pay a bogus tax bill. They convince the victim to send cash, usually through a wire transfer or a prepaid debit card or gift card. They may also leave "urgent" callback requests through phone "robo-calls," or send a phishing email.

Many phone scams use threats to intimidate and bully a victim into paying. They may even threaten to arrest, deport or revoke the driver's license of their victim if they don't get the money.

Scammers often alter caller ID numbers to make it look like the IRS or another agency is calling. The callers use IRS employee titles and fake badge numbers to appear legitimate. They may use the victim's name, address and other personal information to make the call sound official.

The IRS also reminds taxpayers that scammers change tactics. Aggressive and threatening phone calls by criminals impersonating IRS agents remain a major threat to taxpayers, but variations of the IRS impersonation scam continue year-round and they tend to peak when scammers find prime opportunities to strike.

The Treasury Inspector General for Tax Administration (TIGTA) reports they have become aware of over 12,716 victims who have collectively paid over $63 million as a result of phone scams since October 2013.

Here are some things the scammers often do, but the IRS will not do. Taxpayers should remember that any one of these is a tell-tale sign of a scam.

The IRS will never:

- Call to demand immediate payment using a specific payment method such as a prepaid debit card, gift card or wire transfer. Generally, the IRS will first mail a bill to any taxpayer who owes taxes.
- Threaten to immediately bring in local police or other law-enforcement groups to have the taxpayer arrested for not paying.
- Demand that taxes be paid without giving taxpayers the opportunity to question or appeal the amount owed.
- Ask for credit or debit card numbers over the phone.
- Call you about an unexpected refund.

3. IDENTITY THEFT

Tax-related identity theft occurs when someone uses a stolen Social Security number or Individual Taxpayer Identification Number (ITIN) to file a fraudulent tax return claiming a refund.

The IRS, the states and the tax industry began working together in 2015 as the Security Summit to fight tax-related identity theft. Security Summit partners enacted a series of safeguards that are making inroads against identity thieves.

For example, the number of taxpayers reporting themselves as identity theft victims declined by 40 percent in 2017 from 2016. In 2017, the IRS received 242,000 reports from taxpayers compared to 401,000 in 2016. This was the second year in a row this number fell, dropping from 677,000 victim reports in 2015. Overall, the number of identity theft victims has fallen nearly 65 percent between 2015 and 2017.

Because of these successes, criminals are devising more creative ways to steal more in-depth personal information to impersonate taxpayers. Taxpayers and tax professionals must remain vigilant to the various scams and schemes used for data thefts.

Business filers should be aware that cybercriminals also file fraudulent Forms 1120 using stolen business identities and they, too, should be alert.

Security Reminders for Taxpayers

The IRS and its partners remind taxpayers and tax professionals that they can do their part to help in this effort. Taxpayers and tax professionals should:

- Always use security software with firewall and anti-virus protections. Make sure the security software is always turned on and can automatically update. Encrypt sensitive files such as tax records stored on the computer. Use strong passwords.

- Learn to recognize and avoid phishing emails, threatening phone calls and texts from thieves posing as legitimate organizations such as banks, credit card companies and government organizations, including the IRS. Do not click on links or download attachments from unknown or suspicious emails.
- Protect personal data. Don’t routinely carry a Social Security card, and make sure tax records are secure. Treat personal information like cash; don’t leave it lying around.

4. TAX RETURN PREPARER FRAUD

The majority of tax professionals provide honest, high-quality service. But there are some dishonest preparers who operate each filing season to perpetrate refund fraud, identity theft and other scams that hurt honest taxpayers. That’s why unscrupulous preparers who prey on unsuspecting taxpayers with outlandish promises of overly large refunds make the “Dirty Dozen” list.

Tax return preparers are a vital part of the U.S. tax system. About 56 percent of taxpayers use tax professionals to prepare their returns. Selecting the right tax professional is critically important because taxpayers are ultimately responsible for what they submit on their tax return.

The IRS is also working to protect taxpayers from shady return preparers. The pursuit of illegal scams can lead to significant penalties and interest as well as possible criminal prosecution. IRS Criminal Investigation works closely with the Department of Justice to shutdown scams and prosecute the criminals behind them.

5. FAKE CHARITIES

The Internal Revenue Service warned taxpayers against scam groups masquerading as charitable organizations, luring people to make donations to groups or causes that don’t actually qualify for a tax deduction.

These ‘fake’ charities attempt to attract donations from unsuspecting contributors, using a charitable reason and a tax deduction as bait for taxpayers. Fake charities are one of the “Dirty Dozen” tax scams for the 2018 filing season.

The IRS offers these basic tips to taxpayers making charitable donations:

- Be wary of charities with names that are similar to familiar or nationally known organizations. Some phony charities use names or websites that sound or look like those of respected, legitimate organizations. IRS.gov has a search feature, Exempt Organizations Select Check, that allows people to find legitimate, qualified charities to which donations may be tax-deductible. Legitimate charities will provide their Employer Identification Number (EIN), if requested, which can be used to verify their legitimacy through the IRS Select Check.
- Don’t give out personal financial information, such as Social Security numbers or passwords, to anyone who solicits a contribution. Scam artists may use this information to

steal identities and money from victims. Donors often use credit cards to make donations. Be cautious when disclosing credit card numbers to those seeking a donation. Confirm that those soliciting a donation are calling from a legitimate charity.

