

# Joint Committee Refund Review: Twelve Questions to Consider

By *Thomas J. Callahan, Gregory J. Gawlik and Jon R. Stefanik II*

Thomas J. Callahan, Gregory J. Gawlik and Jon R. Stefanik II answer 12 questions facing practitioners moving a case through the Joint Committee refund review process.

## Introduction

Certain decisions in life warrant second opinions: Should I have that major surgery? How much will that home renovation project cost? Should I invest in that tax shelter? (Oops! That's definitely the subject of a different article.) Whether or not we follow the advice given in a second opinion, we somehow feel better about the choice that we ultimately make. Congress believed that the sheer size of certain refunds warrants a second opinion. Thus, pursuant to Code Sec. 6405,<sup>1</sup> the IRS must submit certain proposed refunds to the Joint Committee on Taxation ("Joint Committee") for review.

The concept of Joint Committee refund review is itself simple, but the process by which the review occurs is not. Complex issues can arise regarding the calculation of refund amounts, the timing of Joint Committee review relative to ongoing examinations or appeals cases, and the scope and impact of Joint Committee authority. The INTERNAL REVENUE MANUAL is the primary source on the subject, and it is not always clear. With limited guidance and limited experience on many of these issues, practitioners, revenue agents and appeals officers sometimes must learn as they go. While we do not have all the answers, our experience allows us to share with you 12 questions to consider concerning Joint Committee refund review.

**Thomas J. Callahan** is a Partner and Chair of the Tax Practice Group at Thompson Hine LLP in Cleveland, Ohio.

**Gregory J. Gawlik** and **Jon R. Stefanik II** are Associates in the Tax Practice Group at Thompson Hine LLP in Cleveland, Ohio.

## 1. When Will a Refund Be Referred to Joint Committee for Review?

The Joint Committee has jurisdiction over two types of refunds: (1) Code Sec. 6405(a) refunds or credits of any income, war profits, excess profits, estate or gift taxes (and some others not mentioned here) that exceed \$2 million ("Overpayment Refunds"); and (2) Code Sec. 6405(b) refunds, resulting from tentative carryback adjustments, under Code Sec. 6411, that exceed \$2 million ("Tentative Adjustments").<sup>2</sup> The \$2 million jurisdictional threshold is determined *separately* for Overpayment Refunds and Tentative Adjustments.<sup>3</sup> In other words, refund amounts for the different types of refunds should *not* be aggregated for purposes of determining Joint Committee jurisdiction. Thus, if neither the Overpayment Refunds nor the Tentative Adjustments separately exceed \$2 million, then neither group is subject to review. Similarly, if the total of all Overpayment Refunds does not exceed \$2 million, they will not be subject to Joint Committee review even if Tentative Adjustments exceed the \$2 million threshold.<sup>4</sup>

## 2. Are Interest and Penalties Included in the \$2 Million Jurisdictional Amount?

Yes. Overpayments of previously assessed interest and penalties are included in the calculation to determine whether a refund exceeds the \$2 million jurisdictional threshold.<sup>5</sup> Also, refunds consisting solely of previously assessed interest exceeding \$2 million (where there

was no corresponding reduction in the tax assessed) must be reported to the Joint Committee.<sup>6</sup> However, to be included in the jurisdictional amount, the interest must be the same interest that was previously assessed and paid.<sup>7</sup> Thus, if a tax reduction is caused by a tentative carryback, any refunded or credited interest would not be included in calculating the jurisdictional amount (because any such interest would not have been “previously assessed and paid”).<sup>8</sup>

### 3. Can Deficiencies from the Same Year or Other Years Be Used to Offset the Potential Refund Amount for Purposes of Determining Joint Committee Jurisdiction?

