PacificCPE

COURSE
90001D

Frivolous Tax Arguments and Scams

Get the full picture on frivolous tax arguments, IRS scams, and the real consequences for taxpayers and preparers who pursue them. Covering common frivolous positions, how they surface in collection due process cases, and the updated IRS Dirty Dozen tax scams for 2026, this course also breaks down the penalties facing both taxpayers and return preparers. Whether you're protecting your clients or safeguarding your own practice, understanding these issues is essential for any tax professional navigating today's complex and ever-evolving environment.

CREDIT HOURS 2 | FIELD OF STUDY ETHICS | EXAM QUESTIONS 10

Start Course ↓ | Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

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FRIVOLOUS TAX ARGUMENTS AND SCAMS (COURSE #9000)

ENJOY YOUR COURSE

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FRIVOLOUS TAX POSITIONS

Course Objectives

After completing this course, you should be able to:

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

I. FRIVOLOUS TAX ARGUMENTS IN GENERAL

A. THE VOLUNTARY NATURE OF THE FEDERAL INCOME TAX SYSTEM

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

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

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

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

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

In a similar vein, some argue that they are not required to pay federal taxes because the payment of federal taxes is voluntary. Proponents of this position argue that our system of taxation is based

upon voluntary assessment and payment. They frequently claim that there is no provision in the Internal Revenue Code or any other federal statute that requires them to pay or makes them liable for income taxes, and they demand that the IRS show them the law that imposes tax on their income. They argue that, until the IRS can prove to these taxpayers' satisfaction the existence and applicability of the income tax laws, they will not report or pay income taxes. These individuals or groups reflexively dismiss any attempt by the IRS to identify the laws, thereby continuing the cycle. The IRS discussed this frivolous position at length and warned taxpayers of the consequences of asserting it in Rev. Rul. 2007-20, 2007-1 C.B. 863 and in Notice 2010-33, 2010-17 I.R.B. 609.

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

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

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

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

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

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

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

the tax laws or contain sufficient data to calculate the tax liability, which are necessary elements of a valid tax return. See *Beard v. Commissioner*, 82 T.C. 766, 777-79 (1984). Furthermore, including the phrase "nunc pro tunc" or other legal phrase has no legal effect and does not serve to validate a zero return. See Rev. Rul. 2006-17, 2006-1 C.B. 748; Notice 2010-33, 2010-17 I.R.B. 609.

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

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

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

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

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

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

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

Failure to comply with an IRS administrative summons also could subject the non-complying individual to criminal penalties, including fines and imprisonment. I.R.C. § 7210. While the Second Circuit held in *Schulz II* that, for due process reasons, the government must first seek judicial review

and enforcement of the underlying summons and to provide an intervening opportunity to comply with a court order of enforcement before seeking sanctions for noncompliance, the court's opinion did not foreclose the availability of prosecution under section 7210.

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

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

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

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

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

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

All compensation for personal services, no matter what the form of payment, must be included in gross income. This includes salary or wages paid in cash, as well as the value of property and other

economic benefits received because of services performed or to be performed in the future. Criminal and civil penalties have been imposed against individuals who rely upon this frivolous argument.

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

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

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

The Law: As stated above, for federal income tax purposes, "gross income" means all income from whatever source derived and includes compensation for services. I.R.C. § 61. Further, Treas. Reg. § 1.1-1(b) provides, "[i]n general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States." Sections 861 and 911 define the sources of income (U.S. versus non-U.S. source income) for such purposes as the prevention of double taxation of income that is subject to tax by more than one country. These sections neither specify whether income is taxable nor determine or define gross income. The IRS has warned taxpayers of the consequences of making these frivolous arguments. Rev. Rul. 2004-28, 2004-1 C.B. 624 (discussing section 911); Rev. Rul. 2004-30, 2004-1 C.B. 622 (discussing section 861); Notice 2010-33, 2010-17 I.R.B. 609. Some groups and individuals have adopted a variation of this argument and argue that income derived within the United States is actually foreign earned income and then they claim the foreign earned income exclusion. This contention has been rejected as frivolous by the courts.

3. Contention: Federal Reserve Notes are not income.

Proponents of this contention assert that Federal Reserve Notes currently used in the United States are not valid currency and cannot be taxed because Federal Reserve Notes are not gold or silver and