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#8Frivolous Issues Penalty Under IRC § 6673 and Related  
Appellate-Level Sanctions

## SUMMARY

From June 1, 2012, through May 31, 2013, the federal courts issued decisions in at least 34 cases involving the Internal Revenue Code (IRC) § 6673 “frivolous issues” penalty and at least four cases involving an analogous penalty at the appellate level.<sup>1</sup> These penalties may be imposed when a taxpayer maintains a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.<sup>2</sup> In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future.<sup>3</sup> Nonetheless, we include these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

## PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.<sup>4</sup> The maximum penalty is \$25,000.<sup>5</sup> In some cases, the IRS requests that the Tax Court impose the penalty;<sup>6</sup> in other cases, the Tax Court exercises its discretion, *sua sponte*,<sup>7</sup> to do so.

Taxpayers who institute actions under IRC § 7433<sup>8</sup> for certain unauthorized collection actions can be subject to a maximum penalty of \$10,000 if the court determines the taxpayer’s position in the proceeding is frivolous or groundless.<sup>9</sup> In addition, IRC § 7482(c)(4),<sup>10</sup> §§ 1912 and 1927 of title 28 of the U.S.

- 1 Two of the four appellate cases involved taxpayers appealing the Tax Court’s decision regarding the IRC § 6673 penalty, but also involved an analogous appellate level penalty. Thus, we reviewed a total of 36 cases this year.
- 2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts impose the penalty under IRC § 6673(b). The United States Courts of Appeals generally impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.
- 3 See, e.g., *Good v. Comm’r*, T.C. Memo. 2012-323; *Flint v. Comm’r*, T.C. Memo. 2012-287.
- 4 IRC § 6673(a)(1)(A), (B), and (C).
- 5 IRC § 6673(a)(1).
- 6 The standards for the IRS’s decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual (CCDM). See CCDM 35.10.2, *Special Procedures When Attorneys’ Fees and Sanctions Are Sought, Penalties and Sanctions* (Aug. 11, 2004). For sanctions under IRC § 6673(a)(2) of attorneys or other persons admitted to practice before the Tax Court, all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. See CCDM 35.10.2.2.3, *Sanctions Requiring National Office Review* (Aug. 11, 2004).
- 7 “*Sua sponte*” means without prompting or suggesting; on its own motion. *Black’s Law Dictionary* (9th ed. 2009). In other words, if the Tax Court finds conduct particularly offensive, it can impose a § 6673 penalty even if the IRS has not requested such penalty. See, e.g., *Burt v. Comm’r*, T.C. Memo. 2013-58, *appeal filed* (6th Cir. July 5, 2013).
- 8 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer’s federal tax.
- 9 IRC § 6673(b)(1).
- 10 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court’s decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer’s position in the appeal was frivolous or groundless.

Code,<sup>11</sup> and Rule 38<sup>12</sup> of the Federal Rules of Appellate Procedure authorize federal courts to impose penalties against a taxpayer for raising frivolous arguments or litigating cases primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in nontax cases, the report focuses primarily on the IRC § 6673 penalty.

## ANALYSIS OF LITIGATED CASES

We analyzed 34 opinions issued between June 1, 2012, and May 31, 2013, that addressed the IRC § 6673 penalty. Thirty of these opinions were issued by the U.S. Tax Court and four were issued by U.S. Courts of Appeals in cases brought by taxpayers who sought review of the Tax Court's imposition of the penalty. The Courts of Appeals sustained the Tax Court's position in all four cases.<sup>13</sup>

In ten cases, the Tax Court imposed penalties under IRC § 6673, ranging from \$2,000 to the maximum of \$25,000. In 11 cases, taxpayers prevailed when the IRS asked the court to impose a penalty, but in each case the court warned that they would be issued a penalty if they brought the same arguments in a subsequent proceeding.<sup>14</sup> One taxpayer went to court with representation; all 33 others appeared *pro se* (represented themselves). The taxpayers in these cases presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner*:

We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.<sup>15</sup>

In the cases we reviewed, taxpayers raised the following issues that the court deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1) (or in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same position in a subsequent case):

- **Taxpayers who claim that broadly applicable Internal Revenue Code terms do not apply to their circumstances:** Taxpayers in at least ten cases argued that, in some way or another, they fell

11 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys' fees reasonably incurred because of his or her conduct.

12 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.

13 In every appellate case we have reviewed since June 1, 2005, the Courts of Appeals have not reversed the imposition of the Tax Court's IRC § 6673 penalty in any case brought before them. See National Taxpayer Advocate 2012 Annual Report to Congress 640-642; National Taxpayer Advocate 2011 Annual Report to Congress 666-669; National Taxpayer Advocate 2010 Annual Report to Congress 479-482; National Taxpayer Advocate 2009 Annual Report to Congress 461-464; National Taxpayer Advocate 2008 Annual Report to Congress 533-536; National Taxpayer Advocate 2007 Annual Report to Congress 599-603; National Taxpayer Advocate 2006 Annual Report to Congress 2006 602-606.