- Don't give or send cash. For security and tax record purposes, contribute by check or credit card or another way that provides documentation of the donation.
- Consult IRS Publication 526, *Charitable Contributions*, available on IRS.gov. This free booklet describes the tax rules that apply to making tax-deductible donations. Among other things, it provides complete details on what records to keep to help taxpayers at tax time.

Impersonation of charitable organizations

Another long-standing type of abuse or fraud involves scams that occur in the wake of significant natural disasters.

The IRS encourages taxpayers to donate to recognized charities established to help disaster victims. Following major disasters, it's common for scam artists to impersonate charities to get money or private information from well-intentioned taxpayers.

Scam artists can use a variety of tactics following a disaster. Some scammers operating bogus charities may contact people by telephone or email to solicit money or financial information. They may even directly contact disaster victims and claim to be working for or on behalf of the IRS to help the victims file casualty loss claims and get tax refunds.

Remember, fraudsters may attempt to get personal financial information or Social Security numbers that can be used to steal the victims' identities or financial resources. Bogus websites may solicit funds for disaster victims.

6. FALSELY INFLATED RETURNS

The Internal Revenue Service warned taxpayers to be alert to unscrupulous return preparers touting inflated tax refunds. These scam artists frequently prey on older Americans, low-income taxpayers and others with promises of big refunds.

These refund scams remain on the agency's annual "Dirty Dozen" list of most prevalent tax scams.

Scam artists pose as tax preparers during tax time, luring victims by promising large federal tax refunds. They use flyers, advertisements, phony storefronts or word of mouth to attract victims. They may even make presentations through community groups or churches.

Scammers frequently prey on people who do not have a filing requirement, such as those with low incomes or older Americans. They may also prey on non-English speakers who may or may not have a requirement to file a tax return.

Con artists dupe people into making claims for fictitious rebates, benefits or tax credits. They may also file a false return in their client's name, and the client never knows that a refund was paid.

Scam artists may also victimize those with a filing requirement who are due a refund. They do this by promising larger refunds based on fake Social Security benefits and false claims for education credits or the Earned Income Tax Credit (EITC) among others.

Those perpetrating these scams can see significant penalties and interest and possible criminal prosecution. To protect taxpayers, the IRS Criminal Investigation Division works closely with the Department of Justice to shutdown scams and prosecute the criminals behind them.

Falsely Claiming Zero Wages, Filing Phony Forms W-2, 1099

For years, the IRS has seen a series of contorted and creative efforts by scam artists who try to avoid taxes.

Filing a phony information return, such as a Form 1099 or W-2, is an illegal way to lower the amount of taxes owed. The use of self-prepared, "corrected" or otherwise bogus forms that improperly report taxable income as zero is illegal. So is an attempt to submit a statement rebutting wages and taxes reported by a third-party payer to the IRS.

Some people also attempt fraud using false Form 1099 refund claims. In some cases, individuals have made refund claims based on the bogus theory that the federal government maintains secret accounts for U.S. citizens and that taxpayers can gain access to the accounts by issuing 1099-OID forms to the IRS.

Taxpayers should resist the temptation to participate in any variations of this scheme. The IRS is aware of this scam, and the courts have consistently rejected attempts to use this tax dodge. Perpetrators receive significant penalties, imprisonment or both. Simply filing this type of return may result in a $5,000 penalty.

The IRS sometimes hears about scams from victims worried about losing their federal benefits, such as Social Security, veterans or low-income housing benefits. The loss of benefits comes as a result of false claims being filed with the IRS that provided incorrect income amounts.

7. EXCESSIVE CLAIMS FOR BUSINESS CREDITS

The Internal Revenue Service warned that taxpayers should avoid making improper claims for business credits, a common scam used by unscrupulous tax preparers.

Two common credits targeted for abuse by shady return preparers include the research credit and the fuel tax credit. Both credits have legitimate uses, but there are specific criteria that taxpayers need to qualify for these.

Research Credit Scams

Section 41 of the Internal Revenue Code provides a credit for increasing research activities, commonly known as the "research credit." Congress enacted the research credit in 1981 to provide an incentive for American private industry to invest in research and experimentation.

The IRS continues to see significant misuse of the research credit. Improper claims for this credit generally involve a failure to participate in or substantiate qualified research activities and/or a failure to satisfy the requirements related to qualified research expenses.

To qualify for the credit, a taxpayer's research activities must, among other things, involve a process of experimentation using science with a goal of improving a product or process the taxpayer uses in its business or holds for sale or lease. However, there are certain activities specifically excluded from the credit., including research after commercial production, adaptation of an existing business product or process, foreign research and research funded by the customer. Qualified activities also do not include activities where there is no uncertainty about the taxpayer's method or capability to achieve a desired result.

The IRS often sees expenses from non-qualified activities included in claims for the research credit. In addition, qualified research expenses include only in-house wages and supply expenses and 65 percent (typically) of payments to contractors. Qualified research expenses do not include expenses without a proven nexus between the claimed expenses and the qualified research activity.

