

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Large Dollar Refunds Are Not Always Examined and Sent to the Joint Committee on Taxation

June 3, 2020

Reference Number: 2020-30-023

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

2 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions

HIGHLIGHTS: Large Dollar Refunds Are Not Always Examined and Sent to the Joint Committee on Taxation



Final Audit Report issued on June 3, 2020
Reference Number 2020-30-023

Why TIGTA Did This Audit

This audit was initiated to assess the effectiveness of the IRS's efforts to examine returns with refunds in excess of \$2 million (\$5 million for C corporations) and report to the Joint Committee on Taxation (JCT) on such refunds.

Impact on Taxpayers

Pursuant to Internal Revenue Code (I.R.C.) Section (§) 6405, before the IRS can issue refunds of income, estate, and gift taxes, and certain excise taxes in excess of a statutorily prescribed amount (\$2 million, or \$5 million for C corporations), the IRS must provide a report to the JCT. Taxpayers legally entitled to their refunds may be subject to audit and delays in receiving their refunds, while erroneous high-dollar refund claims present a risk to tax compliance.

What TIGTA Found

TIGTA identified 1,664 tax modules that exceed the refund dollar criteria, but were not referred to or selected for examination because Treasury Regulation § 301.6402-4 and IRS procedures limit the tax returns that are subject to JCT review. The IRS does not examine all of these returns even though they exceed the statutory dollar criteria of \$2 million and \$5 million.

Additionally, the IRS is not always in compliance with I.R.C. § 6405. The existing procedures for identifying potential JCT cases and forwarding such cases to the Examination functions are not always being followed. TIGTA identified 74 tax modules with amended and net operating loss carryback returns that were not properly referred to the Examination functions; therefore, they were not examined or sent to the JCT as legally required.

Even when a return is appropriately sent to the Examination functions as a potential JCT case, not all cases are sent to the JCT when required. Some of the various situations TIGTA identified included:

- 11 instances in which the case was properly referred to the Examination functions, but the classifier accepted the return as filed; therefore, it was not examined or sent to the JCT.
- 28 tax modules meeting JCT review criteria that were not examined; therefore, they were not sent to the JCT for review even though they were properly referred to the Examination functions and properly selected for examination by the classifiers.
- 47 tax modules meeting JCT review criteria that were examined, but the revenue agent failed to refer the case to the IRS's Joint Committee Review team at the conclusion of the examination; therefore, the case was not sent to the JCT for review.

What TIGTA Recommended

TIGTA recommended that the IRS: assess the compliance risk of the large-dollar original return refund claims that exceed I.R.C. § 6405 dollar criteria that are not required to be examined and are not subject to the JCT review process due to Treasury Regulation § 301.6402-4(a), relative to other tax returns, and allocate examination resources accordingly; take corrective actions to ensure that the refunds that were not sent to the JCT for review as required are subject to the JCT review process; and assign oversight responsibilities to a specific group or function for the overall JCT process to ensure that cases are sent to the JCT, when required, and procedures are being followed.

The IRS agreed to three of our four recommendations, and plans to take corrective actions such as coordinating with the JCT to determine the appropriate approach for the returns that were not sent to the JCT as legally required, and strengthening the controls over the process for identifying and submitting returns to the JCT.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 3, 2020

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Large Dollar Refunds Are Not Always Examined
and Sent to the Joint Committee on Taxation (Audit # 201830038)

This report presents the results of our review to assess the effectiveness of the Internal Revenue Service's efforts to examine returns with refunds in excess of \$2 million (\$5 million for C corporations) and report to the Joint Committee on Taxation on such refunds. This review is part of our Fiscal Year 2020 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Reporting and Payment Compliance*.

Management's complete response to the draft report is included as Appendix II.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Large Dollar Refunds Are Not Always Examined and Sent to the Joint Committee on Taxation

Background

In 1926, Congress enacted legislation that created the congressional Joint Committee on Taxation (JCT). This resulted from reports of inefficiency and other problems in the Bureau of Internal Revenue.¹ There were allegations that the method of determining and issuing refunds created the opportunity for fraud. A congressional investigation was conducted that found the agency was failing to treat taxpayers in an even-handed way. The congressional committee that conducted the investigation concluded that the problems resulted from the Bureau of Internal Revenue not establishing principles in advance, for the benefit of both taxpayers and its own employees, concerning how the law should be applied to specific cases. The committee also attributed some of the inconsistent treatment to bureaucratic disorganization.²

Internal Revenue Code Section 6405 provides the JCT with oversight authority of refunds of income, estate, and gift taxes, and certain excise taxes in excess of a statutorily prescribed amount.

