

Frivolous Filing Position Based on Section 861

Notice 2001-40

The Internal Revenue Service and the Treasury Department are aware that certain persons are promoting the view that U.S. citizens and residents are not subject to tax on their wages and other income earned or derived within the United States based on the claim that the Internal Revenue Code imposes taxes only on income derived from certain foreign-based activities. The Service and Treasury are issuing this notice to inform taxpayers that this reporting position has no basis in law.

The proponents of this position misread the Code and the Treasury Regulations. Although the proponents acknowledge that section 1 imposes income tax on “taxable income,” that “taxable income” consists of “gross income” minus deductions (section 63) and that “gross income” is income “from whatever source derived” (section 61), they assert that sections 861 through 865 of the Code and the regulations thereunder (in particular, Treasury regulation section 1.861-8) limit taxable “sources” of income to certain foreign-based activities.

That assertion is refuted by the express and unambiguous terms of the Code. Section 61 includes in gross income “all income from whatever source derived.” As the Supreme Court stated in *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955), “Congress applied no limitations as to the source of taxable receipts . . .” Nothing in sections 861 to 865 of the Code limits the gross income subject to United States taxation to foreign-source income. The rules of sections

861 through 865 have significance in determining whether income is considered from sources within the United States or without the United States, which is relevant, for example, in determining whether a U.S. citizen or resident may claim a credit for foreign taxes paid. See *Great-West Life Assurance Co. v. United States*, 678 F.2d 180, 183 (Ct. Cl. 1982) (stating that “[t]he determination of where income is derived or ‘sourced’ is generally of no moment to either United States citizens or United States corporations, for such persons are subject to tax under I.R.C. § 1 and I.R.C. § 11, respectively, on their worldwide income” and that “[l]ikewise, the income of a resident alien individual is taxed under I.R.C § 1 without regard to source”). The source rules do not operate to exclude from U.S. taxation income earned by United States persons from sources within the United States. *Williams v. Commissioner*, 114 T.C. 136 (2000) (rejecting the claim that income was not subject to tax because it was not from any of the sources listed in Treas. Reg. sec. 1.861-8(a)); *Aiello v. Commissioner*, T.C. Memo. 1995-40 (1995) (rejecting the claim that section 861 lists the only sources of income relevant for purposes of section 61).

The courts have categorically rejected contentions that U.S. citizens are not lawfully subject to Federal income tax on their income from all sources and have upheld criminal convictions of individuals who based their refusal to pay Federal income tax on such contentions. See, e.g., *United States v. Condo*, 741 F.2d 238 (9th Cir. 1984).

The Internal Revenue Service and the Treasury Department advise taxpayers that if they file returns reflecting this the-

ory that only certain foreign-source income is taxable, they may be subject to penalties including, but not limited to, the accuracy-related penalty under section 6662 and the frivolous return penalty under section 6702. Under some circumstances, taxpayers adopting this position on tax returns may be subject to additional sanctions, including failure to file or pay penalties under section 6651 and civil fraud penalties under section 6663, and may be prosecuted for criminal violations of the tax law. In addition, practitioners advocating this position may be subject, under some circumstances, to the return preparer penalty under section 6694 or aiding and abetting penalties under section 6701, and may be prosecuted for criminal violations of the tax law.

The Internal Revenue Service and the Treasury Department recognize that some taxpayers may have chosen not to file or have filed incorrect tax returns, taking the position that they were not required to report wages or other income earned in the United States for taxation. We advise these taxpayers to take prompt action to file correct returns and to comply with the tax laws. Taxpayers can obtain tax forms, including those necessary to amend previously-filed returns, via the IRS web site (<http://www.irs.gov>), obtain them through the IRS’ TaxFax Services (from a fax machine call: 703-368-9694 (not a toll-free number)), or order the forms by phone: 1-800-TAX-FORM (1-800-829-3676).