Steps to Properly Claim the Credit

Taxpayers who qualify for the credit may claim up to 20 percent of qualified expenses above a base amount by completing and attaching Form 6765, Credit for Increasing Research Activities, to their tax return. For tax years beginning in 2016, eligible small businesses may use the research credit to offset the alternative minimum tax. Also for tax years beginning in 2016, qualified small businesses may elect to use a portion of the research credit as a payroll tax credit against the employer's portion of the Social Security tax. Qualified small businesses make this election on Form 6765 and must complete and attach Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities, to their Form 941, Employer's Quarterly Federal Tax Return.

To claim a research credit, taxpayers must evaluate and document their research activities contemporaneously (i.e., over the period of time in which the research occurs) to establish the amount of qualified research expenses paid for each qualified research activity. While taxpayers may estimate some research expenses, taxpayers must have a factual basis for the assumptions used to create the estimates.

Unsupported claims for the research credit may subject taxpayers to penalties. Taxpayers should carefully review reports or studies prepared by third parties to ensure they accurately reflect the taxpayer's activities. Third parties who are involved in the preparation of improper claims or research credit studies also may be subject to penalties.

Fuel Tax Credit Scams

Fraud involving the fuel tax credit is considered a frivolous tax claim and can result in a penalty of $5,000. Furthermore, illegal scams can lead to significant penalties and interest and possible criminal prosecution. IRS Criminal Investigation works closely with the Department of Justice to shutdown scams and prosecute the criminals behind them.

The fuel tax credit is generally limited to off-highway business use or use in farming. Consequently, the credit is not available to most taxpayers. Still, the IRS routinely finds unscrupulous tax return preparers who have enticed sizable groups of taxpayers to erroneously claim the credit to inflate their refunds.

The federal government taxes gasoline, diesel fuel, kerosene, alternative fuels and certain other types of fuel. Certain commercial uses of these fuels are nontaxable. Individuals and businesses that purchase fuel for one of those purposes can claim a tax credit by filing Form 4136, Credit for Federal Tax Paid on Fuels.

The tax is on fuels used to power vehicles and equipment on roads and highways. Taxes paid for fuel to power vehicles and equipment used off-road may qualify for the tax credit and may include farm equipment, certain boats, trains and airplanes.

Improper claims for the fuel tax credit generally come in two forms. An individual or business may make an erroneous claim on their otherwise legitimate tax return. It is also possible for an identity thief to claim the credit as part of a broader fraudulent scheme.

The IRS has taken a number of steps to improve compliance processes involving fuel tax credits. IRS compliance systems are preventing a significant number of questionable fuel tax credit claims from being processed. For example, new identity theft screening filters have also improved the IRS's ability to identify questionable fuel tax credit claims during return processing.

8. FALSELY PADDING DEDUCTIONS ON RETURNS

As part of the "Dirty Dozen" list of tax scams, the Internal Revenue Service warned taxpayers to avoid falsely inflating deductions or expenses on tax returns.

Common areas targeted by unscrupulous tax preparers involve overstating deductions such as charitable contributions, padding business expenses or including credits that they are not entitled to receive – like the Earned Income Tax Credit or Child Tax Credit. Some taxpayers also may be tempted to take these steps in hopes of getting a larger refund or paying less than what is owed.

Padding deductions is part of this year's "Dirty Dozen" lists of common tax scams. Taxpayers may encounter these any time, but many of these schemes peak during the tax filing season as people prepare their returns or hire people to help with their taxes.

The IRS reminds taxpayers to be careful when claiming these credits. If a return preparer suggests using these options improperly, the taxpayer is at risk – and the person who provided the advice is long gone.

Avoids Scams and File an Accurate Return

Preparing an accurate tax return is a taxpayer's best defense against scams – and the best way to avoid triggering an audit. The IRS reminds taxpayers that significant penalties may apply for taxpayers who file incorrect returns including:

- 20 percent of the disallowed amount for filing an erroneous claim for a refund or credit.

- $5,000 if the IRS determines a taxpayer has filed a “frivolous tax return.” A frivolous tax return is one that does not include enough information to figure the correct tax or that contains information clearly showing that the tax reported is substantially incorrect.
- In addition to the full amount of tax owed, a taxpayer could be assessed a penalty of 75 percent of the amount owed if the underpayment on the tax return resulted from tax fraud.

Taxpayers may be subject to criminal prosecution and be brought to trial for actions such as willful failure to file a return; supply information; or pay any tax due; fraud and false statements; preparing and filing a fraudulent return and identity theft.

9. FALSIFYING INCOME TO CLAIM CREDITS

As part of this year’s “Dirty Dozen” list of tax scams, the Internal Revenue Service warned taxpayers to be on the lookout for schemes that falsify income, including elaborate ruses involving bogus Forms 1099.

A common tax scam the IRS sees each year involves falsifying income. The agency warns taxpayers to avoid related schemes to erroneously claim tax credits as well as more elaborate schemes that scam artists peddle.

The “Dirty Dozen” describes a variety of common scams that taxpayers may encounter. Many of these schemes peak during filing season as people prepare their returns or hire others to help them.

Scams can lead to significant penalties and interest and possible criminal prosecution. The IRS Criminal Investigation Division works closely with the Department of Justice to shutdown scams and prosecute the criminals behind them.

Don’t Make Up Income

Some people falsely increase the income they report to the IRS. This scam involves inflating or including income on a tax return that was never earned, either as wages or self-employment income, usually to maximize refundable tax credits.

