



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

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL, GEORGIA
CC:SER:GEO

FROM: Deborah A. Butler
Assistant Chief Counsel (Field Service)
CC:DOM:FS

SUBJECT: Modified expedited refunds in Joint Committee case

This Field Service Advice responds to your memorandum dated January 14, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

CORP X = Authorized representative:

- | | |
|--------|--------|
| YEAR 1 | DATE A |
| YEAR 2 | DATE B |
| YEAR 3 | DATE C |
| YEAR 4 | DATE D |
| YEAR 5 | DATE E |
| YEAR 6 | DATE F |
| YEAR 7 | |

ISSUES:

1. What discretion does the Service have to issue an expedited refund pending the completion of a tax examination after accepting a surety bond to secure the refunded tax?
2. If the Service has discretion to issue an expedited refund under these facts, what factors should the Service consider in obtaining security for the potential recovery of the refunded amount?

CONCLUSION:

1. In considering a request for an modified expedited refund in a Joint Committee case, the Service may only refund the amount that is determined by the Service as the minimum amount of overpaid tax that is due to the taxpayer. If the determined refund exceeds \$1 million, the refund must first be submitted for approval by the Joint Committee. Determined refunds based upon partial agreements that do not exceed \$1 million may be refunded under the Service's refund procedures without obtaining Joint Committee approval. The Service may not, however, refund tax to the taxpayer, even with Joint Committee approval, if such tax is not overpaid.
2. Because we conclude that the Service may not issue the expedited refund sought in this case, we will defer answering what action is necessary to secure the refunded amount.

FACTS:

For YEAR 1 through YEAR 4, CORP X was a member of a consolidated group, and had its income reported on the consolidated return filed by the consolidated group for each tax year. On DATE A in YEAR 5, CORP X was split-off from the consolidated group. CORP X's income for YEAR 5 through DATE A was reported on the group's consolidated return. CORP X reported its own income for the short taxable year beginning after DATE A on a separate return for YEAR 5.

After filing a corporate income tax return for YEAR 5 on DATE B, CORP X filed an amended return, Form 1120X, on DATE C to claim a tax refund of \$5M for YEAR 5 based upon the carry forward of losses incurred by the consolidated group in YEAR 1 through YEAR 4. On DATE D, CORP X filed a second amended return to claim an additional refund of \$8M for YEAR 5 based upon the carry forward of losses from the consolidated group's YEAR 1 through YEAR 4.

While these refund claims were pending, the Service initiated an audit of CORP X's income tax liabilities for YEAR 4 and YEAR 5. On DATE E, CORP X agreed to the assessment of deficiencies for YEAR 4 and YEAR 5, which did not take into account the pending refund claims. The deficiencies were assessed, and CORP X paid the full liabilities with underpayment interest on DATE F.

The Service has not completed its consideration of CORP X's two pending refund claims and has not yet made any determination with respect to those claims. Any action on the claims has been delayed pending completion of a separate audit of the consolidated group's liabilities for YEAR 1 through YEARS 4. That audit is not expected to be completed until at least another year.

CORP X has requested that the Service make an expedited refund of its claimed overpayment of income tax for YEAR 4 while the Service's review of the refund claims is pending because the audit is not expected to be completed for at least one year. The requested tax refunds are in excess of \$1,000,000. The taxpayer has agreed to provide security in the form of a security agreement and a surety bond.

LEGAL ANALYSIS

1. Authority to issue expedited refunds in Joint Committee cases

Section 6402(a) of the Internal Revenue Code is the sole Code provision that affirmatively authorizes the Service to make refunds to a taxpayer. Section 6402(a) provides that Service may "refund any balance" of any "tax overpayment" to a taxpayer after crediting the amount of such overpayment against any outstanding tax liabilities of the taxpayer. An overpayment, although not exhaustively defined in the Code, is the amount by which a payment of tax exceeds the correct total amount of the taxpayer's liability for a tax period or any amount that was assessed or collected after the expiration of the applicable period of limitations. Section 6401; Jones v. Liberty Glass Co., 332 U.S. 524 (1948). The Service is not required or authorized by statute to refund tax payments claimed by a taxpayer if an overpayment has not been determined. Lewis v. Reynolds, 281 U.S. 201 (1932).

Section 6511 provides the limitations period within which a taxpayer must file a claim for refund of any tax overpayments. The general procedures for making an claim for refund of income tax are found in Treas. Reg. §§ 301.6402-2, 3. The Service will issue a refund under these procedures only if it determines, based upon the grounds set forth and detailed in a timely filed refund claim, that there is an overpayment of tax.

Section 301.6402-4 of the regulations, which addresses a claim for refund included on a tax return, provides one exception to the necessity that the Service first determine that there is an overpayment of tax before making a refund. If an overpayment is claimed on the taxpayer's return to recover payments made before the return was filed, the Service may "credit or refund [payments in excess of the amount of tax shown on the return] without awaiting examination of the completed return and without awaiting filing of a claim for refund." Implicit in this exception for refunds claimed on the return is the understanding that the Service must otherwise make a determination with respect to the taxpayer's refund claim before crediting or refunding claimed overpayments under section 6402.