Some of the biggest concerns pertained to the administration of the amortization and depletion allowances and the somewhat haphazard application of the law to different taxpayers. For example, a situation was discovered in which five co-owners of the same property were allowed dramatically different depletion allowances based upon multiple (and inconsistent) valuations of the property. The situation arose because the tax returns of each owner were audited independently; therefore, different employees valued the same property and reached different conclusions, and the agency failed to discover and coordinate all of the overlapping work.³

The Revenue Act of 1926, which called for the creation of the JCT, stressed:

...the need for the institution of a procedure by which the Congress could be better advised as to the systems and methods employed in the administration of the internal revenue laws with a view to the needs for legislation in the future, simplification and clarification of administration, and generally a closer understanding of the detailed problems with which both the taxpayer and the Bureau of Internal Revenue are confronted. It is more properly the function of the Senate Finance Committee and the House Ways and Means Committee, jointly, to engage in such an activity.⁴

While the statutory mandate of JCT review of certain refunds has not changed significantly since its inception, the tax legislative process has. Consequently, the actual responsibilities of JCT staff have expanded considerably.⁵ Today, JCT staff have a significant role in the tax legislative

¹ The Bureau of Internal Revenue was renamed the Internal Revenue Service in 1953.

² 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*, Tax Law Review, vol. 66, no. 4, Summer 2013, p. 787-879.

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*, Tax Law Review, vol. 66, no. 4, Summer 2013, p. 787-879.

⁴ Revenue Act of 1926, Senate Report 52, 69th Congress, 1st Session, Chapter 27, Section 257(b)(1) (1926).

⁵ Some of the JCT's duties set forth in Internal Revenue Code § 8022 are in part to investigate the effects of changes to tax law leading to their clarification, simplification, or revision; to prevent undue hardships or the granting of unintended benefits; to investigate any agency charged with the administration of such taxes; and to make any other investigations in respect of such system of taxes the JCT deems necessary.



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process. The JCT consists of 10 members of Congress: five from the Senate Committee on Finance (three from the majority and two from the minority), and five from the House Committee on Ways and Means (three from majority and two from the minority). The JCT monitors the operation of the Internal Revenue Service (IRS) and its administration of the tax laws.

Generally, pursuant to Internal Revenue Code (I.R.C.)⁶ Section (§) 6405, before the IRS can issue refunds of income, estate, and gift taxes, and certain excise taxes in excess of a statutorily prescribed amount (\$2 million, or \$5 million for C corporations),⁷ the IRS must provide a report to the JCT.⁸ Therefore, one of the statutorily prescribed duties of the JCT is to review proposed income tax refunds in excess of the prescribed amounts.

The JCT review is limited to designated categories of tax. Excluded from review are employment taxes, trust fund recovery penalty cases, windfall profit taxes, and specified excise taxes.⁹ The following refunds are also not reportable to the JCT:

1. A refund or credit of estimated or withheld income tax made without examination.¹⁰
2. A refund or credit of an unassessed advance payment or deposit made prior to determination of a taxpayer's tax liability, or a refund or credit of an amount paid on an early filed return that exceeds the amount of the tax liability reported by the taxpayer on the last return filed on or before the due date of that return.
3. Abatement of an unpaid tax liability in excess of the jurisdictional amount. For example, an abatement of an unpaid portion of an assessment under I.R.C. § 6404, regardless of the amount, is not a refund or credit under I.R.C. § 6405.
4. An overpayment determined by the U.S. Tax Court or any other court of competent jurisdiction as a result of the trial of a case (rather than by a stipulation of settlement). Non-reportable overpayments determined by the U.S. Tax Court or other courts are limited to overpayments from only those years in the court decision. Refund from any years outside of the specific court decision may be reportable if they meet the jurisdictional amount.¹¹

Tax returns with refund claims that meet I.R.C. § 6405(a) criteria must first be examined or must have at least been assigned for examination by the IRS before being reported to the JCT. This is due to the wording that the IRS must issue a report to the JCT providing 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" with respect to that refund. According to IRS Office of Chief Counsel, although the statute does not use the term examination, the IRS

⁶ See Appendix III for a glossary of terms.

