



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

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE SERVICE CENTER ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SALT LAKE CITY

CC:DB:D:SLC

Attn: Mark H. Howard

CHIEF, EXAMINATION POLICY & PROCEDURE

WAGE & INVESTMENT W:CP:EX:P

Attn: David A. Adams

FROM: Assistant Chief Counsel (Administrative Provisions & Judicial Practice ) CC:PA:APJP

SUBJECT: Frivolous Return Program (RRA 3707 and I.R.C. § 6702)

This Significant Service Center Advice responds to your memorandum dated September 15, 2000. Significant Service Center Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

ISSUE

Whether section 3707 of the Internal Revenue Service Restructuring and Reform Act of 1998 prohibits the maintenance of the Frivolous Return Program database which tracks taxpayers who file returns containing potentially frivolous arguments within the meaning of section 6702.

CONCLUSION

No. Section 3707 of the Internal Revenue Service Restructuring and Reform Act of 1998 does not prohibit the maintenance of the Frivolous Return Program database.

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## FACTS

The Frivolous Return Program in Examination has the specific assignment of processing assessments of frivolous return penalties pursuant to section 6702. The employees of that unit receive documents from throughout the country which IRS employees believe may qualify as frivolous returns under section 6702. The employees review the documents and make a determination of how to proceed.

When the documents come into the Frivolous Return Program, employees enter initial data into a computerized inventory database. IRM 21.8.1.5.5. (05-08-2000). Initial data includes name, social security number, and tax examiner assigned the case. Later, a tax examiner reviews the documents to see if they qualify as frivolous. If the documents meet the frivolous test, the tax examiner does a compliance check to see if the taxpayer is properly filing returns. If the taxpayer is properly filing returns and is not potentially subject to a frivolous return penalty, then the tax examiner deletes the individual from the database. If the tax examiner leaves the individual in the database because of filing obligations or a potential frivolous return penalty, then the tax examiner fills out a worksheet for use in entering further data in the inventory database. The fields for data input into this database include the following:<sup>1</sup>

1. Primary/secondary social security number;
2. Primary/secondary name;
3. IRS received date;
4. Location code indicating state of residence of taxpayer;
5. Zip code;
6. Tax examiner assigned the case;
7. Argument code;
8. Type of document filed;
9. Type of letter sent to the taxpayer;
10. Preparer/promoter name;
11. Preparer/promoter employer identification number;
12. Cross-reference employer identification number of the taxpayer when they have other filings that use an employer identification number;
13. Last action date;
14. Closing date;

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<sup>1</sup> The Frivolous Return Program currently has changes to the database in process and plans to remove categories 8, 9, 13, and 14.

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15. Purge date (The Frivolous Return Program reviews the taxpayer filings two years after receipt of the original document to determine if the taxpayers have continued to file documents that qualify as frivolous returns or have not filed returns they are required to file.);
16. Remarks (includes items such as years filed, type of exam opened or closed).

The Frivolous Return Program employees use this database for inventory control and research. The tax examiners and clerical staff update the database using information provided by the taxpayer. The Frivolous Return Program has a standalone database that does not tie into the IRS individual master file. All employees of the Frivolous Program can access this database from the computers on their desks.

The employees of the Frivolous Return Program obtain the information they enter into the inventory database from the administrative file associated with the Form 1040 for the individual taxpayer for each year. This information could be retrieved by ordering the administrative files, but due to the volume of cases this would be extremely inefficient. In addition, it would be essentially impossible to keep track of the trend in filing frivolous returns over a period of time. Without a system of this sort, the IRS would be hampered in its timely identification of frivolous arguments promoted by a particular individual or group. The database assists the IRS in taking the necessary action to effectively inform taxpayers of the frivolous nature of certain positions before they become too widespread.

### LAW AND ANALYSIS

As part of the Internal Revenue Service Restructuring and Reform Act of 1998, Congress enacted section 3707, an off-Code provision. Section 3707(a)(1) prohibits the IRS from designating taxpayers as illegal tax protesters or any similar designation. Congress enacted section 3707 because of its concern that taxpayers may be stigmatized by a designation as an "illegal tax protester." S. Rep. No. 174, 105<sup>th</sup> Cong., 2d Sess. 105 (1998). Under section 3707(a)(2), the IRS is required to remove illegal tax protester designations from its individual master file and disregard any illegal tax protester designation in a place other than the individual master file in the case of any illegal tax protesters designation made on or before July 22, 1998, the date of the enactment of section 3707. Although section 3707 prohibits the IRS from designating taxpayers as illegal tax protesters, it does provide that the IRS may designate any appropriate taxpayer as a nonfiler. However, the nonfiler designation must be removed once the taxpayer has filed income tax returns for two consecutive years and paid all taxes shown on the returns. Section 3707(b).

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We conclude from the language of section 3707 and its legislative history that Congress was concerned that innocent taxpayers may have been mislabeled as illegal tax protesters. However, Congress did not intend to limit the IRS's ability to maintain records and to make designations, other than the illegal tax protesters designation, where such designations are appropriate. H.R. Conf. Rep. No. 599, 105<sup>th</sup> Cong., 2d Sess. 308 (1998).

Section 6702 imposes an immediately assessable penalty of \$500 on any individual who files any document which purports to be a return of income tax if (1) the document fails to contain information from which the substantial correctness of the amount of tax shown on the return can be judged or contains information that on its face indicates that the amount of tax shown on the return is substantially incorrect, and (2) such conduct arises from a position taken by the taxpayer on the purported return which is frivolous, or from a desire (which appears on the face of the purported return), to delay or impede the administration of the Federal income tax laws.

Prior to the enactment of section 6702, Congress was concerned with the rapid growth in deliberate defiance of the tax laws by tax protesters and that the IRS had 13,600 protester returns under examination as of June 30, 1981. Congress recognized that many of those protesters were induced to file protester returns through the criminal conduct of others. Congress also recognized that these advisors frequently emphasized the lack of any penalty when sufficient tax had been withheld from wages and encouraged others to play the "audit lottery." Section 6702 was enacted because Congress believed that an immediately assessable penalty on the filing of protester returns would help deter the filing of such returns, and would demonstrate its determination to maintain the integrity of the income tax system. S. Rep. No. 494, 97<sup>th</sup> Cong., 2d Sess. 277 (1982).

As a result of the enactment of sections 3707 and 6702, the IRS has the tasks of balancing the objectives of section 3707, which prohibits the IRS from designating taxpayers as illegal tax protesters or any similar designation, and section 6702, which assesses a penalty on tax protesters or taxpayers who file frivolous returns. The service center has tried to balance these competing obligations by focusing on the conduct of the taxpayers and specifically identifying those frivolous arguments asserted rather than applying a general label of tax protester. In enacting section 3707, Congress did not indicate that section 6702 should not continue to be enforced or that it was no longer concerned with the effect of the filing of frivolous returns on the integrity of the income tax system. Thus, the IRS still has the obligation of identifying and sanctioning those who file frivolous returns. We do not

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believe that using an inventory database to meet this obligation violates section 3707 where the IRS maintains this inventory database on an independent computer that does not communicate with or put the illegal tax protester or any similar designation in the IRS computer master file.<sup>2</sup>

Please contact Willie E. Armstrong, Jr. at (202) 622-7920 if you have any further questions.

CURTIS G. WILSON

By: \_\_\_\_\_  
Judith M. Wall  
Chief, Branch 2

cc: Compliance Director,  
Wage & Investment W:CP  
Attn: Jane Warriner

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<sup>2</sup> In addition to enforcing section 6702, information in the database assists the IRS in enforcing sections 6700 and 6701.