Yes. Deficiencies in the same year and with respect to the same type of tax as potential refunds are applied as reductions to the potential refund amount. For example, it is possible that after reducing a potential Tentative Adjustment with the amount of a determined deficiency for the same year, the remaining Tentative Adjustment will be less than the \$2 million threshold and will not get reported to Joint Committee.<sup>9</sup> In any event, only the net Tentative Adjustment in excess of \$2 million will get reported.<sup>10</sup>

Additionally, in situations in which multiple years are under the jurisdiction of an IRS examination team (sometimes referred to herein as “Exam”) or before the IRS Appeals Division (“Appeals”), deficiencies from one year are used to offset potential refunds in another year. With respect to Exam’s responsibilities, the INTERNAL REVENUE MANUAL provides, “All open source years, whether previously examined or surveyed, need to be considered in determining the jurisdictional amount.”<sup>11</sup> Furthermore, “[a] deficiency in one taxable year is offset against an overpayment for another taxable year for the same type of tax ... where it involves the same taxpayer and the same examination.”<sup>12</sup> Appeals is directed that:

In determining jurisdiction under both IRC 6405(a) and IRC 6405(b), all open years under Appeals jurisdiction for the same taxpayer and closing at the same time should be considered one case / work product for the purpose of determining JC jurisdiction, regardless of the way in which Appeals work units are structured.<sup>13</sup>

Moreover, “In determining jurisdiction under Code Sec. 6405, Appeals may offset a taxpayer’s agreed

deficiency for one year against an overpayment for another year open in Appeals. ...”<sup>14</sup>

Regardless of the fact that multiple years may be involved in determining Joint Committee jurisdiction, Overpayment Refunds and Tentative Adjustments still are determined *separately*.<sup>15</sup> The procedures for determining the jurisdictional amount in a multiple-year case consist of a series of complex steps that are described in the INTERNAL REVENUE MANUAL as follows:

- Offset deficiency for a given year against refunds for that year.
- Determine the aggregate net deficiency for all net deficiency years.
- Determine the aggregate net overpayment by refund type for all net refund years.
- Apply the aggregate net deficiency against the smallest of the aggregate Code Sec. 6405 refund types (even if the smallest aggregate amount is below Joint Committee review threshold). If the balance of that refund type after the application of the deficiencies is not in excess of \$2 million, then that refund type is not reportable.
- If there is an aggregate overpayment in excess of \$2 million for any of the refund types, only those aggregate refund years within the refund type, in addition to any applicable source years, must be reported.<sup>16</sup>

As stated previously, the mechanics of the steps outlined above are quite complex and further explanation of them is beyond the purpose of this article. The important point is that practitioners should be aware that this procedure exists and can study it at the appropriate time based on the specific facts and circumstances of the case. (The INTERNAL REVENUE MANUAL attempts to provide useful examples of how multiple-year jurisdiction is determined.) In multiple-year cases where there is a net deficiency, no report to the Joint Committee is required.<sup>17</sup>

### 4. What Is the Effect of a Previously Reported Refund?

In general, if a refund or credit has previously been reported to the Joint Committee, and a further overpayment in the same tax year is subsequently determined, the later refund is not reportable unless it independently exceeds the \$2 million jurisdictional threshold.<sup>18</sup> Even if the previously allowed refund was not reportable to Joint Committee because it did not exceed the \$2 million threshold, it will not be combined with the subsequent refund amount for purposes of determining jurisdiction.<sup>19</sup>

Be aware, however, that if refunds are subsequently determined in a multiple-year case involving “open” years under Appeals or Exam jurisdiction, these amounts might have to be aggregated for purposes of determining whether they must be reported to Joint Committee.<sup>20</sup>

### 5. Are Litigation Settlements Subject to Joint Committee Review?

Yes. If a settlement results in a refund or credit in excess of \$2 million the settlement must be reported to the Joint Committee.<sup>21</sup>

However, if a refund in excess of \$2 million results from a court judgment, rather than a settlement or concession, the refund does not have to be referred to the Joint Committee.<sup>22</sup>

The concept of Joint Committee refund review is itself simple, but the process by which the review occurs is not.

### 6. Will the Issuance of a Tentative Adjustment Be Delayed by Joint Committee Review?

No. A Tentative Adjustment can be made prior to Joint Committee review.<sup>23</sup> Thus, if a taxpayer files an application for a tentative carryback adjustment (Form 1139 for corporations; Form 1045 for noncorporate taxpayers) resulting from an NOL carryback, the taxpayer is eligible to receive the refund prior to its being reported to Joint Committee. In contrast, an Overpayment Refund may not be issued until after it is reported to Joint Committee for review.<sup>24</sup>

### 7. With Respect to a Tentative Adjustment, Does the Joint Committee Have Jurisdiction over Both the Source Year and the Carryback Year?