⁷ These amounts were effective as of December 19, 2014.

⁸ I.R.C. § 6405(a) requires: "No refund or credit of any income, war profits, excess profits, estate, or gift tax, or any tax imposed with respect to public charities, private foundations, operators' trust funds, pension plans, or real estate investment trusts under chapter 41, 42, 43, or 44, in excess of \$2,000,000 (\$5,000,000 in the case of a C corporation) shall be made 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."

⁹ Internal Revenue Manual (IRM) 4.36.2.3 (Sept. 22, 2015).

¹⁰ This exclusion is attributable to Treasury Regulation § 301.6402-4, which is discussed later in the report.

¹¹ IRM 4.36.2.3 (Sept. 22, 2015).



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would need to first examine or survey the return in order to provide the JCT with a “summary of the facts” and a “decision.”

The Large Business and International (LB&I) Division is responsible for managing the JCT review process, although other IRS divisions play important roles as well. The IRS’s management of I.R.C. § 6405 provisions are important because taxpayers that are legally entitled to their refunds may be subject to audit and delays in receiving their refunds. On the other hand, if high-dollar refund claims are not examined, erroneous refund claims might be paid.

Results of Review

Existing Criteria for Identifying Potential Joint Committee on Taxation Cases for Examination Limits the Number of Returns Referred to Examination, Is Inconsistent, and Is Not Always Followed

The IRS LB&I Division includes a Joint Committee Review (JCR) team with the responsibility to oversee the preparation of reports for the JCT for all agreed, partially agreed, and no-change examination cases, as well as examination cases that are surveyed after assignment, for I.R.C. § 6405 refunds regardless of the business operating division.¹² For unagreed examination cases, no report is required at the time the case is closed to the Office of Appeals. However, if an agreement between the IRS and the taxpayer is reached and the case still meets JCT criteria, Appeals will be responsible for preparing and submitting a report to the JCT.¹³

In order for the JCR team to be able to report to the JCT on refunds meeting I.R.C. § 6405 criteria, these refunds must first be referred to the JCR team by the examination team or revenue agent (RA) assigned to the case. In order for an RA to be assigned to one of these refunds as an examination case, the return must be properly identified, referred to the Examination functions, and selected for examination.¹⁴

Due to the wording of I.R.C. § 6405, refunds are reported to the JCT only when they are of designated categories of tax. The IRS database that stores various types of taxpayer account information uses Master File Tax (MFT) codes in order to identify the specific module, tax class, and tax form filed by the taxpayer to record transactions (such as the filing of the return, subsequent payments, refunds, *etc.*). Refunds meeting I.R.C. § 6405 criteria are required to be reported to the JCT when the taxpayer uses the tax forms listed in Figure 1.¹⁵

¹² IRM 4.36.1.3(1) (Sept. 21, 2015) and IRM 4.36.1.4(3) (Sept. 21, 2015). The cases that need to be sent to the JCT can come from the IRS’s LB&I, Tax Exempt and Government Entities, and Small Business/Self-Employed Divisions.

¹³ IRM 4.36.3.2(5) (Sept. 22, 2015).

¹⁴ Additionally, an RA assigned to the case could receive a claim for refund directly from the taxpayer or the refund meeting JCT criteria could result from audit adjustments during an examination. These situations would not require a referral to the Examination functions, because there would already be an open examination.

¹⁵ Refunds on these tax forms are required to be reviewed by the JCT only when they do not meet the criteria for exclusion listed in Treasury Regulation § 301.6402-4.



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Figure 1: Tax Returns Required to Be Sent to the JCT for Review

Return*	MFT
Form 1120, U.S. Corporation Income Tax Return**	02
Form 1041, U.S. Income Tax Return for Estates and Trusts	05
Form 1040, U.S. Individual Income Tax Return	30
Form 990-T, Exempt Organization Business Income Tax Return	34
Form 990-PF, Return of Private Foundation	44
Form 709, United States Gift (and Generation Skipping Transfer) Tax Return	51
Form 706, United States Estate (and Generation Skipping Transfer) Tax Return	52

Source: Information provided to the Treasury Inspector General for Tax Administration by the JCR team manager.