Much like falsely claiming an expense or deduction is improper, claiming income the taxpayer didn’t earn is also inappropriate. Unscrupulous return preparers and people do this to secure larger refundable credits such as the Earned Income Tax Credit and it can have serious repercussions.

Remember, taxpayers can face a large bill to repay the erroneous refunds, including interest and penalties. In some cases, they may even face criminal prosecution.

Fake Forms 1099-MISC

The IRS cautions taxpayers to avoid getting caught up in schemes disguised as a debt payment option for credit cards or mortgage debt. This scheme usually involves the filing of a Form 1099-MISC, Miscellaneous Income, and/or bogus financial instruments such as bonds, bonded promissory notes or worthless checks.

Con artists often argue that the proper way to redeem or draw on a fictitious “held-aside” account is to use some form of made-up financial instrument, such as a bonded promissory note, that purports to be a debt payment method for credit cards or mortgage debt. Scammers provide fraudulent Form(s) 1099-MISC that appear to be issued by a large bank, loan service and/or mortgage company with which the taxpayer may have had a prior relationship, all to help further perpetrate the scheme. Form 56, Notice Concerning Fiduciary Relationship, may also be used by participants in this scam to assign fiduciary responsibilities to the lenders.

Taxpayers may encounter unethical return preparers who try to lure them into these scams. It is important to remember that taxpayers are legally responsible for what’s on their tax return even if it is prepared by someone else.

10. FRIVOLOUS TAX ARGUMENTS

The Internal Revenue Service warns taxpayers about using frivolous tax arguments to avoid paying taxes.

Promoters of frivolous schemes encourage taxpayers to make unreasonable and outlandish legal claims to avoid paying their taxes. Time and again, these arguments have been thrown out of court.

A recurring Dirty Dozen theme through the years involves claims about “secret” schemes for taxpayers to avoid paying taxes.

Don’t Get Talked into Using a Frivolous Argument

Taxpayers have the right to contest their tax liabilities using IRS administrative appeals procedures or in court, but they are still obligated to follow the law.

Besides risking criminal prosecution, taxpayers can also face a variety of civil penalties. Key among them is the $5,000 penalty for filing a frivolous tax return. The penalty applies to anyone who submits a frivolous tax return or other specified submissions, such as a request for a collection due process hearing, installment agreement, offer-in-compromise or taxpayer assistance order if any part of these submissions are based on a frivolous position. A list of more than 40 such positions can be found in Notice 2010-33, 2010-17 I.R.B.609. The list is not all inclusive, and the IRS and the courts may add to it at any time.

The IRS reminds taxpayers these schemes also can bring other civil penalties including:

- Accuracy-related penalty—20 percent of the underpaid tax;
- Civil fraud penalty—75 percent of the underpayment attributable to fraud;
- Erroneous refund claim penalty—20 percent of the excessive amount.

Late-filing and late-payment penalties may also apply. The Tax Court may also impose a penalty against taxpayers who make frivolous arguments in court.

11. ABUSIVE TAX SHELTERS

The Internal Revenue Service warned taxpayers to be wary of abusive tax shelters, which remain on the "Dirty Dozen" tax scams.

These sophisticated schemes, particularly those involving micro-captive insurance shelters, can be peddled by promoters and others to avoid taxes.

Through audits, litigation, published guidance and legislation, the IRS continues to address those using abusive micro-captive insurance tax shelters.

Tax law generally allows businesses to create "captive" insurance companies to protect against certain risks. Traditional captive insurance typically allows a taxpayer to reduce insurance costs. The insured business claims deductions for premiums paid for insurance policies. Those amounts are paid, either as insurance premiums or reinsurance premiums, to a "captive" insurance company owned by the insured or parties related to the insured.

Under section 831(b) of the tax code, captive insurers that qualify as small insurance companies can elect to exclude limited amounts of annual net premiums from income so that the captive insurer pays tax only on its investment income.

In certain "micro-captive" structures, promoters, accountants or wealth planners persuade owners of closely-held entities to participate in schemes that lack many of the attributes of genuine insurance.

For example, coverages may insure implausible risks, fail to match genuine business needs, or duplicate the taxpayer's commercial coverages. Premium amounts may be unsupported by underwriting or actuarial analysis, may be geared to a desired deduction amount or may be significantly higher than premiums for comparable commercial coverage. Policies may contain vague, ambiguous or deceptive terms and otherwise fail to meet industry or regulatory standards. Claims' administrative processes may be insufficient or altogether absent. Insureds may fail to file claims that are seemingly covered by the captive insurance.

Micro-captives may invest in illiquid or speculative assets or loans or otherwise transfer capital to or for the benefit of the insured, the captive's owners or other related persons or entities. Captives may also be formed to advance inter-generational wealth transfer objectives and avoid estate and gift taxes. Promoters, reinsurers and captive insurance managers may share common ownership interests that result in conflicts of interest.

In Avrahami v. Commissioner, the U.S. Tax Court disallowed premium deductions the taxpayer had claimed under a section 831(b) micro-captive arrangement, concluding that the arrangement was not "insurance" under long established decisional law principles. To qualify as insurance under those principles, an arrangement must involve risk shifting, risk distribution and insurance risk, and must also meet commonly accepted notions of insurance. The Avrahami court concluded that the taxpayer's arrangement failed to distribute risk and that the taxpayer's captive was not a bona fide insurance company. The court pointed to a number of facts that it found problematic, including circular flows of funds, grossly excessive premiums, non-arm's length contracts, and an ultra-low probability of claims being paid. The court also concluded that the arrangement was not insurance in the commonly accepted sense, due in part to haphazard organization and operation, the captive's investments in illiquid assets, unclear policies, and inflated premiums.

