DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL -- SALT LAKE CITY
(Small Business /Self Employed) CC:SB:5:SLC

FROM: ACTING SENIOR TECHNICIAN REVIEWER, BRANCH 2
(ADMINISTRATIVE PROVISIONS AND JUDICIAL PRACTICE)

SUBJECT: FRIVOLOUS RETURN PENALTIES

This responds to your request for Significant Service Center Advice dated August 23, 2000, in connection with a question posed by the Customer Service function of the Ogden Service Center.

ISSUE

Can the Service assess penalties under I.R.C. §§ 6701 and 6702 against a person who files frivolous documents with the Service?

CONCLUSION

Yes. The facts support the assertion of penalties under both I.R.C. §§ 6701 and 6702.

FACTS

According to your request for advice, the Ogden Service Center has received a number of documents filed on behalf of taxpayers by persons purporting to represent the taxpayers before the Service. These documents, which come in the form of a package, essentially purport to be claims for refund.

Generally, the first page of the package contains the words “LEGAL NOTICE of the Determination of NO Federal Income Tax Liability for below named individual(s) pursuant [to] § 6401(c) for taxable year _____.” This page also contains a statement regarding the alleged nonenforceability of the federal tax lien and orders the Service to withdraw any notices of federal tax lien (NFTL) filed against the taxpayer.

The second page of the package, titled “Overpayment Affidavit(s), lists the taxpayer’s income, deductions, payments, and the amount of refund sought. The taxpayer’s

income, however, is generally listed in the "Excluded" column and the reported "gross income" is generally zero. This page also contains a jurat, which provides as follows:

> Under penalties of perjury I declare the foregoing overpayment affidavit and individual net earnings from self-employment statement is true, correct, and complete as provided with client's verified information and with affiant's full knowledge of § 6701 and 7214 with a § 6662(d)(2)(B)(ii) attached to identify allowable deduction(s).

The signature of the person filing the document on behalf of the taxpayer and the date the document was signed appear directly below the jurat.

The subsequent page is a Worksheet. It appears to contain financial information and calculations necessary to complete the "Overpayment Affidavit(s)." Although the Worksheet is completed and signed by the taxpayer, it does not contain the "penalties of perjury" clause. Likewise, it does not contain an authorization of representation.[1]

The following four pages of the package are titled "Notice of Paradigm" and appear to set forth the taxpayer's arguments in support of his claim that all his income is exempt from taxation. These arguments, however, misconstrue the law and are entirely without merit.

The final item of the package is Internal Revenue Form 56, *Notice Concerning Fiduciary Relationship*. The form purports to give the person who files these documents on behalf of the taxpayer the authority to do so. In relevant part the form provides that the person filing this package has the authority to represent the taxpayer under a "[p]rivate contract (other than 2848 on file)." This form is not signed by the taxpayer.[2]

DISCUSSION

Authority to Practice Before the Service

Treasury Department Circular No. 230, codified in 31 C.F.R. Part 10, sets forth the regulations governing practice before the Internal Revenue Service (Service). In

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[1] Packages filed on behalf of a husband and wife contain a separate "Overpayment Affidavit" and Worksheet for each spouse.

[2] We do not know whether the person in question has previously filed a Power of Attorney form with the Service. For purposes of this advice, however, we assume that the person has not filed any document regarding representation with the Service other than the Form 56.

accordance with these regulations, only a recognized representative is authorized to act on behalf of a taxpayer before the Service. 31 C.F.R. § 10.3; 26 C.F.R. § 601.501. A recognized representative is an individual who is "appointed as an attorney-in-fact under a power of attorney" and is either an attorney, certified public accountant (CPA), enrolled agent, or an enrolled actuary.[3] 26 C.F.R. § 601.502. In addition to these recognized representatives certain other individuals may enjoy the privilege of a limited practice. Id. For example, an individual may represent a member of his or her immediate family. See 31 C.F.R. § 10.7(c)(i). Likewise, a "trustee, receiver, guardian, personal representative, administrator, executor, or regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate." 31 C.F.R. § 10.7(c)(v). Finally, an "individual who prepares and signs a taxpayer's return . . . may represent the taxpayer before officers and employees of the Examination Division of the [Service] with respect to the tax liability of the taxpayer for the taxable year or period covered by that return." 31 C.F.R. § 10.7(c)(viii). See also Rev. Proc. 81-38.