**Other versions of the form are also included in the MFT.*

***MFT 02 is refunds over \$5 million, while all other MFTs are over \$2 million.*

In order to review the IRS's processes and procedures for identifying and referring potential JCT cases with refunds in excess of \$2 million (\$5 million for C corporations) to the Examination functions, we identified a population of 5,416 tax modules by MFT codes of tax returns that are required to be sent to the JCT and contain at least one refund that posted to the module during Fiscal Years 2016, 2017, or 2018 that meets the dollar criteria of I.R.C. § 6405.¹⁶

We then removed all modules that were at some point reported to the JCT.¹⁷ Within the population of 5,416 tax modules, there were 973 tax modules that IRS management indicated had been sent to the JCT.¹⁸ The remaining 4,443 tax modules had not been sent to the JCT. Some of the 4,443 tax modules may still be subject to examination and JCT review; however, as we subsequently describe in detail, some refund claims met the statutory criteria but were not examined because Treasury Regulations exempt them from JCT review. Other high-dollar refund claims met all of the criteria for examination and JCT review, but the IRS failed to follow the required procedures.

¹⁶ Refunds on these tax returns are required to be reviewed by the JCT only when they do not meet the criteria for exclusion listed in Treasury Regulation § 301.6402-4. Each tax module may include numerous returns (the originally filed return and however many amended returns, net operating loss carryback returns, *etc.* that the taxpayer may have filed), and it may include numerous refunds over the dollar criteria in I.R.C. § 6405. However, for the purpose of our population and data analysis, each tax module is counted only once. Additionally, we consider the entire module to be part of our population, which includes all taxpayer activity for that particular tax period and type of return. This includes returns, transactions, and refunds that occurred outside of Fiscal Years 2016, 2017, and 2018.

¹⁷ We were unable to independently validate that these tax modules were actually sent to the JCT due to our inability to review any documents that could be considered to be a "Congressional Record." Therefore, this number and information is based strictly on data provided to us by the IRS.

¹⁸ Of the 973 tax modules, 942 were listed in JCR team- and Appeals-provided data, whereas 31 were not included in the data provided by the JCR team and Appeals, but the examination team indicated that they were sent to the JCT for review.



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Based on our review of the IRS's processes and procedures for identifying and referring potential JCT cases with refunds in excess of \$2 million (\$5 million for C corporations) to the Examination functions, as well as our review of this population of tax modules, we found:

1. Treasury Regulations and IRS procedures limit the number of returns subjected to JCT review.
2. The criteria used for selecting potential JCT cases for examination is inconsistent.
3. The existing procedures for identifying potential JCT cases and forwarding such cases to the Examination functions are not always being followed.

Treasury Regulations and IRS procedures limit the number of returns subjected to JCT review

The origins of I.R.C. § 6405 related to concerns about possible inconsistent application of the law in which large refunds were involved. However, our review demonstrates that the IRS's I.R.C. § 6405 process does not serve as a check to ensure that all refunds that exceed the monetary criteria in I.R.C. § 6405 are examined and sent to the JCT for review. As we subsequently describe, Treasury Regulations exclude some high-dollar refunds from these processes, while IRS procedures single out other high-dollar refunds for JCT review. However, these IRS procedures do not appear to single out these high-dollar refund types based on compliance risk or any other type of objective criteria.

The JCR team does not track nor have they performed any type of analysis to determine the actual types of returns or tax situations included in their inventory. However, according to the JCR team manager, the vast majority of the JCR team's inventory, and therefore the vast majority of the refunds that are sent to the JCT for review are examination cases with refunds resulting from net operating loss carrybacks (Form 1139, *Corporation Application for Tentative Refund*, and Form 1045, *Application for Tentative Refund*) and amended returns. The manager indicated that the JCR team receives very few original returns (the ones they do receive are mostly from insurance companies) and very few Forms 1041, Forms 706, and Forms 709. Additionally, in the past five fiscal years, the JCR team has received no cases that fall under I.R.C. § 6405(c), and they have received *****1***** from the Tax Exempt and Government Entities Division (in Fiscal Year 2015).¹⁹ Considering the narrow existing criteria for identifying potential JCT cases, the lack of this type of inventory is not surprising.

