



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

OFFICE OF  
CHIEF COUNSEL

December 10, 2001

Number: **200203003**  
Release Date: 1/18/2002  
CC:PA:APJP:01  
TL-N-583-01  
UIL: 6011.06-00; 6611.09-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL  
AREA 5, SALT LAKE CITY

FROM: Pamela W. Fuller  
Senior Technician Reviewer  
Administrative Provisions & Judicial Practice CC:PA:APJP:01

SUBJECT: OGD-Section 861 Frivolous Returns

This Significant Service Center Advice responds to your memorandum dated September 4, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

**ISSUES**

1. Whether Forms 940 and 941c, filed together, constitute a valid return wherein employers frivolously claim exemption from Federal taxes pursuant to I.R.C. § 861.
2. Whether Forms 940 and 941c, filed together, constitute a processible return wherein employers frivolously claim exemption from Federal taxes pursuant to I.R.C. § 861.

**CONCLUSIONS**

1. When an employer claims exemption from Federal taxes under I.R.C. § 861, Form 941 filed with Form 941c attached is a valid return if the forms satisfy the substantial compliance standard. The IRS should consider the returns on a case-by-case basis to determine whether the documents purport to be returns, contain sufficient information to calculate tax liability and have been executed under penalties of perjury. In addition, the forms must manifest an honest and reasonable attempt to satisfy the requirements of the tax law. Thus, a return that includes numerous frivolous arguments may not meet this standard and should be treated as a nullity.
2. When an employer claims exemption from Federal taxes under I.R.C. § 861, Forms 941 and 941c filed together constitute a processible return provided that all required taxpayer information is included and all required forms are submitted. Thus, where the exemption is claimed, neither Form 941 nor Form 941c alone meets this standard. In addition, the return must contain sufficient required

information to permit mathematical verification of the tax liability as shown. Neither form filed separately may contain sufficient required information to allow for processing. Therefore, the forms should be filed together and should be reviewed on a case-by-case basis to determine if the return is processible.

### **FACTS**

The IRS has received a substantial number of returns from employers claiming exemption from Federal taxes based on an erroneous interpretation of I.R.C. § 861. Employers claiming the exemption have filed Forms 941 and 941c together, and Form 941c separately, for processing by the IRS. The Frivolous Return Program has treated these returns as frivolous, invalid returns which should not be processed. Recently, however, the Frivolous Return Program has begun to send these documents to field revenue officers for investigation. After reviewing the returns, some investigating field revenue officers have come to the conclusion that some of the returns are valid, processible returns that should be accepted and processed by the IRS.

You note that some employers have filed duplicate copies of these returns and may have been issued erroneous refunds as a result. Further, you note that processing the original returns with appropriate freeze codes could prevent the issuance of erroneous refunds on any subsequent duplicate returns. You request advice on whether the returns at issue are valid and processible even though they contain frivolous claims for exemption.

### **LAW & ANALYSIS**

#### **ISSUE 1**

##### **Valid Returns: In General**

Section 6011 of the Internal Revenue Code ("Code") provides that when required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and the regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms and regulations.

Section 1.6011-1(b) of the Income Tax Regulations provides, in part:

(b) *Use of prescribed forms.* Copies of the prescribed return forms will so far as possible be furnished taxpayers by district directors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the district director in ample time to have their returns prepared, verified, and filed on or before the due date with the internal revenue office where such returns are required to be filed. . . .

the absence of a prescribed form, a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and, if filed within the prescribed time, the statement so made will relieve the taxpayer from liability for the addition to tax imposed for the delinquent filing of the return, provided that without unnecessary delay such a tentative return is supplemented by a return made on the proper form.

The Service's broad authority to prescribe the manner of filing has been recognized by the Supreme Court. In Commissioner v. Lane-Wells Co., 321 U.S. 219, 223 (1944), the Court indicated:

Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished.

The Court of Appeals for the Eighth Circuit has noted:

Taxpayers are required to file timely returns on forms established by the Commissioner. . . . The Commissioner is certainly not required to accept any facsimile the taxpayer sees fit to submit. If the Commissioner were obligated to do so, the business of tax collecting would result in insurmountable confusion.

Parker v. Commissioner, 365 F.2d 792 (8<sup>th</sup> Cir. 1966).

Despite the Service's broad authority to prescribe the manner of filing, the issue of what constitutes a valid return is frequently litigated. In an early case addressing the issue, the Supreme Court indicated that a "defective" or "incomplete" return may be sufficient to start the running of the period of limitation if it is a specific statement of the items of income, deductions, and credits in compliance with the statutory duty to report information. However, to have such effect, the return must honestly and reasonably be intended as such. Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930).

Subsequently, the Court summarized the criteria as: "[p]erfect accuracy or completeness is not necessary to rescue a return from nullity, if it purports to be a return, is sworn to as such, and evinces an honest and genuine endeavor to satisfy the law." Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 180 (1934).

