tax notes

Volume 151, Number 9 ■ May 30, 2016



# Large IRS Refunds Via Joint Committee on Taxation

*By Robert W. Wood and Milan N. Ball*

Reprinted from *Tax Notes*, May 30, 2016, p. 1271

taxanalysts®

# Large IRS Refunds Via Joint Committee on Taxation

**By Robert W. Wood and Milan N. Ball**

Robert W. Wood

Milan N. Ball

Robert W. Wood practices law with Wood LLP (http://www.WoodLLP.com) and is the author of *Taxation of Damage Awards and Settlement Payments*, *Qualified Settlement Funds and Section 468B*, and *Legal Guide to Independent Contractor Status*, all available at http://www.TaxInstitute.com. Milan N. Ball is an associate with Wood LLP in San Francisco. This discussion is not intended as legal advice.

Tax refunds exceeding $2 million (or $5 million for C corporations) need approval from the Joint Committee on Taxation. Wood and Ball address what a refund is for this purpose, details of the process, and what to expect.



The IRS must submit all refunds or credits more than $2 million to the Joint Committee on Taxation for review before payment. The threshold is $5 million for C corporations. An individual taxpayer is likely to be anxious about any large tax refund. And although what is large to one taxpayer may not be to another, a refund of $2 million or more is likely to be of interest to *any* taxpayer.

The $5 million threshold for C corporations may be of interest as well. Even a *Fortune* 500 company likes getting a big check back from the government. Accordingly, many taxpayers may have an interest in knowing about how this process unfolds and whether special handling is necessary.

Knowing that the proverbial check is in the mail is a little different from knowing that a refund is still subject to some kind of review. Regardless of statistics, there is always that nagging fear that something will go wrong. Beyond that, there is simply the worrisome delay.

Historically, the entire process has been known to take up to half a year. For any taxpayer that must run this gauntlet, the timing of a refund depends on several variables. How quickly will the IRS examiners submit a case to an IRS Joint Committee specialist? Thereafter, how long will it take the specialist to submit his report to the JCT?

Once both events occur, absent an unfavorable review, the JCT may complete its refund review process in as little as 10 business days. The taxpayer is notified once when the Joint Committee specialist sends a report to the JCT. The taxpayer is notified again after the committee approves the refund or credit.

### What Is a Refund?

You might assume that it would be obvious whether you are asking for a refund, particularly a large one. Perhaps you filed a return, paid $2 million, and then filed an amended tax return asking for a $2 million refund. Clearly, that big refund request must go to the JCT, if you even get that far!

But is *every* request for money a refund for this purpose? For example, suppose that you receive large payments during the year on which the payer withholds taxes under your Social Security number or employer identification number. You then file an initial tax return, asking for most of the withheld money back from the IRS.

Plainly, you are asking for a ''refund'' and refer to it in that way. But is this really a refund for purposes of the JCT? The answer appears to be no, as discussed below. And this is not the only situation worth noting.

Apart from withholding, suppose that you sell many items during the year. There is no withholding, but you make estimated tax deposits during the year, thinking that you sold and received ordinary income. Then, after realizing that each of your sales should have been reported as capital gain, you file your initial tax return and ask for a large amount of money back.

Once again, in common parlance, you ask for a refund. But you were merely making estimated payments, and now you are filing a timely initial return. If you meet the $2 million threshold, is this a ''refund'' subject to JCT review? Again, the answer appears to be no.

The answer lies in reg. section 301.6402-4. It provides that overpayments ''caused by timely payments of tax which exceed the amount of tax shown on a timely return'' are not subject to section 6405's JCT refund review process. Of course, many other kinds of refunds more than the dollar threshold — most in fact — must go to the JCT.

### Statutory Role

Section 6405 states that the IRS cannot make a refund of tax:

> *until after the expiration of 30 days from the date upon which a report* giving the name of the person to whom the refund or credit is to be made, the amount of such refund or credit, and a summary of the facts and the decision of the Secretary, *is submitted* to the Joint Committee on Taxation. [Emphasis added.]

The IRS refers to the 30-day period following the submission of the report to the JCT as the ''report and wait'' period.[1] CC-2003-023 confirms that the report and wait period allows the JCT to consider and comment on the IRS's proposed refund within a limited period.