We identified the following factors that are contributing to the limited number of returns that are identified as potential JCT cases and referred to the Examination functions:

- While all amended returns meeting the dollar criteria in I.R.C. § 6405 are forwarded to the Examination functions as potential JCT cases, the existing criteria is narrow and identifies very few original returns.

¹⁹ I.R.C. § 6405(c) requires: "If any refund or credit of income taxes is attributable to the taxpayer's election under section 165(i) to deduct a disaster loss for the taxable year immediately preceding the taxable year in which the disaster occurred, the Secretary is authorized in his discretion to make the refund or credit, to the extent attributable to such election, without regard to the provisions of subsection (a) of this section. If such refund or credit is made without regard to subsection (a), there shall thereafter be submitted to such Joint Committee a report containing the matter specified in subsection (a) as soon as the Secretary shall determine the correct amount of the tax for the taxable year for which the refund or credit is made."



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- Current procedures for identifying original returns include only two of the five different MFT codes that are eligible for the JCT.
- Treasury Regulation § 301.6402-4 states that refunds of overpayments such as estimated tax payments and withholdings are not required to be reviewed by the JCT.²⁰ This regulation is interpreted to exclude all refundable credits that result in refunds meeting the dollar criteria in I.R.C. § 6405 from JCT review.

Very few original Forms 1120, and no original Forms 1040, are identified as potential JCT cases and forwarded to the Examination functions each year.

Identifying potential JCT cases for referral to the Examination functions involves the Wage and Investment (W&I) Division. Because Treasury Regulation § 301.6402-4 indicates that refunds resulting from over payments (such as excessive withholding and estimated payments) are exempt from JCT review in I.R.C. § 6405, many of the refunds that the IRS considers as potential JCT cases are amended returns and net operating losses (carrybacks).

The examination requirement

Tax returns with refund claims exceeding the statutory dollar criteria in I.R.C. § 6405 must be examined or at least assigned for examination. The IRS bases this interpretation on the language from I.R.C. § 6405(a) that prohibits the IRS from releasing a refund that meets the statutory criteria before first making 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 to the JCT.

The W&I Division Accounts Management (AM) function is responsible for identifying amended returns and carrybacks for referral to the Examination functions based on Category-A (CAT-A) criteria. Tax returns that meet CAT-A criteria must be referred to the Examination functions. Additionally, all IRS employees who receive an amended return/claim²¹ from a taxpayer are responsible for determining if the claim meets CAT-A criteria and forwarding the return to the Examination functions.²²

²⁰ Treasury Regulation § 301.6402-4 states: "(a) If the IRS determines that the payments by the taxpayer that are made within the period prescribed for payment and before the filing of the return exceed the amount of tax shown on the return (for example, excessive estimated income tax payments or excessive withholding), the IRS may credit or refund such overpayment without awaiting examination of the completed return and without awaiting the filing of a claim for refund. The provisions of §§ 301.6402-2 and 301.6402-3 are applicable to such overpayment, and taxpayers should submit claims for refund (if the income tax return is not itself a claim for refund, as provided in § 301.6402-3) to protect themselves in the event the IRS fails to make such determination and credit or refund. The provisions of section 6405 (relating to reports of refunds in excess of the statutorily prescribed threshold referral amount to the Joint Committee on Taxation) do not apply to the overpayments described in this section."

²¹ A claim is a request for refund, or a request for an adjustment of tax paid or credit not previously reported or allowed. Claims are usually filed on Form 1040-X, *Amended U.S. Individual Income Tax Return*, Form 1120-X, *Amended U.S. Corporation Income Tax Return*, Form 843, *Claim for Refund and Request for Abatement*, Form 8849, *Claim for Refund of Excise Taxes*, or one of the Employment tax returns, including Forms 941X, 943X, 944X, 940X, 945X, etc. Additionally, although net operating loss carrybacks filed on Form 1045 or Form 1139 are not claims for credit or refund, they are requests for a tentative carryback and refund adjustment under I.R.C. § 6411, and as such, are subject to JCT review under I.R.C. § 6405(b).

