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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL
KENTUCKY-TENNESSEE DISTRICT COUNSEL
CC:SER:KYT:NAS

FROM: Deborah A. Butler
Assistant Chief Counsel (Field Service)
CC:DOM:FS

SUBJECT: Statute of Limitations on Frivolous Returns

This Field Service Advice responds to your memorandum dated March 6, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Taxpayer A =
Taxpayer B =
Taxpayer C =
Taxpayer D =
Organization X =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Month 1 =

ISSUE

Whether there is a statute of limitations on assessment of the I.R.C. § 6702 frivolous return penalty where what purports to be an amended return (claim for refund), later determined to be frivolous, is filed after a valid original return?

CONCLUSION

The statute of limitations on the assessment of the section 6702 frivolous return penalty depends on whether the purported claim for refund is valid. If the claim for refund contains the requisite information and is sworn under penalties of perjury so as to qualify as a valid claim for refund, or if the Service waives any defects in the claim for refund by processing it, then the section 6501 statute of limitations applies to the assessment of the section 6702 frivolous return penalty. However, if the claim for refund is not valid, and the Service does not process it, then the section 6501 statute of limitations does not apply to the assessment of the section 6702 frivolous return penalty, and the penalty may be assessed at any time.

FACTS

Taxpayer A and Taxpayer B filed a valid joint federal income tax return for Year 1 through Year 2. Taxpayer C and Taxpayer D also each filed proper Year 1 through Year 2 federal income tax returns. In Month 1 of Year 3, Taxpayer A and Taxpayer B filed joint Forms 1040X with Forms 1040NR attached (claims for refund) for Year 1 through Year 2. Taxpayer C and Taxpayer D also each filed claims for refund for Year 1 through Year 2. The Forms 1040X each claimed a refund of all taxes paid during Years 1 through Year 2. Taxpayer A and Taxpayer B amended the jurat on the joint Forms 1040X by adding, “With express reservation of all my rights in law, equity, and all other natures of law. Expressly or by acquiescence,” after the penalties of perjury statement and before the signatures. Taxpayer A and Taxpayer B also each included a three page attachment with each claim for refund consisting of frivolous return filer rhetoric. Taxpayer A signed the Forms 1040NR, but Taxpayer B did not. Taxpayer A, Taxpayer B, Taxpayer C, and Taxpayer D were all followers of Organization X, an organization that advocates the frivolous filing of federal individual income tax returns.

The claims for refund were labeled “frivolous returns - do not process” by the Service and were referred to the Criminal Investigation Division. Although three separate guilty plea offers were ultimately made by Taxpayer A, Taxpayer C, and Taxpayer D, the Department of Justice authorized a plea for Taxpayer A, but not for Taxpayer C and Taxpayer D. Taxpayer A pled guilty to the charge of failing to file his Year 4 income tax return in violation of section 7203. The assessments of the section 6702 frivolous return penalty against Taxpayer A and Taxpayer B for the frivolous Forms 1040X for Years 1 through 2, and the assessments of the section 6702 frivolous return penalty against Taxpayer A for the frivolous Forms 1040NR for Years 1 through Year 2 were suspended while the criminal investigation was pending. The Internal Revenue Service seeks to assess the section 6702 frivolous return penalty against Taxpayers based on the frivolous claims for refund for Years 1 through Year 2, filed in Month 1 of Year 3.

LAW AND ANALYSIS

Section 6702(a) generally provides that an individual who files a frivolous return shall pay a penalty of $500.[1] For purposes of section 6702, a frivolous return is that which purports to be a return of tax imposed by subtitle A, but which does not contain information on which the substantial correctness of the self-assessment may be judged, or which contains information that on it's face indicates that the self-assessment is substantially incorrect. The purported return must take a position that is frivolous or must reflect a desire to delay or impede the administration of federal income tax laws. Section 6702 applies to both original returns and claims for refund filed on amended returns. See Sisemore v. United States, 797 F.2d 268 (6th Cir. 1986), cert. denied, 479 U.S. 849 (1986); Branch v. Internal Revenue Service, 846 F.2d 36 (8th Cir. 1988); Colton v. Gibbs, 902 F.2d 1462, 1463 (9th Cir. 1990).

Section 6702 is part of subchapter B of chapter 68 (entitled "Assessable Penalties"), and section 6671 provides that subchapter B penalties and liabilities are assessed and collected in the same manner as taxes.[2]

Section 6501(a) provides, in part, that tax[3] must be assessed within 3 years after the return was filed, and no proceeding in court without assessment for the collection of such tax shall begin after the expiration of the 3-year period.

The statute of limitations for assessment on an original return is not extended by an amended return unless the taxpayer files an amended return within 60 days of the expiration of the 3-year period described in section 6501(a) for making an

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[1]The legislative history to section 6702 indicates that the provision was intended to deter the filing of frivolous returns. The penalty applies only to returns that are patently improper. Since it is unnecessary to determine the taxpayer's true tax liability before imposing the penalty, the deficiency procedures do not apply, and the penalty may be assessed immediately. S. Rept. No. 97-494, 277-278, Vol. 1, 97th Cong., 2nd Sess. (July 12, 1982).

[2]It is possible that, even though the section 6702 penalty is part of subchapter B of chapter 68, the penalty does not have to be assessed and collected in the same manner as taxes, in that the legislative history to section 6702 indicates that the penalty may be immediately assessed without notice. See supra, note 1. If so, the statute of limitations of section 6501 may not apply to the assessment of the penalty. However, this is not the position that the Service has taken in the past, and the Service should not change its position with respect to the assessment of the section 6702 penalty at this time. See, infra, note 8.