Section 6405(a) requires the IRS to submit cases involving refunds or credits of tax in excess of $2 million ($5 million in the case of C corporations).[2] The refund review function of the JCT was instituted in part to address lawmakers' concern that large businesses active during World War I were receiving substantial refunds because of favoritism.[3] Under section 8021, the JCT is authorized to obtain and inspect income returns in order to carry out its general oversight responsibilities.[4]

In each section 6405 refund review, the IRS is required to submit a written report to the JCT.[5] CC-2003-023 clarifies that section 6405(a):

> *Does not give the Joint Committee the authority to approve, disapprove, authorize, or, in any way, prohibit the Service from taking whatever action the Service determines is appropriate*. The determination whether to issue or deny a refund or credit rests solely with the Commissioner, regardless of the Joint Committee's favorable or unfavorable views on the Service's proposed action. [Emphasis added.]

CC-2003-023 was published to address inconsistences in the responsibilities of the IRS, the Office of Chief Counsel, and the JCT. There is, after all, a difference between a ''report and wait'' requirement and one suggesting that the IRS must obtain ''approval'' or ''authorization'' from the JCT.[6] The notice states that the guidance would be updated to accurately reflect the JCT's ''precise statutory role'' under section 6405(a).

Nevertheless, the nature of the JCT's responsibilities regarding its refund review function remains largely informal and is not specified by statute or regulation.[7] The IRS is required to report to the JCT under section 6405(a) and in accordance with the Internal Revenue Manual. However, the JCT's ''obligation once a report is received remains indefinite.''[8]

The written report to the JCT contains a brief history of the taxpayer's situation, explains the IRS's reasoning in allowing a refund or credit, states the amount of all adjustments, and explains the reasons for all adjustments for the tax years under review.[9] In general, these submissions are used to determine whether federal tax provisions ''operate as intended or cause unintended administrative, interpretive, or statutory problems.''[10] The JCT's review focuses on the technical aspects of the case and the IRS's resolution of the issues before it.[11]

The reports are used to help the JCT become familiar with issues in individual industries and to identify problems in the administration of the tax law.[12] After the JCT finishes reviewing a report, it may recommend amending the IRC, request that the IRS clarify or reconsider its published position, or request that the IRS publish guidance on an issue.[13] In rare cases, the JCT will also identify issues that were technically handled incorrectly by the IRS.[14]

### Effect of Joint Committee Review

The IRS may withhold final action on a refund for more than 30 days after submitting its report to

[1] CC-2003-023.

[2] *See also* FSA 20133301F (''The only distinction between a section 6405(a) refund and a section 6405(b) refund is that the latter type of refund is paid first and reviewed later, while the former type of refund is submitted to the JC for review prior to issuance.'').

[3] George K. Yin, ''James Couzens, Andrew Mellon, the 'Greatest Tax Suit in the History of the World,' and the Creation of the Joint Committee on Taxation and Its Staff,'' 66 *Tax L. Rev.* 787, 868 (summer 2013); *see also* Eric Kroh, ''JCT Will Review a Refund if It's Big Enough,'' *Tax Notes*, Apr. 14, 2014, p. 160.

[4] *See* Internal Revenue Manual section 35.5.4.9.

[5] JCT, ''About the Joint Committee on Taxation,'' at 12 (Feb. 18, 1970), *available at* https://www.jct.gov/about-us/refund-review.html.

[6] CC-2003-023.

[7] Diana Lisa Erbsen, ''The Joint Tax Committee Refund Review Function: Is 'It Worth a Damn'?'' *Tax Notes*, July 8, 1996, p. 227.

[8] *Id.*

[9] JCT, *supra* note 5; *see* section 6405(a).

[10] JCT, *supra* note 5; *see* sections 8022, 8023.

[11] JCT, *supra* note 5.

[12] *Id.*; *see* section 8022.

[13] JCT, *supra* note 5.

[14] *Id.*

the JCT. Usually, the IRS extends the report and wait period to respond to the JCT's request for additional information and to provide the JCT with additional time for complex cases.[15] Technically, the IRS's position on a refund remains tentative until compliance with section 6405 is complete.[16]

CC-2003-023 suggests that compliance with section 6405 is not complete until "a report, in accordance with section 6405, has been submitted to, *and the timely views of the Joint Committee have been considered*" (emphasis added). Thus, one can assume that the report and wait period is a minimum of 30 days from the submission of the report to the JCT. It can be extended at the IRS's discretion.