²² IRM Exhibit 21.5.3-2 (July 30, 2018). According to IRS management, an exception to this is RAs and other examiners in the field who receive amended returns do not have to review for CAT-A criteria; they would evaluate the return and decide themselves whether or not it should be examined.



The W&I Division Submission Processing (SP) function has criteria in place to review originally filed Forms 1120 (MFT 02) and Forms 1040 (MFT 30) to identify potential JCT cases at the time of filing. This criteria does not include some tax returns that satisfy I.R.C. § 6405 refund criteria because of Treasury Regulation § 301.6402-4, which excludes most refunds on original returns from requiring JCT review.²⁴ Even though there are seven different types of tax returns that the IRS considers to meet I.R.C. § 6405 criteria, the SP function has criteria in place to identify only originally filed returns that are in the Form 1120 (MFT 02) and Form 1040 (MFT 30) series as potential JCT cases. Therefore, there are five different types of original returns that the SP function is not looking at to identify whether the return should be considered a JCT case, *i.e.*, Form 1041, Form 990-T, Form 990-PF, Form 709, and Form 706.

W&I Division SP function employees who receive the paper-filed returns review the returns for "unusual credits" *****2*****. When such returns are identified, that return is coded with a Computer Condition Code "N."²⁵ IRS procedures identify only four different unusual credits that employees have to look for in order to determine if the return is a potential JCT case, which are:²⁶

- The LB&I Division Workflow Coordination and Liaison group then runs a report to identify all the Computer Condition Code "N" returns and reviews the returns to ensure that they meet the "unusual credit" criteria listed in the procedures. All returns that meet these criteria are then

²⁷ These four credits are listed in IRM 3.11.16.8.1.14 (Jan. 1, 2020). Note: For the first and fourth credits listed, the line numbers in the IRM are incorrect; the correct information is previously stated. The IRS is aware of this problem and will be correcting the IRM. Additionally, IRS Office of Chief Counsel believes the fourth credit is a duplicate of the second credit.



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selected for examination. In these cases, it does not matter what the refund amount is on the return. In these potential JCT cases, the IRS is only looking for the four credits listed in the procedures *****2*****

According to the Workflow Coordination and Liaison group, there are only 10 to 12 Form 1120 returns per year identified by following this criteria, and it is more often only two or three returns a year. Further, the Workflow Coordination and Liaison group stated that the reciprocal tax paid is the only unusual credit that has ever been identified as part of the JCR process; they have never identified any of the other unusual credits listed in the procedures.

As part of our review, we identified 191 tax modules that are part of the Form 1120 series (MFT 02) that exceeded the refund dollar criteria of I.R.C. § 6405(a) but were not referred to or selected for examination in which the refunds all appear to be the result of originally filed returns.²⁸ Of these 191 tax modules, we identified 105 that included refundable credits *****2***** These returns are not legally required to be sent to the JCT for review due to the Treasury Regulation. However, these refund claims are significant and may warrant additional IRS attention.

Originally filed Forms 1040

Although the Treasury Regulations appear to significantly limit the original tax returns with high-dollar refunds that are subject to JCT review, the IRS has internal procedures for identifying original Forms 1040 for potential JCT review. However, as written, these procedures do not appear to relate to I.R.C. § 6405. Internal Revenue Manual (IRM) 3.11.3.6.2.14 takes into consideration only the tax liability and various tax credits (as opposed to the total amount of the refund claim) on the originally filed Forms 1040 in order to determine if it is a potential JCT case. W&I Division SP function employees receiving paper-filed Form 1040 returns are instructed to route the return to the Small Business/Self-Employed (SB/SE) Division Examination function as a potential JCT case if the original tax liability for Tax Year 2019 on line 12a, Form 1040 is *****2***** and the total credit amount reported on line 13b, Form 1040 is *****2***** **2**.²⁹ Given that the amount of tax liability has no apparent connection to I.R.C. § 6405, we asked the IRS the origins of these criteria. Even though IRM procedures were last updated in January 2020, the IRS was unable to explain how these criteria came to be or how they relate to JCT cases.