14 See, e.g., *Weatherly v. Comm'r*, T.C. Memo. 2012-320; *Trescott v. Comm'r*, T.C. Memo. 2012-321.

15 737 F.2d 1417, 1417-18 (5th Cir. 1984).

outside the parameters of the IRC and, therefore, were not obligated to pay federal income taxes.<sup>16</sup> Five of those taxpayers argued they did not earn “wages” as defined in the IRC.<sup>17</sup> One taxpayer argued he was not a “person” as defined in the IRC.<sup>18</sup> Most of these taxpayers avoided penalties, but the court warned them that further similar conduct could lead to a penalty.

- **Taxpayers who claim the IRS lacked authority to issue a notice of deficiency:** In at least five cases, taxpayers argued the IRS did not have authority to determine deficiencies or assess tax against them.<sup>19</sup> In three out of five cases, the court imposed the § 6673 sanction on the taxpayer.<sup>20</sup> In one case, the taxpayer argued that both the person certifying his substitutes for returns and the person issuing the notices of deficiency lacked authority to do so.<sup>21</sup>
- **Taxpayers who object to the admission of their IRS form W-2 as hearsay:** Taxpayers (husband and wife) in at least one case<sup>22</sup> argued the information returns filed by their employers were hearsay under Federal Rule of Evidence 802, and therefore, not admissible to show they received unreported income. The court declined to impose the § 6673 penalty but warned the taxpayers that continuing to advance frivolous or groundless arguments could result in a penalty in the future.

## CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year.<sup>23</sup> When the taxpayer is asserting a frivolous argument for the first time or, in raising the frivolous argument, has at least one other valid claim, then the court appears reluctant to impose a penalty on the taxpayer.<sup>24</sup> However, when the taxpayer is only asserting frivolous and groundless claims and has previously been warned about bringing such claims, the court will almost invariably impose a penalty.<sup>25</sup> If the court has already imposed a penalty in an earlier case against the taxpayer (or has admonished the taxpayer about his or her behavior in an earlier proceeding), the court is more likely to impose the maximum (or close to the maximum) penalty.<sup>26</sup> Where the IRS has not requested a penalty, the court may nonetheless raise the issue *sua sponte*, and in many cases imposes the penalty or at least cautions the taxpayer that

16 See, e.g., *Snow v. Comm’r*, T.C. Memo. 2013-114 (taxpayer argued his activities were not taxable because his employers were not “Subtitle C statutory employers”); *Flint v. Comm’r*, T.C. Memo. 2012-287 (taxpayer argued he did not have income as he was not a federal employee or corporate officer).

17 See, e.g., *Grandy v. Comm’r*, T.C. Memo. 2012-196; *Nix v. Comm’r*, T.C. Memo. 2012-304, *appeal filed* (11th Cir. May 20, 2013).

18 *Crites v. Comm’r*, T.C. Memo. 2012-267.

19 See, e.g., *Rice v. Comm’r*, T.C. Memo. 2012-301 (taxpayer argued that the IRS was merely a debt collector and therefore not a part of the U.S. government); *Roye v. Comm’r*, T.C. Memo. 2012-246 (taxpayer argued that the IRS lacked the authority under section 6020(b) to prepare substitutes for returns).

20 The court imposed the penalty in *Roye v. Comm’r*, T.C. Memo. 2012-246 and *Winslow v. Comm’r*, 139 T.C. 270 (2012), but declined to impose the penalty in *Leyshon v. Comm’r*, T.C. Memo. 2012-248, and *Rice v. Comm’r*, T.C. Memo. 2012-301 and instead strongly warned the taxpayers that future similar conduct in court would result in the imposition of the penalty. In *Palmer v. Comm’r*, 503 F. App’x 596 (10th Cir. 2012), *aff’g* T.C. Docket No. 1398-10 (Feb. 6, 2012), the Court of Appeals affirmed the Tax Court’s imposition of the penalty.

21 *Winslow v. Comm’r*, 139 T.C. 270.

22 *Davenport v. Comm’r*, T.C. Memo. 2013-41.

23 See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 640-642.

24 See, e.g., *Crites v. Comm’r*, T.C. Memo. 2012-267.

25 See, e.g., *Roye v. Comm’r*, T.C. Memo. 2012-246.

26 See, e.g., *Curtis v. Comm’r*, T.C. Memo. 2013-12 (\$25,000 penalty when the court had imposed \$15,000 in an earlier case); *Burt v. Comm’r*, T.C. Memo. 2013-58, *appeal filed* (6th Cir. July 5, 2013) (\$20,000 penalty when the court had admonished the taxpayer in an order in an earlier case that the court would impose the penalty if the taxpayer continued to advance frivolous arguments).

similar future behavior will result in a penalty.<sup>27</sup> Finally, the U.S. Courts of Appeals have shown their willingness to uphold the penalties imposed by the Tax Court without fail in the cases analyzed since June 1, 2005.

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<sup>27</sup> See, e.g., *Davenport v. Comm’r*, T.C. Memo. 2013-41 (court raised the penalty *sua sponte* and imposed sanctions of \$4,000).