In Notice 2016-66 (Nov. 1, 2016), the IRS advised that micro-captive insurance transactions have the potential for tax avoidance or evasion. The notice designated transactions that are the same as or substantially similar to transactions that are described in the notice as "Transactions of Interest." The notice established reporting requirements for those entering into such transactions on or after Nov. 2, 2016, and created disclosure and list maintenance obligations for material advisors.

Separately, Congress has also acted to curb micro-captive abuses. The Protecting Americans from Tax Hikes (PATH) Act, effective Jan. 1, 2017, established strict diversification and reporting requirements for new and existing captives.

12. OFFSHORE TAX AVOIDANCE

Avoiding taxes by hiding money or assets in unreported offshore accounts remains on the IRS "Dirty Dozen" tax scams for 2018.

This long-running scheme to hide money in international accounts to avoid paying taxes has been a major focus for the IRS in recent years. Taxpayers should remain wary of these schemes given the continuing focus on this by the tax agency and the Justice Department.

As the IRS intensified efforts on offshore issues in recent years, many taxpayers have voluntary disclosed their participation in these schemes.

There have been more than 56,400 disclosures and the IRS has collected more than $11.1 billion from the Offshore Voluntary Disclosure Program (OVDP) since it opened in 2009. With applications dwindling in recent years to a few hundred annually, the IRS announced earlier this month the voluntary program will end Sept. 28.

In addition, another 65,000 taxpayers have made use of separate streamlined procedures to correct prior non-willful omissions and meet their federal tax obligations. The IRS conducted thousands of offshore-related civil audits that resulted in the payment of tens of millions of dollars in unpaid taxes. The IRS has also pursued criminal charges leading to billions of dollars in criminal fines and restitutions.

Illegal scams can lead to significant penalties as well as interest and possible criminal prosecution. The IRS Criminal Investigation Division works closely with the Department of Justice to shut down scams and prosecute the criminals behind them.

Hiding Income Offshore

Over the years, numerous individuals have been identified as evading U.S. taxes by attempting to hide income in offshore banks, brokerage accounts or nominee entities. They then access the funds using debit cards, credit cards or wire transfers. Others have employed foreign trusts, employee-leasing schemes, private annuities or insurance plans for the same purpose.

The IRS uses information gained from its investigations to pursue taxpayers with undeclared accounts, as well as bankers and others suspected of helping clients hide their assets overseas.

While there are legitimate reasons for maintaining financial accounts abroad, there are reporting requirements that need to be fulfilled. U.S. taxpayers who maintain such accounts and who do not comply with reporting requirements are breaking the law and risk significant fines, as well as the possibility of criminal prosecution.

Since 2009, tens of thousands of individuals have come forward to voluntarily disclose their foreign financial accounts, taking advantage of special opportunities to comply with the U.S. tax system and resolve their tax obligations. Information on the existing Offshore Voluntary Disclosure Program can be found on IRS.gov.

Third-Party Reporting

Under the Foreign Account Tax Compliance Act (FATCA) and the network of intergovernmental agreements between the U.S. and partner jurisdictions, automatic third-party account reporting has entered its third year. The IRS continues to receive more information regarding potential non-compliance by U.S. persons because of the Department of Justice's Swiss Bank Program. This information makes it less likely that offshore financial accounts will go unnoticed by the IRS.

With the Offshore Voluntary Disclosure Program coming to a close on Sept. 28, the IRS reminded taxpayers there is a limited amount of time to take advantage of this option.

Potential civil penalties increase substantially if U.S. taxpayers associated with participating banks wait to resolve their tax obligations.

V. STATISTICAL DATA – ABUSIVE RETURN PREPARERS

	FY 2016	FY 2015	FY 2014
Investigations Initiated	252	266	305
Prosecution Recommendations	174	238	261
Indictments/ Informations	204	224	230
Sentenced	202	204	183
Incarceration Rate*	72.8%	80.4%	86.3%
Avg. Months to Serve	22	27	28

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

Data Source: Criminal Investigation Management Information System.

Following are a few examples of abusive return preparer investigations written from public record documents.

A. TAX PREPARATION BUSINESS OWNER SENTENCED FOR FILING FALSE TAX RETURNS

On April 26, 2017, in Sacramento, California, TM was sentenced to 120 months in prison, two years of supervised release and ordered to pay $9,500,492 in restitution to the IRS. TM was the owner of AFS, a tax return preparation business. TM conspired with her staff, PH and RBM, to file fraudulent federal tax returns that claimed more than $60 million in refunds. TM and PH recruited clients by falsely representing that the clients could legally receive large refunds by filing tax returns using IRS Forms 1099-OID. AFS prepared false Forms 1099-OID that reported the clients' debts as income, and used the same amount as income tax withheld, resulting in significant claims for refunds to which the clients were not entitled. The scheme included clients from 26 states and caused the IRS to pay out over 40 tax refunds, totaling more than $9 million. Clients of AFS have been prosecuted in Arizona, Colorado, Florida, Georgia, Missouri, Oregon and Washington for filing false claims for refund that TM and AFS prepared.