We asked the IRS if the reason these tax returns are singled out is they reflect more compliance risk than other tax returns that are not required to be examined and sent to the JCT, and the IRS responded that this was not the case. Neither I.R.C. § 6405 nor Treasury Regulation § 301.6402-4 requires the IRS to take into consideration the tax liability and different credit amounts identified in these procedures when identifying refunds as being subject to JCT review.

²⁸ Our data analysis was based on the information that is captured in IRS Master File transaction codes, and it is possible for a transaction to be input or coded incorrectly. We did not review copies of the actual tax returns to verify this information.

²⁹ Line 11a is all tax, except for any amount from Schedule 2 (Schedule 2 tax is listed on 11b). Line 12 is the sum of 12a (child tax credit/credit for other dependents) and 12b (nonrefundable credits listed on Schedule 3). IRM 3.11.3.6.2.14 (Jan. 14, 2020). This IRM is updated yearly prior to tax season, and the tax years and/or line numbers are updated as needed at that time. After the W&I Division SP function sends the return to the SB/SE Division Examination function, the Examination function is then supposed to tell the W&I Division SP function if the Form 1040 original return is in fact a "Joint Committee Return," at which point SP function employees would code the return with Computer Condition Code "O" and Audit Code "L."



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The IRS is unable to confirm with any certainty that the JCT ever requested to review these types of refunds prior to issuance.

While the IRS is unaware of the previous rationale for the reporting of these criteria, compliance risk is not a factor in determining whether a refund is subject to JCT review. According to the W&I Division SP function, they do not develop criteria to identify potential JCT cases themselves; their job is to identify only the returns that meet the criteria that the business operating divisions (SB/SE and LB&I Divisions) provide. However, SB/SE and LB&I Division management do not know where the criteria comes from and have not reevaluated it. The Office of Chief Counsel responded that these criteria likely came from the JCT, or in collaboration with the JCT, and stated that these are “long-standing procedures” and “we have never had any complaints from the JCT.” However, in conversations with JCT staff, we were informed that the JCT is not the source of the Form 1040 procedures.

We also asked the SB/SE Division Examination function Exam Case Selection group what their process and procedures are for reviewing these cases and informing the W&I Division SP function if the return is “Joint Committee Return” and were told: “We have no indication that an original Joint Committee Return has been routed to SB/SE so there are no separate procedures for this.” As part of our review, we identified 1,205 tax modules that are part of the Form 1040 series (MFT 30) that were not referred to or selected for examination in which the refunds all appear to be the result of originally filed returns. The refunds we identified are not legally required to be reviewed by the JCT because of the previously cited Treasury Regulation. However, it is unclear why the IRS has these seemingly irrelevant IRM criteria in place, the origins of which the IRS cannot explain, to refer some original Form 1040 returns to examination as potential JCT cases because the returns identified by these criteria are not legally required to be reviewed by the JCT.

Management Action: After we brought it to management’s attention that the criteria are not reasonably related to I.R.C. § 6405, and the origins or the rationale for it cannot be explained, the W&I Division SP function eliminated IRM 3.11.3.6.2.14, *Joint Committee Return*.

We identified 1,664 tax modules that were not referred to or selected for examination that contained high-dollar refunds.

The IRS’s internal process for identifying returns for JCT review is not designed to look at risky, high-dollar refund returns. The process does not identify returns with credits or deductions that have been found to have a significant risk of improper use. I.R.C. § 6405 does not serve as an overall check on the validity of refunds above the \$2 million and \$5 million criteria contained in the statute. Treasury Regulation § 301.6402-4 and the existing IRS criteria for identifying returns for examination limit the usefulness of this process to serve that purpose.³⁰ Additionally, the IRS has no other high-dollar refund compliance program in place to specifically examine refunds that may not fall under I.R.C. § 6405 despite meeting the dollar criteria.³¹

³⁰ IRS management stated that any change to the application of I.R.C. § 6405 in determining what returns should be sent to the JCT would need to be approved by the JCT.

³¹ The IRS does have programs that target identity theft, refund schemes, and excessive withholding that could potentially include high-dollar refund returns; however, none of these programs contain a dollar criteria or specifically look at high-dollar refunds. Additionally, the IRS has procedures in place that require all Business Master File refunds *****2***** to be reviewed by the Examination function; however, this dollar amount is much higher than the dollar criteria in I.R.C. § 6405.



