

## Section 911.—Citizens or Residents of the United States Living Abroad

(Also, Sections 6662, 6663, 6702.)

**Frivolous tax returns; excluding gross income under section 911.** This ruling emphasizes to taxpayers, and to promoters and return preparers who assist taxpayers with frivolous tax schemes, that there is no basis for excluding income earned in a State, Commonwealth, or Territory of the United States under section 911 of the Code. The ruling also describes many of the possible civil and criminal penalties that apply to people who claim tax benefits on their return based on frivolous claims under section 911.

## Rev. Rul. 2004-28

### PURPOSE

The Service is aware that some taxpayers are attempting to reduce their federal tax liability by taking the position that their wages or other income are excluded from gross income under section 911 of the Internal Revenue Code because the State, Commonwealth, or Territory of the United States in which they resided or performed services is a foreign country. The Service also is aware that promoters, including return preparers, are advising or recommending that taxpayers take frivolous positions based on this argument. Some promoters may be marketing a package, kit, or other materials that claim to show taxpayers how they can avoid paying income taxes based on this and other meritless arguments.

This revenue ruling emphasizes to taxpayers, and to promoters and return preparers who assist taxpayers with this scheme, that there is no basis under section 911 for excluding income earned in a State, Commonwealth, or Territory of the United States. This argument has no merit and is frivolous. Section 911 of the Internal Revenue Code permits a taxpayer to elect to exclude income from gross income for U.S. income tax purposes only when the taxpayer earns income and resides outside the United States under the conditions and limitations set forth in that section. For purposes of section 911, States, Commonwealths, and Territories of the United States are not foreign countries.

The Service is committed to identifying taxpayers who attempt to avoid their tax obligations by taking frivolous positions, such as frivolous positions based on meritless section 911 arguments. The Service will take vigorous enforcement action against such taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions.

Frivolous returns and other similar documents submitted to the Service are processed through its Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service

also determines whether civil or criminal penalties should apply to return preparers, promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether a court injunction should be sought to halt such activities. Other information about frivolous tax positions is available on the Service website at [www.irs.gov](http://www.irs.gov).

### ISSUE

Whether an individual may exclude income under section 911 by claiming that he met the requirements of section 911 because a State, Commonwealth, or Territory of the United States is considered to be a foreign country under section 911.

### FACTS

Situation 1. A, an individual, resides in State X, a State or Commonwealth of the United States, and performs services exclusively in State X. A was present in State X for all of his taxable year and is therefore not eligible in that taxable year for the exclusion from income under section 911 for citizens or residents of the United States living abroad. Based on the advice of a person who promotes the view that section 911 excludes income earned in a State, Commonwealth, or Territory of the United States because such State, Commonwealth or Territory is a foreign country, A files a return including a Form 2555, *Foreign Earned Income*, or a Form 2555-EZ, *Foreign Earned Income*. On the Form 2555 or Form 2555-EZ, A asserts that he is entitled to the exclusion from gross income under section 911 because he earned such income by performing services in, is a *bona fide* resident of, and has a tax home in, a foreign country (*i.e.*, State X). A acknowledges on Form 2555 or Form 2555-EZ that the services were performed in State X and that he was a *bona fide* resident of State X, but contends that State X is a foreign country and not a part of the United States.

Situation 2. Same as Situation 1 except that A, a resident of State X, claims an exclusion from gross income under section 911 based upon his physical presence in State X. Specifically, A claims he satisfies the physical presence test of section 911 because he was physically present in a foreign country for at least 330 days during his taxable year. A acknowledges on Form 2555 or Form 2555-EZ that he was present

in State X, but contends that State X is a foreign country and not a part of United States.

Situation 3. B, an individual, performed services in and resided on Johnston Island, one of the islands on Johnston Atoll. The Johnston Atoll is a Territory of the United States. B files a U.S. Federal Income Tax Return with a Form 2555 or a Form 2555-EZ in which he asserts that he is entitled to the exclusion from gross income under section 911 because he performed services in, is a *bona fide* resident of, and has a tax home in, a foreign country (*i.e.*, Johnston Atoll).

## LAW AND ANALYSIS

Section 911 allows individuals that meet its requirements to elect to exclude from gross income certain foreign earned income. To qualify for the exclusion under section 911, a U.S. citizen or resident working abroad must have a tax home in a foreign country and satisfy either the *bona fide* residence test or the physical presence test. For purposes of section 911, States, Commonwealths, and Territories of the United States are not foreign countries. Treas. Reg. § 1.911-2(g) & (h).

In the situations described above, A and B do not meet the requirements for the exclusion from gross income under section 911. The claim that section 911 excludes income earned in a State, Commonwealth, or Territory of the United States because such State, Commonwealth or Territory is a foreign country has no basis in law or fact. Courts repeatedly have rejected similar arguments as frivolous, imposed penalties for making arguments such as these in court, and upheld criminal tax evasion convictions against individuals making such arguments. Courts repeatedly have rejected similar arguments as frivolous, imposed penalties for making arguments such as these in court, and upheld criminal tax evasion convictions against individuals making such arguments. *See, e.g., In re Becraft*, 885 F.2d 547, 549-50 (9th Cir. 1989) (rejecting the claim that federal law governs only the District of Columbia and U.S. territories and sanctioning attorney for making frivolous arguments); *United States v. Ward*, 833 F.2d 1538, 1539 (11th Cir. 1987) (affirming tax evasion conviction and noting that claim that federal law applies only the District of Columbia,

federal enclaves within States and U.S. territories is “utterly without merit”).

## CIVIL AND CRIMINAL PENALTIES

In determining the correct amount of tax due, the Service will include income that taxpayers attempt to exclude based on frivolous section 911 arguments. In addition to liability for tax due plus statutory interest, individuals who claim tax benefits on their returns based on this and other frivolous arguments face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (2) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (3) a \$500 penalty under section 6702 for filing a frivolous return; and (4) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on this scheme also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201 for which the penalty is a fine of up to \$100,000 and imprisonment for up to 5 years; or (2) making false statements on a return under section 7206 for which the penalty is a fine of up to \$100,000 and imprisonment for up to 3 years.

Persons who promote this scheme and those who assist taxpayers in claiming tax benefits based on this scheme also may face penalties. Potential penalties include: (1) a \$250 penalty for each return prepared by an income tax return preparer who knew or should have known that the taxpayer’s argument was frivolous (or \$1,000 for each return where the return preparer’s actions were willful, intentional or reckless); (2) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (3) criminal prosecution under section 7206 for which the penalty is a fine of up to \$100,000 and imprisonment for up to 3 years for assisting or advising about the preparation of a false return or other document under the internal revenue laws. Promoters and others who assist taxpayers in engaging in these schemes also may be enjoined from doing so under section 7408.

## HOLDING

Any position that the exclusion from gross income under section 911 applies to a taxpayer’s income because a State, Commonwealth, or Territory of the United States is considered to be a foreign country is frivolous. Taxpayers attempting to reduce their federal tax liability by taking frivolous positions based on this argument will be liable for the actual tax due plus statutory interest. In addition, the Service will determine civil penalties against taxpayers where appropriate, and those taxpayers also may face criminal prosecution. The Service also will determine appropriate civil penalties against persons who prepare frivolous returns or promote frivolous positions, and those persons also may face criminal prosecution. Promoters and others who assist taxpayers in engaging in these schemes also may be enjoined from doing so under section 7408.

## DRAFTING INFORMATION

This revenue ruling was authored by the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact that office at (202) 622-4910 (not a toll-free call).