Section 6411 also provides a special procedure under which a taxpayer may apply for the tentative carryback adjustment of tax for a prior taxable year affected by certain carrybacks from another taxable year. Because the Service must quickly respond to these carryback applications, the Service makes a limited review of the application only for material omissions and computational errors before either disallowing the application or making a tentative refund under section 6411. Treas. Reg. § 1.6411-3(b). The application for a carryback adjustment must be filed within twelve months after the source year in which the loss or credit to be carried back arose. Except for determining overpayment interest, the application is not a claim for credit or refund. Section 6411 (last sentence); see Thompson v. United States, 99-1 U.S.T.C. ¶ 504,886 (Fed. Cl. 1999); Thrif-Tee, Inc. v. United States, 492 F.Supp. 530 (N.C. 1979), aff'd without pub. op., 638 F.2d 1351 (4th Cir. 1980). CORP X's refund claims are not applications under section 6411.

In general, except with respect to refunds claimed on the taxpayer's original tax return or on an application for tentative carryback on which a taxpayer claims an overpayment of tax, the Service does not make refunds of tax, unless it has first determined that there is an overpayment of tax to be refunded. Refund claims submitted pursuant to Treas. Reg. §§ 301.6402-2 and 3, do not, in themselves, provide a basis for making a refund of tax, until the Service determines that an overpayment exists and that the taxpayer is entitled to the refund.

If the overpayment, once determined by the Service, is very large, the Service cannot refund or credit the overpayment unless it also satisfies the additional requirement under section 6405(a) that the refund be approved by the Joint Committee on Taxation. Section 6405(a) prohibits the refund or credit of income tax in excess of \$1,000,000 until after a report is submitted to the Joint Committee on Taxation. The Service's current procedures for submitting proposed refunds for approval by the Joint Committee are found in IRM 4.3.5, Joint Committee Handbook (4/30/99). Under the normal procedure, a report is prepared and a case is submitted for Joint Committee Review only if there is a net overpayment to be

refunded or credited to the taxpayer in excess of \$1 million after the Service has completed an examination of one or more tax years. A “regular report” is used if refunds have already been made (e.g., in response to a section 6411 tentative refund claim) so that less than \$1 million is left to be refunded, and an “expedited report” is made if there is a net unpaid refund in excess of \$1 million to be made. See IRM 4.3.5.1.2; 4.3.5.5.2; and 4.3.5.5.3. A “supplemental report” is filed if further adjustments are made after one report has been filed. See IRM 4.3.5.5.5.

IRM 4.3.5.5.4 also provides for a “modified expedite refund report” to be prepared when the Service has not completed action on a case. It may be used when there are “unagreed issues, as shown in Section 6.2” or “unexamined source years, as shown in section 6.3.” Cases involving unagreed issues are those in which the taxpayer and the Service are prepared to make a partial agreement for the assessment or abatement of some tax liabilities without resolving all of the pending issues for a tax period. Cases involving unexamined source years are those in which the Service and the taxpayer have resolved the issues for the tax year with the exception of carrybacks or carryforwards from other “source years” that are still being examined. In both situations, the refund must first be approved by the Joint Committee. The “modified expedite refund report” is the mechanism for seeking such approval for an “expedited refund” without waiting until all issues affecting the tax period have been resolved.

The handbook requires certain conditions to be met before a “modified expedited refund report” can be prepared and sent to the Joint Committee:

- A. There must be a claimed section 6405(a) refund amount subject to Joint Committee Review in excess of \$1,000,000.00 in an unexamined or unsurveyed source or carryback year, IRM 4.3.5.6.5.1;
- B. The examination of the unagreed issues or the source year will require a substantial period of time (six months or more) to resolve, and “the delay would deprive the taxpayer of a timely refund to which the taxpayer is clearly entitled,” IRM 4.3.5.6.5.1, 4.3.5.6.2(1), and 4.3.5.6.3(1);
- C. The taxpayer must post an acceptable bond or similar security, IRM 4.3.5.6.5.1 and IRM 4.3.5.6.3(1);
- D. The report must contain an explanation of why the refund is being issued before the case is completed or surveyed, including a conclusion that no disadvantage to the government will occur as a result of the early refund, IRM 4.3.5.6.5.2, 4.3.5.6.2(2), and 4.3.5.6.3.(2);

- E. The refund may reflect only the minimum amount to which the taxpayer is entitled, regardless of the outcome of the unagreed issue, IRM 4.3.5.6.2(1), 4.3.5.6.2.(4), 4.3.5.6.3(1), and 4.3.5.6.3(5);
- F. A supplemental report must be submitted at the end of the examination or survey, IRM 4.3.5.6.2(3) and 4.3.5.6.3(4); and
- G. The refund may not be one involving tentative refunds. IRM 4.3.5.6.2(1) and 4.3.5.6.3(2).