Yes. All source years of credits or losses that affect a refund or credit year must be included in the report to the Joint Committee.<sup>25</sup> Thus, if a capital loss in 2005 generates a Tentative Adjustment for 2002, both the capital loss in 2005 and the refund in 2002 must be reported to the Joint Committee.<sup>26</sup> Intervening years that are unaffected by a carryback are not reported. Thus, for example, if in consideration of years 2005–2007, a net operating loss for 2007 is carried back to and fully absorbed in

2005, intervening year 2006 is not included in the report to the Joint Committee.<sup>27</sup>

### 8. What If an Application for Tentative Adjustment Is Filed While Affected Years Are Still Under Examination?

If a refund year is under examination, or has been examined but not closed out of the examining group, and the taxpayer files an application for Tentative Adjustment, the examination will be extended to the source year of the application for Tentative Adjustment.<sup>28</sup> For example, if a taxpayer’s period 2002–2004 is under examination, and if the taxpayer submits an application for Tentative

Adjustment based on an NOL from 2005 (which results in a refund of over \$2 million for one or more years in the 2002–2004 audit period), year 2005 would be wrapped into the examination. The refund year(s) plus 2005 would be subject to Joint Committee review.

As long as the source year remains *unexamined*, the report to the Joint Committee for the refund year will not be submitted *unless* (1) the refund year qualifies for Joint Committee review *independently* of the carryback from the source year (e.g., if there also was an Overpayment Refund exceeding \$2 million for that year); and (2) the examination of the source year will not be completed for a “substantial period of time” (one year for Coordinated Industry Cases (CIC), six months for all others).<sup>29</sup> Thus, if the current examination would not be a Joint Committee case but for carrybacks from a source year included in the current examination, the case should not be submitted to the Joint Committee for review until the examination action is completed on the source years.<sup>30</sup> If a carryback is allowed subject to future examination of the source year, the examination report (Form 4549-A) should contain the following statement: “The net operating loss (or capital loss or credit) carryback from the year ending xx/xx/xxxx, reflected herein, is subject to correction upon examination of the tax return from which it originated.”<sup>31</sup> If, upon final examination of the source year, the refund for the period under examination is reduced to less than the jurisdictional amount, the examiner must notify the Joint Committee in writing.<sup>32</sup>

### **9. Can an Overpayment Refund Be Reported to Joint Committee for Consideration Prior to the Resolution of All Issues Under Examination?**

Maybe. If *unagreed* issues remain upon completion of the examination, but the taxpayer is entitled to an Overpayment Refund, the case will be submitted for Joint Committee review if (1) the unagreed issues may require a “substantial period of time to resolve” (one year for CIC, six months for all others) and the delay would “deprive the taxpayer of a timely refund to which it is clearly entitled,” and (2) the refund reflects the “minimum” amount to which the taxpayer is entitled, regardless of the outcome of the unagreed issues.<sup>33</sup>

There is also a similar procedure that permits Appeals to send a case on to Joint Committee prior to resolution of all issues.<sup>34</sup>

### **10. Can Appeals Allow Tentative Adjustments and Submit Reports to the Joint Committee for Years Under Appeals’ Jurisdiction if the Source Year Is Still Under Examination?**

Maybe. If Appeals has jurisdiction over a year in which a Tentative Adjustment is claimed, Appeals should allow the Tentative Adjustment if Exam is still auditing the source year and will not be able to complete the examination “within a reasonably short period of time” (a minimum of two months, but may be longer depending on the facts and circumstances).<sup>35</sup> Although Appeals may close its case, it usually will not report the Tentative Adjustment to the Joint Committee until the correct amount of the carryback has been determined for the source year.<sup>36</sup> There is a limited exception for Tentative Adjustments in excess of \$5 million; in these cases, Appeals may go ahead and request “informal” Joint Committee review that will assist Appeals in closing its case.<sup>37</sup> If Appeals has an Overpayment Refund in the same cycle, for which it is already obligated to submit a report, Appeals should proceed to tentatively close the Overpayment Refund case and submit the report.<sup>38</sup> However, the report must disclose that there is a Tentative Adjustment affecting the cycle and that a supplemental report will follow after examination of the source year is completed.<sup>39</sup> In all cases, however, if Exam will complete the audit of the source year

within a reasonably short period of time, Appeals should retain the refund case and wait for Exam to forward the source year to Appeals.<sup>40</sup>

### **11. If a Refund Is Reported to Joint Committee for Review, Will Joint Committee Review or Comment on Other Issues for the Same Year or Cycle Unrelated to the Refund?**