Before one of the above referenced individuals is recognized as a taxpayer's representative, he must first file a power of attorney and declaration of representative with the Service. 26 C.F.R. § 601.501(a) and 601.502. See also IRM 121.3. In order to be valid, a power of attorney must be signed by the taxpayer, as principal, and appoint the authorized representative as attorney-in-fact on behalf of the taxpayer. See 26 C.F.R. § 601.503(c). In addition, "a power of attorney must contain certain information concerning the taxpayer, the recognized representative, and the specific tax matter(s) for which the recognized representative is authorized to act." 26 C.F.R. §§ 601.501; 601.503(a). Finally, a "declaration of representative is a written statement made by a recognized representative that he or she is currently eligible to practice before the Service and is authorize to represent the particular party on whose behalf he or she acts. See 26 C.F.R. § 601.502(c).

In order to represent an individual taxpayer before the Service, the representative must file with the Service a completed Form 2848, *Power of Attorney and Declaration of Representative*, or another form that contains all of the information required by 26 C.F.R. § 601.503(a). See IRM 121.3.1.2.1.3; IRM 121.3.2.2.3. A form that does not contain all of the required information is not a valid power of attorney. See IRM 121.3.1.2.1.3. Form 56, *Notice Concerning Fiduciary Relationship*, which serves to notify the Service of a fiduciary relationship, is not a power of attorney. A fiduciary (generally a trustee, receiver, guardian, personal representative, administrator, or an executor) stands in the position of a taxpayer (a trust, receivership, guardianship, or estate) and acts as the taxpayer. A fiduciary does not act as a representative of the taxpayer. If a fiduciary wishes to authorize an individual to represent or perform certain

[3] Enrolled actuaries are authorized to practice before the Service with respect to only certain issues. See 31 C.F.R. § 10.3(d).

acts on behalf of the taxpayer (a trust, receivership, guardianship, or estate), a power of attorney must be filed and signed by the fiduciary acting in the position of the taxpayer.

In the instant case, the Service has not received a valid "power of attorney and declaration of representative" from the person(s) filing the above referenced documents with the Service. Since the taxpayers on whose behalf the above described documents are filed are neither trusts, receiverships, guardianships, or estates, Form 56 is an inappropriate document to file with the Service. Without a valid power of attorney and declaration of representative, the Service need not, and in fact can not, recognize these individuals as taxpayers' representatives. As will be discussed later, however, the fact that these individuals are not authorized to practice before the Service does not preclude the Service from asserting section 6701 or section 6702 penalties against them.

Application of I.R.C. § 6701

The Service has authority to impose substantial monetary penalties upon persons who knowingly aid and abet in the understatement of the tax liability of another person. I.R.C. § 6701. Specifically, section 6701(a) imposes a penalty, in the amount of $1000 per person per tax period, against "any person"

> (1) who aids or assist in, procures, or advises with respect to, the preparation of presentation of any portion of a return, affidavit, claim, or other document,
>
> (2) who knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and
>
> (3) who knows that such portion (if so used) would result in an understatement of the liability for tax of another person.

I.R.C. § 6701(a).

Section 6701 does not define the term "person." The provision, however, is intended to apply broadly. See S. Rep. 494, 97Th Cong., 2d Sess. 275, *reprinted in* 1982 U.S. Code Cong. & Admin. News 781, 1022. This is evidenced not only in the legislative history, but also in the language of the statute itself and other applicable provisions. Section 6671, for example, provides that the term "person" as used in subchapter 68B, includes, but is not limited to, "an officer or employee of a corporation, or a member or employee of a partnership who as such officer, employee, or member is under a duty to perform an act in respect to which the violation occurs." I.R.C. § 6671(b). Section 7701(a) further provides that unless "otherwise distinctly expressed or manifestly incompatible" with the intent of the applicable statute, the term "person" shall be "construed to mean and include an individual, a trust, estate, partnership, association,