B. CALIFORNIA RETURN PREPARER SENTENCED FOR FILING FRAUDULENT TAX RETURNS

On April 21, 2017, in San Diego, California, MLC, a San Diego tax return preparer was sentenced to 37 months in prison, one year of supervised release and ordered to pay $91,867 in restitution to the Internal Revenue Service (IRS). MLC owned and operated CTS, a tax preparation business located in El Cajon, California. From 2010 through 2012, MLC prepared fraudulent returns for her clients that reported fake business losses, charitable contributions, and medical, dental, education and unreimbursed employee expenses. MLC caused a tax loss of approximately $1,237,943.

C. MISSISSIPPI TAX RETURN PREPARERS SENTENCED FOR FILING FRAUDULENT RETURNS

On April 20, 2017, in Gulfport, Mississippi, AB and JW were sentenced to 63 and 46 months in prison, respectively, for preparing fraudulent tax returns. In addition, AB and JW were ordered to serve one and three years of supervised release, respectively. AB was ordered to pay restitution of $1,919,820 to the IRS and JW was ordered to pay $1,954,352. JW was a tax return preparer who owned and operated FF, and AB was JW's sole employee. From 2009 through 2011, the two men filed fraudulent tax returns for multiple clients with the IRS that included bogus education expenses and retirement contributions, which they never discussed with their clients. As a result, the clients received refunds they were not entitled to.

D. TEXAS TAX PREPARER SENTENCED FOR FILING FALSE TAX RETURNS, AGAIN

On March 24, 2017, in Houston, Texas, CKO, a local tax return preparer, was sentenced to 36 months in prison for a second time for preparing false tax returns and obstructing the IRS. CKO will also serve one year of supervised release and pay restitution of $400,457. CKO was previously sentenced to 33 months in prison on charges he prepared dozens of false 2006-08 client tax returns though OTS. He was released on bond in that case under a condition that he had no further involvement in the preparation of tax returns other than his own. However, CKO resumed tax return preparation and continued to claim the same false deductions for unsuspecting clients while awaiting sentencing in the earlier case. As part of the scheme, CKO changed the name of his business to “TS” to make it appear he had stopped preparing client tax returns and that someone else was the owner of his tax preparation business. CKO allegedly attributed the fees to the nominal owner of his tax office but manipulated those tax returns to make it appear the tax office had produced almost no taxable income. CKO established a series of bank accounts in the names of others in order to deposit the fees into these accounts. He then transferred those fees through these intermediate accounts to accounts in his own name. This scheme enabled CKO to conceal his personal use of the fees generated by the business during the course of the prosecution on the first case according to the plea agreement. Through this scheme, CKO generated $2 million in fees and a total loss to the IRS of another $400,457. CKO’s plea agreement requires that he surrender approximately $205,000 in bank accounts linked to the scheme, his personal residence, and three automobiles valued at $32,600 as restitution to the IRS in both cases.

E. TEXAS RETURN PREPARER SENTENCED FOR FILING FALSE TAX RETURNS

On February 22, 2017, in Dallas, Texas, LR, a Mexico national unlawfully residing in the United States was sentenced to serve 22 months in prison, one year of supervised release and ordered to pay $128,958 in restitution to the Internal Revenue Service for preparing false tax returns. LR operated TX ASAP Tax Services and FTS located in Greenville. From 2011 through 2014, LR prepared approximately 1,163 federal tax returns that included fraudulent business income, losses, credits and deductions and sought refunds to which her clients were not entitled. LR intended to cause a tax loss of approximately $1,155,383. LR will be deported to Mexico following her sentence.

F. GEORGIA TAX RETURN PREPARER SENTENCED FOR FILING FRAUDULENT RETURNS

On January 31, 2017, in Atlanta, Georgia, CS, of Atlanta, was sentenced to 150 months in prison, three years of supervised release and ordered pay restitution of $4,944,524 to the Internal Revenue Service (IRS) for filing fraudulent tax returns. CS owned and operated ATS, a tax preparation business with multiple locations throughout the Atlanta area. CS hired and trained employees to prepare fraudulent tax returns and encouraged them to manipulate the numbers to maximize their clients’ refunds.

G. TEXAS TAX RETURN PREPARER SENTENCED FOR TAX FRAUD/IDENTITY THEFT SCHEME

On January 26, 2017, in Tyler, Texas, JK, of Palestine, was sentenced to 102 months in prison for tax fraud and aggravated identity theft. JK also agreed to a cash forfeiture of $110,919. JK prepared tax returns for individuals at a tax preparation business, EZ Tax, and devised a scheme to prepare false tax returns, steal clients’ refunds, and use the clients’ and other individuals’ identities to accomplish the theft. JK made false statements and representations in the tax returns that he submitted in order to increase the amount of tax refunds to which the taxpayer would be entitled. JK was able to intercept the government tax refunds for his own benefit by printing the refund checks, not giving them to his clients, and then cashing them with the assistance of two individuals who were not associated with EZ Tax.