Maybe. This is a thorny issue with no clear-cut answer. However, experience has shown that the Joint Committee may voice its opinion regarding other transactions or issues unrelated to the refund being reported—including tentative settlements that have been brokered with Exam or Appeals. The likelihood of this happening may be slim, but it is possible and practitioners should be aware.<sup>41</sup>

### **12. Must the IRS Follow the Joint Committee’s Recommendations?**

No. The IRS is not statutorily required to follow the Joint Committee’s recommendations. In fact, when the Joint Committee raises an issue, the IRS can either agree and adopt the Joint Committee’s position or it can “reply to the Committee with the reasons for disagreement.”<sup>42</sup> Practitioners should remind revenue agents and appeals officers of this procedure and demand that they stand firm on the position as originally submitted to Joint Committee.

Be aware, however, that the IRS may choose to follow the Joint Committee’s recommendation in order to foster the improvement of tax administration. In fact, the Joint Committee’s Web site states: “[T]he IRS will not pay any part of a refund while the Joint Committee Staff has a continuing objection.”<sup>43</sup> Accordingly, “no settlement should be made effective until receipt of notice that the JCT has no objection to the proposed overpayment.”<sup>44</sup> Moreover, the IRS must “not execute any closing agreement on behalf of the Commissioner until after the JCT clears the case.”<sup>45</sup>

## **Conclusion**

---

The foregoing discussion presents what is a small subset of the many issues facing practitioners moving a case through the Joint Committee refund review process. Knowledge of the review process is crucial to strategic decision-making with respect to refund case resolution.