When the JCT disagrees with the IRS's position taken in a report, the committee may recommend adjustments to the amount of a taxpayer's refund.[17] This usually occurs: (i) when the "tax effect in the case is significant" or (ii) when "as a result of the correction, loss or credit carryforwards will be reduced significantly even though there is no effect on the proposed refund."[18] The IRS is not required to comply with the JCT's recommendations.[19]

However, the general policy of the IRS is that it will not issue a refund until the JCT has concluded its review of the case and any dispute with the IRS's position taken in a report has been resolved.[20] Notably, when the impact of a case is small, usually no adjustment is recommended.[21] Instead, the JCT gives comments to the IRS to prevent repetition of the error.[22]

**Coordination With IRS**

Once a case has gone through the examination process and is determined to be subject to section 6405, it goes to a Joint Committee specialist. He prepares the report for the committee.[23] The specialist reviews section 6405 cases for "procedural, computational, and technical accuracy."[24]

The specialist submits the report to the Joint Committee Review team of the IRS.[25] The team is a part of the Large Business and International Division[26] and reviews all agreed servicewide examined and surveyed section 6405 cases regardless of operating division.[27]

The reviews are conducted as electronic or physical case reviews.[28] Electronic case reviews are conducted remotely by the team[29] for all LB&I section 6405 cases except for International Individual Compliance Division section 6405 cases.[30] Physical case reviews are conducted by the Joint Committee Review team at the specialist's post-of-duty for all International Individual Compliance, Small-Business/Self-Employed, and Tax-Exempt and Government Entity Division section 6405 cases.[31]

The specialist will submit the report to the JCT within two business days of approval by the review team.[32] The specialist will also mail Letter 1573(P) to the taxpayer and his representative to inform them that the IRS has submitted the report to the JCT.[33] The JCT reviews the IRS's report, which contains an explanation of the IRS's computations and supporting documentation.[34]

The JCT does not receive a taxpayer's entire return unless it is considered critical.[35] Most of the delay in the JCT refund review process comes from the IRS's preparation of the report.[36] Often, when taxpayers are informed that the JCT refund review is holding up their funds, it is because the JCT is still awaiting the report from the IRS.[37]

Again, the report and 30-day waiting period does not commence until the specialist submits the report to the JCT. Generally, the committee does not recommend any changes because, in most cases, the reason for the IRS's position is uncontroversial and straightforward.[38] According to JCT data from 2005

[15]CC-2003-023.
[16]*Id.*
[17]JCT, *supra* note 5.
[18]*Id.*
[19]*Id.*
[20]IRM section 4.36.1.4.
[21]JCT, *supra* note 5.
[22]*Id.*
[23]Kroh, *supra* note 3.
[24]IRM section 4.36.4.1.
[25]*Id.*

[26]*Id.*
[27]*Id.* Similar procedures apply to agreements reached in cases on appeal from the Tax Court, docketed cases, and cases pending in appeals. *See* IRM section 35.5.4; IRM section 8.7.9.
[28]IRM section 4.36.3.3.
[29]The examination team assists the Joint Committee Review team as needed. IRM section 4.36.4.3.
[30]IRM section 4.36.3.3.1.
[31]IRM section 4.36.3.3.2.
[32]IRM section 4.36.4.3. The examination team should answer any questions that the taxpayer may have until Letter 1573(P) is issued. At that time, the review team will answer a taxpayer's questions. IRM section 4.36.3.2.5.
[33]IRM section 4.36.4.6.1.
[34]Kroh, *supra* note 3. The IRS treats documents and information prepared in connection to a JCT inquiry as congressional records, not IRS agency records subject to the Freedom of Information Act, 5 U.S.C. section 552. IRM section 35.5.4.9.
[35]Kroh, *supra* note 3; IRM section 4.36.3.4.4.
[36]*Id.*
[37]*Id.*
[38]*Id.*

to 2010, the JCT refund review office raised concerns in only 5 percent of the reports submitted to it (33 out of 688 cases).[39]

The JCT refund counsel will remain in contact with the IRS agent who prepared the report to go over the report and request information.[40] The counsel acts under the supervision of the JCT's chief of staff.[41] In general, only one counsel is assigned the responsibility of reviewing a report submitted by the IRS.[42] If no problem appears on the face of the report, then the JCT will inform the IRS by standardized form that it has no concerns.[43]

If there is an issue on the face of the report, the JCT refund counsel usually requests additional information by telephone or email.[44] Often, the committee ends its inquiry after receiving additional information from the IRS.[45] If the counsel does not receive sufficient information, he may send a formal memorandum to the IRS and request additional time to review the matter.[46]

The IRM states that the IRS has three days to respond to informal inquiries and 15 days to respond to formal inquiries. If the IRS is unable to respond within 15 days, the agency is required to provide the JCT with a status report. The IRM also requires the IRS to provide status reports every 30 days thereafter.[47]