H. MISSOURI TAX PREPARER SENTENCED FOR FRAUD SCHEME, FAILURE TO PAY TAXES

On January 25, 2017, in Jefferson City, Missouri, DLK, of Columbia, was sentenced to 24 months in prison and ordered to pay $291,041 in restitution to his victims. DLK owned and operated K&A, offering tax preparation and payroll tax services in Columbia. DLK was hired by his clients to prepare proper tax returns, as well as send the tax deposits to the government. After accepting funds from his clients, DLK used the money for his own personal benefit instead of paying his client's taxes. When clients contacted DLK after receiving letters from the IRS indicating these returns had not been filed or taxes had not been paid, he told his clients he would contact the IRS to correct it. The total amount of these misappropriated funds is $120,354. DLK also admitted that he willfully failed to file federal income tax returns for tax years 2009 through 2013.

I. IDAHO RETURN PREPARER SENTENCED FOR DEFRAUDING THE IRS

On January 24, 2017, in Boise, Idaho, MG, of Twin Falls, Idaho, was sentenced to 24 months in prison, three years of supervised release, and ordered to forfeit and pay restitution of $336,926 to the IRS. From around 2006, MG owned and operated GA in Twin Falls and prepared tax returns for clients. In about 2013 and through about 2015, MG conspired to defraud the IRS by claiming education credits through the American Opportunity Credit on clients' tax returns knowing that they did not qualify to claim the credit. MG and her co-conspirators prepared 187 tax returns for 165 taxpayer clients claiming $342,901 in education credits, with a tax loss of $336,926. For some taxpayer clients, MG prepared tax returns directing the IRS to deposit refunds – belonging to taxpayer clients – into personal bank accounts belonging to MG and her co-conspirators. In total, MG received direct deposits of taxpayer client refunds of $219,490.

J. OKLAHOMA TAX RETURN PREPARER SENTENCED FOR TAX FRAUD SCHEME

On January 23, 2017, in Oklahoma City, Oklahoma, LQF, of Lawton, was sentenced to 18 months in prison, three years of supervised release and ordered to pay $133,955 in restitution to the IRS for an earned income credit tax fraud scheme. LQF was a self-taught tax return preparer who worked in the Lawton area for tax years 2010 through 2014. She recruited clients by word of mouth and distribution of flyers. LQF advised her clients that all they needed was a dependent child in order to receive a refund from the government. She then falsified returns for clients by adding fictitious income to increase the earned income credit (EIC) and by adding false dependents to maximize the EIC, which resulted in false refund claims. LQF prepared and submitted the returns for her clients electronically to the IRS.

K. TEXAS TAX RETURN PREPARER SENTENCED FOR FILING FALSE TAX RETURNS

On January 11, 2017, in Sherman, Texas, SM was sentenced to 18 months in prison and ordered to pay restitution in the amount of $152,471 to the Internal Revenue Service (IRS). SM was in the business of preparing federal income tax returns and admitted to preparing and presenting to the IRS, false tax returns for tax years 2009 through 2012. The returns falsely represented that the taxpayers was entitled to claim deductions for losses from a business on Schedule C and losses for rental property on Schedule E. In addition, some of the false tax returns included fraudulent tax deductions for things such as Education Credits, American Opportunity Credits, Charitable Contributions, Unreimbursed Employee Expenses, Medical and Dental Expenses, Losses for Rental Property, and Losses from a Business.

L. MASSACHUSETTS TAX PREPARER SENTENCED FOR TAX AND IDENTITY FRAUD

On January 5, 2017, in Boston, Massachusetts, CC, of Lynn, was sentenced to 30 months in prison, three years of supervised release and ordered to pay restitution of $320,760 and forfeiture. CC co-owned MMS, a tax return preparation business. From 2008 to 2011, CC filed dozens of false tax returns for her clients that included fraudulent dependents—real people who were not the dependents of her clients—intended to increase the tax refund amount, generally without her clients' knowledge. CC then directed the inflated portion of the refunds to be deposited into her bank account. In order to conceal the scheme, CC gave her clients versions of their tax returns that did not reflect the fraudulent dependents and sought smaller refunds than the returns she actually filed with the IRS.

VI. 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 the greater of $1,000 or 50% of the income derived by the tax return preparer with respect to the return or claim for refund.

IRC § 6694(b) – Understatement due to willful or reckless conduct. The penalty is the greater of $5,000 or 50% of the income derived by the tax return preparer with respect to the return or claim for refund.

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. The penalty is $50 for each failure to comply with IRC § 6107 regarding furnishing a copy of a return or claim to a taxpayer. The maximum penalty imposed on any tax return preparer shall not exceed $25,500 in a calendar year.

IRC § 6695(b) – Failure to sign return. The penalty is $50 for each failure to sign a return or claim for refund as required by regulations. The maximum penalty imposed on any tax return preparer shall not exceed $25,500 in a calendar year.

IRC § 6695(c) – Failure to furnish identifying number. The penalty is $50 for each failure to comply with IRC § 6109(a)(4) regarding furnishing an identifying number on a return or claim. The maximum penalty imposed on any tax return preparer shall not exceed $25,500 in a calendar year.

IRC § 6695(d) – Failure to retain copy or list. The penalty is $50 for each failure to comply with IRC § 6107(b) regarding retaining a copy or list of a return or claim. The maximum penalty imposed on any tax return preparer shall not exceed $25,500 in a return period.