[3]The penalty under section 6702 is a tax within the meaning of section 6501(a). See section 6671.

assessment showing that the taxpayer owes an additional amount of tax. In such a case, the period for making an assessment will not expire before 60 days after the day on which the Service receives the amended return. Section 6501(c)(7).

In the instant case the frivolous claims for refund for Years 1 through 2 did not indicate that Taxpayer A and Taxpayer B owed additional tax. Therefore, even if the claims for refund were valid, they did not extend the statute of limitations on the respective original returns under section 6501(c)(7).

The rules of section 6501 apply to return-based liabilities, i.e., tax liabilities or other liabilities required to be shown on a tax return or related to or based on a return.[4] Statutes of limitation that are used to bar the rights of the government are narrowly construed in favor of the government. See Badaracco v. Commissioner, 464 U.S. 386, 391 (1994). Therefore, if a penalty is not a return-based penalty, the Service may assess the penalty at any time.[5] Neither section 6501 nor any other statute of limitations applies to the assessment of such penalties.

Part 120 of the Internal Revenue Manual, Handbook 120.1, section 10.9.0(5), provides that the statute of limitations for assessing the section 6702 frivolous return penalty is 3 years from the filing date if the purported return is a valid return (i.e., the Service is able to process the return); if the purported return is invalid, then the section 6702 frivolous return penalty may be assessed at any time.

Based on the relevant case law and the Service's position with regard to the assessment of the section 6702 penalty, we conclude that the section 6702 penalty is a return-based penalty if the purported return was a valid return or was

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[4]An example of a penalty that was held to be a return-based penalty is the section 6672 trust fund recovery penalty, which is imposed on corporate officers and other "responsible persons" if withheld employment taxes are not paid by the employer to the government. Courts have held that the section 6672 penalty is return-based because it is not separate and distinct from the underlying employment tax liability. Rather the penalty is a mechanism for collecting the underlying employment tax liability. Therefore, the assessment of the section 6672 penalty is subject to the period of limitations in section 6501. See, e.g., Lauckner v. U.S., 68 F.3d 69 (3d Cir. 1995), aff'g No. 93-1594 (D.N.J. 1994), acq., A.O.D. 1996-006, 1996-2 C.B. 1.

[5]The Service has successfully argued that the promoter penalties under sections 6700 and 6701 are not return-based penalties and thus may be assessed at any time. The courts have rejected both the application of section 6501 and other statutes of limitations not found in the Internal Revenue Code (28 U.S.C. § 2462) with respect to those penalties. See Capozzi v. U.S., 980 F.2d 872 (2d Cir. 1992); Mullikin v. U.S., 952 F.2d 920 (6th Cir. 1991).

processed as a valid return by the Service. As such, the 3-year statute of limitations of section 6501(a) applies to the assessment of the section 6702 frivolous return penalty when the purported return is valid. In contrast, if the purported return is not valid and the Service does not process the purported return, then the section 6702 penalty is not a return-based penalty. As such, the statute of limitations of section 6501 does not apply, and the penalty may be assessed at any time.

The analysis of the statute of limitations for assessing the section 6702 penalty for claims for refund filed on Forms 1040X and Forms 1040NR is the same as that for original returns. If the Service is able to process the claim for refund as a valid claim for refund, then the section 6702 frivolous return penalty is a return-based penalty relating to the original return. Therefore, it must be assessed within the 3-year statute of limitations for assessment running from the date the original return was filed. However, if the Service is unable to process the purported claim for refund because it is invalid, then the section 6702 frivolous return penalty is not a return-based penalty. An invalid claim for refund is unrelated to an original return because it cannot be used to amend the original return. Therefore, the 3-year statute of limitations for making an assessment, running from the date the original return was filed, is inapplicable, and the penalty may be assessed at any time.

There are four requirements to a valid return: (1) there must be sufficient data to calculate the tax liability; (2) the document must purport to be a return; (3) there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and (4) the taxpayer must execute the return under penalties of perjury. See Beard v. Commissioner, 82 T.C. 766, 777 (1984), aff'd. 793 F.2d 139 (6th Cir. 1986). The fourth requirement is required under section 6065.

A tax return that is not sworn under penalties of perjury does not contain the requisite information on which the substantial correctness of the return may be judged. Mosher v. Internal Revenue Service, 775 F.2d 1292, 1294 (5th Cir. 1985), cert. denied 475 U.S. 1123 (1986). In addition, changes to portions of a jurat invalidate an otherwise accurate return. Hettig v. United States, 845 F.2d 794, 795 (8th Cir. 1988). Additions to a jurat also invalidate the Form 1040 as a return. See Sloan v. Commissioner, 102 T.C. 137, 144 (1994), aff'd. 53 F.3d 799 (7th Cir. 1995), cert. denied 516 U.S. 897 (1995). Any change to the jurat on the return results in a questioning of the correctness of the return information, and impedes the administration of the federal income tax laws. Id.; see also Williams v. Commissioner, 114 T.C. 8, 14 (2000). Therefore, an amendment to, and/or an addition to, the jurat on a claim for refund may invalidate the claim for refund.

Any change to the jurat necessitates that the return be removed from normal processing channels, and as such, it impedes the process of verifying the return. See Beard, 82 T.C. at 776-777; and Sloan 102 T.C. at 146. As such, the Service

should be entitled to construe alterations to the jurat against the taxpayer, at least when there is any doubt as to its meaning. See Sloan v. Commissioner, 53 F.3d 799 (7th Cir. 1995), cert. denied, 516 U.S. 897 (1995). Therefore, when the jurat on a claim for refund is amended, the claim for refund is invalid, and the Service may assess the section 6702 frivolous return penalty at any time.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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