The most recent Supreme Court reaffirmation of the test articulated in Florsheim and Zellerbach is found in Badaracco v. Commissioner, 464 U.S. 386 (1984). There, the taxpayer filed a fraudulent original income tax return and followed it with a nonfraudulent amended return. The taxpayer argued that the original return, to the

extent it was fraudulent, was a nullity for purposes of the statute of limitations. The Court disagreed, noting that the fraudulent original returns “purported to be returns, were sworn to as such, and appeared on their faces to constitute endeavors to satisfy the law.”

The lower courts have subsequently synthesized the criteria enunciated by the Supreme Court into the following four-part test for determining whether a defective or incomplete document is a valid return: "First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury." Beard v. Commissioner, 82 T.C. 766, 777 (1984), aff'd per curiam, 793 F.2d 139 (6th Cir. 1986).

This generally accepted formulation of the criteria for determining a valid return is known as the "substantial compliance" standard. If a defective or incomplete document meets the substantial compliance standard, the document is a valid return for purposes of the statute of limitations on assessment and for purposes of determining the failure to file penalty of section 6651(a) of the Code. A document that does not meet the substantial compliance standard is a nullity for purposes of the Code.

### **Forms 941 and 941c as Valid Returns**

Although the cases cited above do not specifically address employment tax returns, nothing in these cases suggests that the rationale was limited to income tax returns. The substantial compliance standard applies to defective or incomplete documents submitted by a taxpayer that purport to be returns, and may be applied to the returns at issue.

Accordingly, a Form 941 return in which an employer erroneously claims exemption from Federal taxes under I.R.C. § 861 and attaches Form 941c should be treated as a valid return where there is sufficient information to calculate tax liability, the form purports to be a return and has been executed under penalties of perjury, and exhibits an honest and reasonable attempt to comply with tax laws. Likewise, Form 941c should be considered under the same standard when filed alone without an accompanying Form 941. Where the return fails to meet the substantial compliance standard, it should be treated as a nullity. Although the returns at issue include frivolous claims for exemption, they may be treated as defective documents that qualify as valid returns so long as the substantial compliance standard is satisfied. Specifically, each return should be reviewed to determine if, despite the frivolous claim, the employer made a reasonable, good faith attempt to file an accurate return. If, however, a return contains numerous frivolous arguments, the IRS may treat it as an unreasonable attempt to satisfy the requirements of the tax law, thereby making the return invalid. The IRS should determine the validity of these returns on a case-by-case basis after considering all of the information included in the Form 941 and/or Form 941c and any documents attached thereto.

## **ISSUE 2**

### **Processible Returns: In General**

Section 6611(a) of the Code provides that interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621.

Section 6611(b)(3) provides that in the case of a return filed after the last date prescribed for filing the return (determined with regard to extensions), no interest shall be allowed or paid for any day before the date on which the return is filed.

Section 6611(e)(1) provides that if any overpayment of tax is refunded within 45 days after the last day prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or, in the case of a return filed after such last date, is refunded within 45 days after the date the return is filed, no interest shall be allowed under section 6611(a) on such overpayment.

Section 6611(g) of the Code provides that for purposes of sections 6611(b)(3) and 6611(e), a return shall not be treated as filed until it is filed in processible form. Under the statute, a return is in processible form if: (1) it is filed on a permitted form; and (2) it contains the taxpayer's name, address, identifying number, the required signature, and sufficient required information (whether on the return or on required attachments) to permit the mathematical verification of tax liability shown on the return.

The Court of Appeals for the Federal Circuit has described the mathematical verification test as follows:

Mathematical verifiability requires sufficient information to permit IRS to recalculate and corroborate the mathematics and data reported by the taxpayer. Thus, under section 6611, a taxpayer must submit, in good faith, all the required forms with the required signatures and enough underlying data for IRS to verify the tax liability shown on the return. The information must be sufficient to enable IRS to calculate the tax liability without undue burden.

The Columbia Gas System, Inc. v. United States, 70 F. 3d 1244, 1246 (Fed. Cir. 1995).

### **Forms 941 and 941c as Processible Returns**

The standard for determining processible returns is a strict one. While Forms 941 and 941c may qualify as valid returns, more is required for these documents to be processible when filed by an employer claiming a section 861 exemption. As stated above, a processible return must include all required forms. Thus, an employer who claims the exemption and files Form 941 without an attachment has failed to file all required forms since a supporting attachment is required. Likewise, if Form 941c is filed separately from the return on which an adjustment is claimed, the document is not processible. The form instructs the taxpayer to file it with another return as it should be

used to provide background information to support the adjustments. Therefore, neither form filed alone is a processible return.

In addition, a processible return must include sufficient required information to allow for mathematical verification of the tax liability as shown on the return. If an employer claims the section 861 exemption, there must be sufficient information supporting that claim so that the reported tax liability may be verified. Unless it is attached to Form 941, Form 941c may not provide the requisite information. Form 941c is designed to supplement various tax documents, including Form 941, and may not contain enough information to verify the tax liability if filed alone. However, when filed together, the forms are likely to provide the requisite information and should be reviewed on a case-by-case basis to ensure that all processible returns are accepted and processed accordingly.

### **DISCLOSURE STATEMENT**

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please contact (202) 622-4910.