If the JCT refund counsel needs additional assistance, he will seek assistance from other staff members at the committee or chief counsel.[48] In exceptional cases, the refund counsel will contact the taxpayer to resolve an inquiry.[49] If the counsel finds significant error with the IRS's proposed adjustments, he notifies the agency, which corrects it.[50]

When the IRS and JCT disagree, the JCT may concede the point and close the case.[51] In rare cases when the IRS and JCT disagree, a conference may be held to reconcile any differences, or the refund counsel will compose a memo stating the disagreement for future cases.[52] In cases in which the JCT questions a refund, the JCT and IRS ultimately agree on the issue 90 percent of the time.[53]

Accordingly, 75 percent of reports are processed within 30 days after reaching the JCT refund review office, and 90 percent are processed within 45 days.[54] Indeed, the refund review process may take as little as 10 business days if the JCT has no further inquiries. When the Joint Committee Review team of the IRS receives the clearance letter or staff review memorandum from the JCT, the committee specialist will issue Letter 1574(P) to inform the taxpayer.[55]

Thereafter, the section 6405 case file will be processed and closed in accordance with JCT electronic case review[56] or physical case review.[57] Upon receiving the clearance letter, the examination team will be responsible for executing any closing agreement.[58]

**Practice Tips**

To return to where we started, if it isn't over until the fat lady sings, the refund isn't real until you have it in hand. The tax adviser might tell the client that the JCT review is some kind of formality (a rubber stamp?). Even so, the client may worry.

Some taxpayers will ask about it frequently, calling and writing to push it along. With that inevitability in mind, here are seven tips for practitioners to ease clients' stress and manage their expectations:

1. Contact the IRS examination team to determine where a taxpayer is in the refund review process.

[39]*Id.*

[40]*Id.* The ex parte rules that apply to communications between the IRS Office of Appeals and other IRS employees do not apply to communication with the JCT. Rev. Proc. 2012-18, 2012-10 IRB 455, section 2.08(1).

[41]Erbsen, *supra* note 7.

[42]*Id.*

[43]*Id.*

[44]*Id.*; IRM section 4.36.4.4.1; IRM section 35.5.4.6.

[45]Erbsen, *supra* note 7; IRM section 4.36.4.4.1; IRM section 35.5.4.6.

[46]Erbsen, *supra* note 7.

[47]IRM section 4.36.4.4.2.

[48]Kroh, *supra* note 3.

[49]IRM section 4.36.3.3.4; IRM section 35.5.4.6.

[50]IRM section 4.8.2.8.

[51]Kroh, *supra* note 3.

[52]*Id.*; Erbsen, *supra* note 7; Caroline Rule, ''IRS Procedures: Examinations and Appeals,'' 623 *Tax Mgmt.* (BNA) U.S. Income, at A-120-121 (July 27, 2015).

[53]*Id.*

[54]Kroh, *supra* note 3; *see*, *e.g.*, Brief for the Appellee at 6-7, *BMC Software Inc. v. Commissioner*, 780 F.3d 669 (5th Cir. 2015) (''In February 2007, taxpayer proposed a settlement of this transfer-pricing dispute, under which it agreed to adjustments for 2003 through 2006 and, accordingly, signed a closing agreement (the 'transfer-pricing closing agreement'), pursuant to I.R.C. section 7121, on April 4, 2007. . . . The Commissioner signed the transfer-pricing closing agreement on August 30, 2007, and it was accepted, following review by the Congressional Joint Committee on Taxation (*see* section 6405), on September 25, 2007.'').

[55]IRM section 4.36.4.6.1.

[56]IRM section 4.36.3.8.

[57]IRM section 4.36.3-4.

[58]IRM section 4.36.3.6.2. The failure to make a report to the JCT does not provide the government with a basis for an erroneous refund suit and may not invalidate a closing agreement. CCA 199931007; FSA 20133301F.

2. Contact the JCT refund counsel if more than 30 days have lapsed since receiving a notification that the case report was submitted to the committee.

3. Provide comprehensive and timely responses to any additional inquiries from the IRS or JCT.

4. Submit additional information that may be helpful in preparing or reviewing a report to the IRS and JCT.

5. Advise the client of the steps in the refund review process that may delay the processing of a refund or credit.

6. Remember that if the IRS makes changes to a proposed settlement based on the JCT's comments, taxpayers can disagree with the proposed changes and exercise their appeal rights.

7. Bear in mind that even if a taxpayer is entitled to a refund, the IRS may be obligated to divert some or all of it to pay state income tax liabilities, child support, or liabilities due to other federal agencies.