The key requirement for both unagreed issue cases and unexamined source year cases is that the modified expedite report procedures apply only to “the minimum amount to which the taxpayer is entitled” and only if that amount is over \$1 million. IRM 4.3.5.6.2(1). In this case, the amount claimed by CORP X is over \$1 million, but the Service has not determined that CORP X is entitled to recover any portion of that claimed amount. Before determining that CORP X is entitled to the refund of any portion of the amount claimed by CORP X on its two refund claims, the Service will need to determine the amount of the losses or credits generated by The consolidated group in YEAR 1 through YEAR 4, which portion (if any) of those losses is allocable to CORP X, and which portion of the losses allocable to CORP X is available for carryover to YEAR 5. Until those determinations are made and some of CORP X’s YEAR 5 tax liabilities are abated, there is no overpayment of tax to be refunded.

The “modified expedited refund report” process could apply if, instead of determining a deficiency for CORP X’s YEAR 5, the Service had determined that CORP X had overpaid its YEAR 5 income tax liability by more than \$1 million. Pursuant to a partial agreement, the Service would have authority to refund the agreed overpayment to CORP X while the determination of CORP X’s claims for the carryforward of losses from YEAR 1 through YEAR 4 was still pending. However, because the agreed overpayment would have exceeded \$1 million, any refund would first be subject to Joint Committee review. By filing a modified expedite refund report that explained the amount and reason for the refund as well as the action still pending on the carryforward claim, the Service could solicit the necessary Joint Committee review. The Service could then make the refund after obtaining the bond or other security from the taxpayer to ensure that the Service could recover the refunded amount if the Service, in the course of completing the examination of the source years, determined that the taxpayer had not overpaid its income tax and was not entitled to the expedited refund of tax.

Chapter 6 of the Joint Committee Handbook (rev. 4/30/99) revised the language manual provisions concerning modified expedited refunds. Before April 30, 1999, use of the modified expedited report procedures had been authorized at IRM

457(10).5, revised 5/14/90, whenever a taxpayer requested that a refund be made prior to the completion of survey or examination action. These procedures could be applied where:

- A. A refund was claimed in excess of \$25,000;
- B. Any examination or survey action was not expected to be completed within six months;
- C. A modified expedite refund request report was sent to the Joint Committee;
- D. The taxpayer posted bond or other security, as required by the Service, to secure repayment, if necessary, of the tax being refunded;
- E. The taxpayer provided an executed written security agreement; and
- F. The Service found that no disadvantage to the government would occur.

Thus, before April 30, 1999, the manual provisions did not explicitly require that the Service determine that a taxpayer was entitled to a refund if the expedited refund was sought before the tax examination or survey was completed. Since the Service is not authorized to refund tax unless the tax is overpaid, the Service's determination that the taxpayer is entitled to a refund is a condition precedent for finding that there is no disadvantage to the government. Like the current manual provisions, the former manual provisions provided a mechanism under which the Service could expeditiously make a refund subject to Joint Committee approval based upon a partial agreement, rather than waiting until all adjustments were completed for a tax period.

Nevertheless, some taxpayers may have interpreted the failure to include an express limitation prohibiting refunds unless there was a Service determination of an overpayment of tax as an indication that refunds could be made solely if claimed by a taxpayer. Under this misinterpretation, taxpayers claiming refunds of more than \$1 million would be able to obtain an immediate refund of any taxes previously paid by claiming a refund and posting a bond. Because section 6402 does not authorize such refunds, we do not believe that this interpretation of either the former or current manual provisions is correct.

On the facts presented, the Service does not have the authority to make a refund of tax in exchange for a bond or other security unless it first determines that there is an overpayment of tax to be refunded to the taxpayer. The Service has not determined that CORP X overpaid its tax liability for YEAR 5. Thus, no portion of

the previously paid tax liability may be refunded to CORP X under the expedited refund procedures for Joint Committee cases.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We believe that the Service can rely upon the current provisions of Chapter 6 of the Joint Committee Handbook to decline taxpayer requests to have proposed refunds submitted for Joint Committee review even if the taxpayer offers to provide a bond or other security. The handbook reflects the Service's limited authority to issue refunds of overpayments under section 6402. A modified expedited refund report for Joint Committee review should only be prepared for a proposed refund that exceeds \$1 million and represents the minimum amount to which the Service determines the taxpayer is immediately entitled in a case involving either additional unagreed issues for the same tax year or carrybacks or carryforwards from unexamined source years.

Since use of the modified expedited refund request procedures is not appropriate in this case, we have not addressed the question of what type of bond or other security must be posted by the taxpayer under those procedures.

Please call if you have any further questions.