company or corporation." I.R.C. § 7701(a)(1). Thus, section 6701 is intended to reach any person who has aided or abetted another in an understatement of another's liability, and not just individuals authorized to practice before the Service. See, e.g., Bailey Vaught Robertson & Co. v. United States, 828 F. Supp. 442 (N.D. Tex. 1993) (upholding assertions of section 6701 penalty against a partnership); Mitchell v. United States, 977 F.2d 1318 (9th Cir. 1992) (individual was subject to penalty for aiding in the preparation of several Forms K-1 containing information that investors incorporated into their tax returns to generate tax understatements); Nielsen v. United States, 976 F.2d 951 (5th Cir. 1992) (general partner of an abusive tax shelter found liable under section 6701 for aiding and abetting investors who joined his partnership in their quest to diminish their tax liability).

Before a person can be considered to have aided and abetted under section 6701, the person must be shown to meet all three criteria set forth in subsection (a). See Mitchell, supra. See also IRM 120.1.6.6. The burden of proof is on the Service. I.R.C. § 6703(a). The Service need not, however, show that the taxpayer whose tax is understated either had knowledge or authorized the actions which result in the understatement for the Service to assess the penalty. I.R.C. § 6701(d). Likewise, it is not necessary that the documents so filed are actually used by the Service in computing the taxpayer's liability. Bailey, supra.

Given the facts, we support the assertion of section 6701 penalties against persons filing the above referenced documents with the Service. We are of the opinion that the documents filed with the Service constitute sufficient evidence to carry the Service's burden of proof on all of the required elements of section 6701(a). The Service should follow the procedures set forth in IRM 120.1.6.6 *et seq* when developing a case and asserting the penalty.

Application of Section 6702

Enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, section 6702 is meant to halt what Congress perceived as the "rapid growth in deliberate defiance of the tax laws by tax protestors." S. Rep. No. 494, 97th Cong., 2d Sess. 74, 277, *reprinted in* 1982 U.S. Code. Cong. & Ad. News 781, 1023. The Congressional draftsmen recognized that under the existing law, a taxpayer filing a protest return was potentially subject to other civil penalties, such as the penalty for failure to file under I.R.C. § 6651(a), or the penalty for fraud under I.R.C. § 6653(b). The draftsmen concluded, however, that the limitations in the amount of those penalties and the inherent delays in their imposition had rendered those penalties ineffective as a deterrent to the filing of protest "returns." Accordingly, in an effort to "maintain the integrity of the income tax system," Congress enacted section 6702. Id.

Section 6702 allows for the immediate assessment of civil penalty in the amount of $500 against:

> (1) any individual [who] files what purports to be a return of the tax imposed by subtitle A but which:
>
> (A) does not contain information on which the substantial correctness of the self-assessment may be judged, or
>
> (B) contains information that on its face indicate that the self-assessment is substantially incorrect; and
>
> (2) the conduct referred to in paragraph (1) is due to –
>
> (A) a position which is frivolous, or
>
> (B) a desire ... to delay or impede the administration of Federal income tax laws.

I.R.C. § 6702(a).

The provision is intended to apply broadly. The penalty is not based on tax liability. In fact, there need be no underpayment or understatement of tax in order for the penalty to be imposed in addition to any other penalty, such as the section 6701 penalty. I.R.C. § 6702(b). The section 6702 liability arises immediately with the filing of a frivolous return. There is no requirement of advance notice, and the deficiency procedures are not applicable. I.R.C. § 6703.

Since I.R.C. § 6703 places the burden of proof with respect to the section 6702 penalty on the Service, the Service needs to determine that all three requirements of section 6702 are met before it asserts the penalty. See Sullivan v. United States, 788 F.2d 813 (1st Cir. 1986). First, an individual against whom the Service intends to assert the section 6702 penalty must file" what purports to be a return." I.R.C. § 6702(a)(1). Second, the return must either fail to contain information which is sufficient to ascertain whether the self-assessment is correct or must contain information which on its face indicates that the self-assessment is substantially incorrect. I.R.C. §§ 6702(a)(1)(A) and 6702(a)(1)(B). Finally, the position taken by the filer of the "return" must be frivolous or demonstrate a desire to delay or impede the administration of the income tax laws. I.R.C. § 6702(a)(2)(A) and 6702(a)(2)(B).