## ENDNOTES

- <sup>1</sup> All “Code Sec.” references are to the Internal Revenue Code of 1986, as amended.
- <sup>2</sup> Joint Committee review also may be necessary for disaster loss refunds and certain credits. See Code Sec. 6405(c) and IRM §4.36.2.2.2 (Feb. 15, 2002), 4.36.2.2.3 (Aug. 15, 2004) and 8.7.9.6.9 (Nov. 9, 2007).
- <sup>3</sup> IRM §4.36.2.4(4) (Feb. 15, 2002); IRM §8.7.9.6.3(1) (Nov. 9, 2007).
- <sup>4</sup> In the example above, the Overpayment Refunds still would be mentioned in the report given to Joint Committee for the Tentative Adjustments, but the Overpayment Refunds would not be subject to review. See IRM §4.36.2.4, Example 3 (Feb. 15, 2002).
- <sup>5</sup> IRM §4.36.2.4.1(1) (Aug. 15, 2004); IRM §8.7.9.1(6) (Nov. 9, 2007); IRM §8.7.9.6.7(1) (Nov. 9, 2007).
- <sup>6</sup> IRM §4.36.2.4.1(3) (Aug. 15, 2004); IRM §8.7.9.6.7(3) (Nov. 9, 2007).
- <sup>7</sup> IRM §4.36.2.4.1(2) (Aug. 15, 2004); IRM §8.7.9.6.7(2) (Nov. 9, 2007).
- <sup>8</sup> *Id.*
- <sup>9</sup> IRM §8.7.9.6.3(3) (Nov. 9, 2007); IRM §4.36.2.2.1 (Aug. 15, 2004).
- <sup>10</sup> IRM §8.7.9.6.3(3) (Nov. 9, 2007); IRM §4.36.2.2.1 (Aug. 15, 2004).
- <sup>11</sup> IRM §4.36.2.4(3) (Feb. 2, 2002).
- <sup>12</sup> IRM §4.36.2.4.2(1) (Aug. 15, 2004).
- <sup>13</sup> IRM §8.7.9.6.6(1) (Nov. 9, 2007).
- <sup>14</sup> IRM §8.7.9.6.5(1) (Nov. 9, 2007).
- <sup>15</sup> IRM §4.36.2.4.4(1) (Feb. 15, 2002); IRM §8.7.9.6.4(2) (Nov. 9, 2007).
- <sup>16</sup> IRM §4.36.2.4.4(1) (Feb. 15, 2002); IRM §8.7.9.6.5(2) (Nov. 9, 2007).
- <sup>17</sup> IRM §4.36.2.4.3(1) (Feb. 15, 2002); IRM §8.7.9.6.3(4) (Nov. 9, 2007).
- <sup>18</sup> IRM §8.7.9.6.1 (Nov. 9, 2007); IRM §4.36.2.3(1)(c) (Aug. 15, 2004).
- <sup>19</sup> *Id.*
- <sup>20</sup> IRM §8.7.9.6.6(1) (Nov. 9, 2007); IRM §4.36.2.4(3) (Feb. 15, 2002). See also IRM §8.7.9.6.4 (Nov. 9, 2007) (illustrating aggregation of refunds in multi-year case).
- <sup>21</sup> IRM §34.8.2.8(2) (Aug. 11, 2004).
- <sup>22</sup> *Id.*
- <sup>23</sup> IRM §4.36.2.2.1(1) (Aug. 15, 2004); IRM §8.7.9.2(2) (Nov. 9, 2007).
- <sup>24</sup> Code Sec. 6405(a); IRM §4.36.2.2 (Aug. 15, 2004); IRM §8.7.9.2(2) (Nov. 9, 2007).
- <sup>25</sup> IRM §4.36.2.4(3) (Feb. 15, 2002); IRM §8.7.9.7.2(1) (Nov. 9, 2007).
- <sup>26</sup> IRM §4.36.2.4(5) Examples; IRM §8.7.9.7.2(1) (Nov. 9, 2007).
- <sup>27</sup> IRM §8.7.9.7.2(1) (Nov. 9, 2007).
- <sup>28</sup> IRM §4.36.3.2.2(1) (Feb. 15, 2002).
- <sup>29</sup> IRM §4.36.3.7.2(1) (Aug. 15, 2004).
- <sup>30</sup> IRM §4.36.3.7.2(4) (Aug. 15, 2004).
- <sup>31</sup> IRM §4.36.3.7.2(2) (Aug. 15, 2004).
- <sup>32</sup> IRM §4.36.3.7.2(3) (Aug. 15, 2004).
- <sup>33</sup> IRM §4.36.3.7.1(1) (Aug. 15, 2004).
- <sup>34</sup> IRM §8.7.9.5.1.5 (Nov. 9, 2007).
- <sup>35</sup> IRM §8.7.9.5.1.3(1) and (5) (Nov. 9, 2007); 8.7.9.5(2) (Nov. 9, 2007).
- <sup>36</sup> IRM §8.7.9.5.1.4 (Nov. 9, 2007).
- <sup>37</sup> IRM §8.7.9.5.1.5.1 (Nov. 9, 2007).
- <sup>38</sup> IRM §8.7.9.5.1.3(7) (Nov. 9, 2007).
- <sup>39</sup> *Id.*
- <sup>40</sup> IRM §8.7.9.5.1.3(3) (Nov. 9, 2007).
- <sup>41</sup> If a limited issue focused examination (“LIFE”) case subsequently becomes a Joint Committee case, the Joint Committee has authority to inquire into issues beyond the scope of the LIFE. IRM §4.36.3.2(1) (Aug. 15, 2004). However, if Joint Committee review of additional issues occurs, the IRS is still bound by the LIFE agreement unless fraud or malfeasance is found. *Id.* A LIFE case involves a formal agreement, Memorandum of Understanding (MOU), between the IRS and a taxpayer to govern key aspects of an examination. See IR-2002-133 (Dec. 4, 2002). A MOU contains certain dollar thresholds, determined on a case-by-case basis, below which the IRS will agree not to raise issues and the taxpayer will agree not to file refund claims. *Id.*
- <sup>42</sup> IRM §4.36.3.10(2) (Aug. 15, 2004).
- <sup>43</sup> [www.jct.gov/aboutjct\\_refundreview.html](http://www.jct.gov/aboutjct_refundreview.html).
- <sup>44</sup> IRM §8.7.9.5.1(2) (Nov. 9, 2007).
- <sup>45</sup> IRM §8.7.9.5.6(1) (Nov. 9, 2007).

This article is reprinted with the publisher's permission from the JOURNAL OF TAX PRACTICE & PROCEDURE, a bi-monthly journal published by CCH, a Wolters Kluwer business. Copying or distribution without the publisher's permission is prohibited. To subscribe to the JOURNAL OF TAX PRACTICE & PROCEDURE or other CCH Journals please call 800-449-8114 or visit [www.CCHGroup.com](http://www.CCHGroup.com). All views expressed in the articles and columns are those of the author and not necessarily those of CCH.