IRC § 6695(e) – Failure to file correct information returns. The penalty is $50 for each failure to comply with IRC § 6060. The maximum penalty imposed on any tax return preparer shall not exceed $25,500 in a return period.

IRC § 6695(f) – Negotiation of check. The penalty is $510 for a tax return preparer who endorses or negotiates any check made in respect of taxes imposed by Title 26 which is issued to a taxpayer.

IRC § 6695(g) – Failure to be diligent in determining eligibility for earned income credit. The penalty is $510 for each failure to comply with the EIC due diligence requirements imposed in regulations.

IRC § 6700 – Promoting abusive tax shelters.

The penalty is for a promoter of an abusive tax shelter and is generally equal to $1,000 for each organization or sale of an abusive plan or arrangement (or, if lesser, 100 percent of the income derived from the activity).

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

The penalty is $1,000 ($10,000 if the conduct relates to a corporation's tax return) for aiding and abetting in an understatement of a tax liability. Any person subject to the penalty shall be penalized 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.

The penalty is $250 for each unauthorized disclosure or use of information furnished for, or in connection with, the preparation of a return. The maximum penalty on any person shall not exceed $10,000 in a calendar year.

IRC § 7206 – Fraud and false statements.

Guilty of a felony and, upon conviction, a fine of not more than $100,000 ($500,000 in the case of a corporation), imprisonment of not more than three years, or both (together with the costs of prosecution).

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

Guilty of a misdemeanor and, upon conviction, a fine of not more than $10,000 ($50,000 in the case of a corporation), imprisonment of not more than one year, or both.

IRC § 7216 – Disclosure or use of information by preparers of returns.

Guilty of a misdemeanor for knowingly or recklessly disclosing information furnished in connection with a tax return or using such information for any purpose other than preparing or assisting in the preparation of such return. Upon conviction, a fine of not more than $1,000, imprisonment for not more than 1 year, or both (together with the costs of prosecution).

IRC § 7407 – Action to enjoin tax return preparers.

A federal district court may enjoin a tax return preparer from engaging in certain proscribed conduct, or in extreme cases, from continuing to act as a tax return preparer altogether.

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

A federal district court may enjoin a person from engaging in certain proscribed conduct (including any action, or failure to take action, which is in violation of Circular 230).

VII. 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.

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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 Sixteen Amendment's income tax laws **D.** the Sixteenth Amendment was ratified by all fifty states
5.	**Which of the following is <u>not</u> one of the IRS Dirty Dozen Tax Schemes for 2018:** **A.** identity theft **B.** hiding income with fake documents **C.** phone scams **D.** offshore tax avoidance
6.	**Which of the following is correct regarding identity theft:** **A.** identity theft is on the rise in the United States **B.** tax-related identity theft refers specifically to the theft of refund checks **C.** only an individual can be the victim of identity theft **D.** as identity theft is fought more vigorously, criminals must change tactics

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 pages 2 to 3 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. Although identity theft has been on the decline over the past few years, it is still high on the list of the 2018 Dirty Dozen tax scams. **B.** **CORRECT**. Hiding income using fake documents was not on the IRS 2018 Dirty Dozen tax scams. **C.** Incorrect. Offshore tax avoidance once again made an appearance on this year's Dirty Dozen. **D.** Incorrect. Phishing scams are at the top of the list for the IRS Dirty Dozen tax scams for 2018. *(See pages 23 to 35 of the course material.)*
6.	**A.** Incorrect. Between 2015 and 2017, incidents of identity theft have actually declined in the United States. **B.** Incorrect. Tax-related identity theft occurs when someone uses a stolen Social Security number or ITIN to file a fraudulent tax return claiming a refund. **C.** Incorrect. Individual, as well as business, identities can be misappropriated by criminals to perpetrate fraud. **D.** **CORRECT**. Criminals are changing their identity theft methods in response to the successful methods of combating identity theft that have been deployed over recent years. *(See page 25 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.

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FRIVOLOUS TAX ARGUMENTS AND SCAMS (COURSE #5001A) –FINAL EXAM

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 business entity
- **D.** a corporation sole may own property and enter into contracts for the individual office holder's personal benefit

5. All of the following are discredited arguments challenging the authority of IRS employees <u>except</u>:

- **A.** IRS employees are not sworn officers of the court
- **B.** certain IRS employees are not authorized to conduct collection due process hearings
- **C.** IRS employees lack credentials
- **D.** revenue officers are not authorized to seize property in satisfaction of unpaid taxes

6. Which of the following is the maximum allowable fine that can be imposed on a taxpayer that instituted a proceeding primarily for delay under Section 6673(a):

- **A.** $2,500
- **B.** $10,000
- **C.** $25,000
- **D.** $50,000

7. Which of the following Dirty Dozen tax scams is frequently connected with significant natural disasters:

- **A.** fake charities
- **B.** excessive claims for business credits
- **C.** abusive tax shelters
- **D.** offshore tax avoidance

8. **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. a penalty of 20 percent of the excessive amount can be assigned to erroneous refund claims

9. **Which of the Dirty Dozen tax scams is often associated with micro-captive insurance:**

   A. frivolous tax arguments

   B. abusive tax shelters

   C. offshore tax avoidance

   D. excessive claims for business credits

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:**

   A. $5,000

   B. $50,000

   C. $100,000

   D. $500,000