The threshold issue in the instant case is whether the documents filed with the Service can be said to constitute "what purports to be a return" within the meaning of section 6702. We believe that they do. First, the legislative history of section 6702 makes it clear that the provision is intended to apply to a variety of documents, including returns, amended returns, or documents which purport to be returns, that contain altered line items or claim clearly unallowable deductions or credits based on a frivolous position. See S. Rep. No. 494, 97th Cong., 2d Sess. 74, 277, *reprinted in* 1982 U.S. Code. Cong. & Ad. News 781, 1023-25. Although we found no cases directly on point, the relevant

law unequivocally holds that a document need not qualify as a valid return in order to fall within the parameters of section 6702. See, e.g., Kelly v. United States, 789 F.2d 94 (1st Cir. 1986); Davis v. United States, 742 F.2d 171 (5th Cir. 1984) (per curiam); Holker v. United States, 737 F.2d 751 (8th Cir. 1984) (per curiam). In fact, more often than not, the section 6702 penalty is asserted against a taxpayer who files a document which does not contain sufficient information to constitute a valid return.

In Sullivan v. United States, 788 F.2d 813 (1st Cir. 1986), for example, the court upheld the imposition of the section 6702 penalty against a taxpayer who filed with the Service a letter entitled "Request for Refund of Income Tax," and attached two documents entitled "Income Tax Refund Statement for the Tax Year 1983" and "Business Income/Loss Statement for the Tax Year 1983." Id. at 814. In the letter, the taxpayer (Sullivan) stated that he was a "natural individual and unenfranchised freeman" who "neither requested, obtained, nor exercised any privilege from an agency of government" for the taxable year in question. Id. He, therefore, claimed not to owe any federal income taxes and sought a refund of all taxes paid for 1983.

The Service found that the taxpayer filed a purported return and assessed the section 6702 penalty against him. The taxpayer paid a portion of the penalty and instituted a suit for refund. The court held for the Service. The court found that the documents filed by Sullivan constituted a "purported return" within the meaning of section 6702. Although the court noted that the documents made references to Form 1040 and Schedule C, we do not think this to be dispositive of the issue. Instead, we believe the proper inquiry is one of purpose. As explained by the court in Sullivan: "[the] stated purpose in submitting the document was to obtain a refund of taxes withheld in 1983. A taxpayer cannot obtain a refund without first filing a return." Id. at 815. Finally, the court noted that the taxpayer's statement that the submitted documents were "for information purposes only" and were "NOT intended to be returns of income" did not remove them from the reach of section 6702. Id.

We are of the opinion that the facts in the instant case are sufficiently similar to those before the court in Sullivan to justify the application of section 6702. The legislative history makes it clear that in applying to individuals who file "what purports to be a return," section 6702 was intended to deter the filing of precisely the type of documents filed with the Service in the instant situation.

Furthermore, although we have not found any cases where the section 6702 penalty was imposed upon an individual other than the taxpayer, the application of the statute is not limited to taxpayers. Generally, unless specifically provided otherwise, words in statutes are presumed to carry their ordinary meaning. The term "individual" is not defined in either section 6702 or section 6671. Webster's New Collegiate Dictionary defines the word "individual" as "a particular being [or] a particular person," "a single human being as contracted with a social group or institution." Webster's New Collegiate Dictionary (8th ed. 1975). In addition, had Congress intended to limit the application of section 6702 either to taxpayers or to individuals authorized to represent

taxpayers before the Service it could have done so. The use of the term “individual” rather than “taxpayer” or “return preparer” demonstrates the Congressional intent not to limit the application of section 6702 only to those individuals. Accordingly, we are of the opinion that the Service would be justified in asserting the frivolous return penalty against the persons filing above described documents with the Service.