OFFICE OF
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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SALT LAKE CITY
SMALL BUSINESS /SELF EMPLOYED CC:SB:5:SLC

FROM: ASSISTANT CHIEF COUNSEL
(ADMINISTRATIVE PROVISIONS AND JUDICIAL PRACTICE)

SUBJECT: Proper Application of I.R.C. §§ 6701 and 6702

This responds to your request for Significant Service Center Advice dated April 20, 2001, in connection with a question posed by the Ogden Customer Service Center. In accordance with I.R.C. § 6110(k)(3), this document should not be cited as precedent.

ISSUE

Can the Service assess a frivolous income tax return penalty under I.R.C. § 6702 against a tax return preparer when the purported return was signed by both the taxpayer and the return preparer?

CONCLUSION

Under the facts presented, the section 6702 penalty should be assessed against the taxpayer, not the return preparer.

FACTS

The Ogden Customer Service Center has the responsibility for determining the applicability of various civil penalties including the aiding and abetting penalty under section 6701 and the frivolous income tax return penalty under section 6702. In a prior request for Significant Service Center Advice, you asked us to consider the application of section 6701 and section 6702 penalties against a tax return preparer who prepared, executed, and filed documents purporting to be returns with the Service. The documents in question were not signed by the taxpayer on whose behalf they were allegedly filed. We concluded that when a tax return preparer completes and files with the Service a document that purports to be a return, but which is frivolous in nature, the Service may assess both the section 6701 and section 6702 penalties against that return preparer. Because in that scenario the taxpayer did not execute the documents in question, the frivolous return penalty set forth in section 6702 could not be asserted

against the taxpayer. See SCA 200102047 (Nov. 27, 2000).

In the present request, you ask us whether the section 6702 frivolous return penalty may be asserted against the tax return preparer if the document filed with the Service is signed by both the return preparer and the taxpayer. For the reasons set forth below, we believe the section 6702 penalty should not be assessed against the return preparer under these circumstances.

DISCUSSION

Although your question concerns the application of section 6702, we would like to reiterate our discussion of section 6701. In relevant part, section 6701 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).

The statute 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 of section 6701, 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. See, e.g., Nielsen v. United States, 976 F.2d 951 (5th Cir. 1992); Mitchell v. United States, 977 F.2d 1318 (9th Cir. 1992); Bailey Vaught Robertson & Co. v. United States, 828 F. Supp. 442 (N.D. Tex. 1993).

Before the Service can assess the section 6701 penalty for aiding and abetting, however, the Service must be able to establish that the person against whom the penalty is proposed meets all three criteria set forth in section 6701(a). I.R.C. § 6703(a); Mitchell, supra. This determination is largely a question of fact and must be made on a case by case basis. The Service, however, need not show that the taxpayer whose tax was understated either had knowledge or authorized the actions which result in the understatement. I.R.C. § 6701(d). Likewise, it is not necessary that the documents filed with the Service be actually used by the Service in computing the taxpayer's liability. Bailey, supra. We suggest that the Service Center employees follow IRM 120.1.6.6, *Penalties for Aiding and Abetting*, when developing a case and asserting the section 6701 penalty.

Application of Section 6702

As noted in our previous advice, section 6702 was enacted 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 section 6651(a), or the section 6653(b) fraud penalty. Nonetheless, the draftsmen concluded 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) (emphasis added).

The provision is intended to apply broadly. The penalty is not based on the tax liability. In fact, no understatement or underpayment of tax is necessary for the penalty to apply. 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 section 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 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).

Whether the section 6702 penalty may be asserted in a particular case most often depends on whether the document in question constitutes "what purports to be a return" within the meaning of section 6702. The legislative history of section 6702 provides that the statute is intended to apply to a variety of documents, including returns, amended returns, and any other documents which purport to be returns, 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. 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.

The question presented here is whether a tax return preparer may be deemed to be the "individual" who files the purported return when the document in question is signed by both the taxpayer and the tax return preparer. We believe that where the taxpayer signs the frivolous return filed with the Service, the taxpayer is the individual filing the return and, thus, the one liable for the penalty under section 6702.

When a taxpayer's name is signed to a return, statement, or other document filed with the Service, the signature constitutes prima facie evidence that the document at issue was actually signed by the taxpayer. I.R.C. § 6064. Thus, under the facts presented involving a purported return signed by both the return preparer and the taxpayer, the

taxpayer's signature is presumed to be genuine. Furthermore, by signing the purported return, the taxpayer attests to its correctness and authorizes its filing with the Service. For these reasons, we conclude that under the fact presented, the taxpayer is the individual filing the return for purposes of section 6702.[1] This conclusion is applicable regardless of which party actually mailed or electronically filed the purported return.

In our prior Service Center Advice we concluded that the Service can (and should) assess the section 6702 penalty against the tax return preparer when the frivolous return is not signed by the taxpayer partly because such documents are often filed without the taxpayer's knowledge or authorization. Asserting the frivolous return penalty against the taxpayer under those facts would not only be unfair but also contrary to the intent and purpose of the statute. On the other hand, where the document is signed by the taxpayer, the taxpayer is the "individual" contemplated by section 6702 and it is the taxpayer who should be penalized under section 6702. The return preparer may in appropriate cases be penalized under section 6701.

As always, we hope the advice provided herein is helpful. If you have further questions regarding the above or need additional assistance, please contact Branch 2 of the Office of Assistant Chief Counsel, Administrative Provisions and Judicial Practice, at 202-622-4940.

CURTIS G. WILSON
By: */s/ Michael Gompertz*
Assistant to the Branch Chief,
Branch 2

[1] However, if the return preparer alters the return after it is signed by the taxpayer, thereby converting what had been a proper return into a frivolous return, the tax return preparer rather than the taxpayer is the "individual" contemplated by section 6702.