



# Frivolous Tax Positions

---

**Course #9221D**

**Ethics**

**2 Credit Hours**

**Support@PacificCPE.com | (800) 787-5313**

**PacificCPE.com**

# FRIVOLOUS TAX POSITIONS

---

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

## LEARNING ASSIGNMENTS AND OBJECTIVES

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

### SUBJECTS

#### Frivolous Tax Positions

Study the course materials from pages 1 to 38

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

#### Objectives:

- 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.

## **NOTICE**

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties or merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

The End User shall be permitted to use the Licensed Content for internal purposes only and not for resale or distribution. The Licensed Content is provided on an “as is” basis and without any warranties of any kind, express or implied. CCH INCORPORATED AND ITS LICENSORS AND AFFILIATES DISCLAIM ALL WARRANTIES WITH RESPECT TO THE LICENSED CONTENT, EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO, WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, NON-INFRINGEMENT, TITLE, QUIET ENJOYMENT AND INFORMATION COMPLETENESS, CURRENCY OR ACCURACY.

End User assumes all responsibilities and obligations with respect to the selection of the Licensed Content to achieve End User’s intended results. End User assumes all responsibilities and obligations with respect to any decision or advice made or given as a result of the use or application of the Licensed Content. CCH and its licensors and affiliates are not engaged in the rendering of legal, accounting, tax or other professional advice or services. If legal, accounting, tax or other expert assistance is required, the services of a competent professional should be sought.

This course is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice.

© **Pacific CPE, LP 2023**

Program publication date 11/29/22

## 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 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.

---

---

# TABLE OF CONTENTS

---

---

<b>Frivolous Tax Positions</b>	<b>1</b>
<b>I. Frivolous Tax Arguments in General</b>	<b>1</b>
A. The Voluntary Nature of the Federal Income Tax System	1
B. The Meaning of Income: Taxable Income and Gross Income	4
C. The Meaning of Certain Terms Used in the Internal Revenue Code	6
D. Constitutional Amendment Claims	8
E. Fictional Legal Bases	11
<b>II. Frivolous Arguments in Collection Due Process Cases</b>	<b>16</b>
A. Invalidity of the Assessment	16
B. Invalidity of the Statutory Notice of Deficiency	17
C. Invalidity of Notice of Federal Tax Lien	17
D. Invalidity of Collection Due Process Notice	18
E. Verification Given as Required by I.R.C. § 6330(c)(1)	18
F. Invalidity of Statutory Notice and Demand	19
G. Tax Court Authority	19
H. Challenges to the Authority of IRS Employees	20
I. Use of Unauthorized Representatives	21
J. Authorization Under I.R.C. § 7401 is Required in a Collection Due Process Case	21
<b>III. Penalties for Pursuing Frivolous Tax Arguments</b>	<b>21</b>
<b>IV. IRS Dirty Dozen Tax Scams for 2022</b>	<b>24</b>
1. Use of Charitable Remainder Annuity Trust (CRAT) to Eliminate Taxable Gain	24
2. Maltese (or Other Foreign) Pension Arrangements Misusing Treaty	24
3. Puerto Rican and Other Foreign Captive Insurance	24
4. Monetized Installment Sales	24
5. Pandemic Related Scams	25
6. Offer in Compromise “mills” and unscrupulous tax preparers	26
7. Attempts to obtain personal financial information	27
8. Spear phishing attacks	28
9. Concealing Assets in Offshore Accounts and Improper Reporting of Digital Assets	29
10. High-income individuals who don’t file tax returns	29
11. Abusive Syndicated Conservation Easements	30
12. Abusive Micro-Captive Insurance Arrangements	30
<b>V. Summary of Preparer Penalties Related to Frivolous Tax Return Positions</b>	<b>31</b>

<b>VI. Conclusion</b>	<b>33</b>
<b>Test Your Knowledge</b>	<b>34</b>
<b>Solutions and Suggested Responses</b>	<b>36</b>
<b>Glossary</b>	<b>38</b>
<b>Index</b>	<b>39</b>
<b>Final Exam Copy</b>	<b>40</b>

---

# 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, relying on one or more of the frivolous arguments discussed throughout this outline to support their position.

**The Law:** A taxpayer that has taxable income cannot legally avoid income tax by filing a zero return. Section 61 provides that gross income includes all income from whatever source derived, including compensation for services. Courts have repeatedly penalized taxpayers for making the frivolous argument that the filing of a zero return can allow a taxpayer to avoid income tax liability or permit a refund of tax withheld by an employer. Courts have also imposed the frivolous return and failure to file penalties because these forms do not evidence an honest and reasonable attempt to satisfy the tax laws or contain sufficient data to calculate the tax liability, which are necessary elements of a valid tax return.



See *Beard v. Commissioner*, 82 T.C. 766, 777-79 (1984). Furthermore, including the phrase “nunc pro tunc” or other legal phrase has no legal effect and does not serve to validate a zero return. See Rev. Rul. 2006- 17, 2006-1 C.B. 748; Notice 2010-33, 2010-17 I.R.B. 609. 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.