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In our review of the 4,443 tax modules that were not sent to the JCT, but that had at least one refund in excess of \$2 million (\$5 million for C corporations), we found 1,664 tax modules that were not referred to or selected for examination in which the refunds all appear to be the result of originally filed returns. The existing criteria to select original returns for examination based strictly on the potential need for JCT review would not identify these returns. Therefore, the returns on these modules would have to be selected for examination based on other case selection criteria (for example, other types of special projects or the traditional means of scoring returns for audit: the Discriminant Function and the Discriminate Analysis System).³²

Even though the 1,664 tax modules that were not referred to or selected for examination are not required to be reviewed by the JCT because of Treasury Regulation § 301.6402-4, these returns represent a compliance risk to tax administration given the large refunds that are claimed. It is important that the IRS evaluate the compliance risk and the potential revenue from examining large refund returns. Performing such an evaluation could result in a significant compliance and revenue benefit. For perspective, Figure 2 includes information about the results of IRS examinations that occurred during Fiscal Year 2018 for five of the types of returns that are included in our population.

Figure 2: Fiscal Year 2018 Examination Results³³

Type of Return	Number of Field Exams in FY 2018	Percentage of No-Change Exams	Number of No-Change Exams	Percentage Resulting in Refund	Number Resulting in Refund	Percentage Resulting in Additional Tax Assessed	Number Resulting in Additional Tax Assessed	Average Recommended Additional Tax Per Return
Form 1040 Returns with total positive income of \$1,000,000 or more	10,671	17%	1,814	20%	2,106	63%	6,751	\$143,062
Form 1120 Corporation income tax returns (except Form 1120-S)	15,747	32%	5,039	10%	1,519	58%	9,189	\$881,203
Form 1041 Estate and trust income tax returns	764	6%	46	20%	156	74%	562	\$9,990
Form 706 Estate tax returns	2,898	19%	551	20%	578	61%	1,769	\$532,542
Form 709 Gift tax returns	2,090	30%	627	1%	28	69%	1,435	\$222,338

Source: Treasury Inspector General for Tax Administration analysis of the Fiscal Year 2018 IRS Data Book Table 9a, Table 9b, and Table 12.

The 1,664 tax modules are in the same categories as shown in Figure 2. They include: 191 modules in MFT 02 (Form 1120), 1,205 modules in MFT 30 (Form 1040), 222 modules in MFT 05 (Form 1041), five modules in MFT 52 (Form 706), and three modules in MFT 51 (Form 709).³⁴ Without additional efforts by the IRS in this area, it is not possible to project with any certainty the compliance risk presented by the 1,664 tax returns. If the 1,664 modules have the same level of compliance risk as those that have been examined, approximately \$210 million of

³² The Discriminant Function and Discriminant Analysis System are methods for selecting returns for examination based on the use of an algorithm. The Discriminant Function is used by the SB/SE Division, and the Discriminant Analysis System is used by the LB&I Division.

³³ The numbers and/or percentages within Figure 2 may not compute exactly as shown due to rounding.

³⁴ There were additionally 38 modules in MFTs 34 and 44 pertaining to exempt organizations and private foundations included in the 1,664 tax modules.



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additional tax could potentially be assessed if those modules were examined.³⁵ Tax returns that are examined can be selected using a variety of methods, *e.g.*, risk-based scoring methods, as part of Compliance Initiative Projects. Given that the IRS's audit rate for individual returns (Form 1040) has dipped below less than one-half of 1 percent,³⁶ the IRS should reexamine whether taxpayers claiming large-dollar refunds (in excess of \$2 million or \$5 million for C corporations) on original returns warrant the IRS's additional attention.

The existing procedures for identifying potential JCT cases and forwarding such cases to the Examination functions are not always being followed

Not all cases that meet the IRS's existing JCT case criteria are being sent to the Examination functions to be examined and sent to the JCT. Therefore, the IRS is not always in compliance with I.R.C. § 6405.

In our review of the 4,443 tax modules that were not sent to the JCT, but that had at least one refund in excess of \$2 million (\$5 million for C corporations), we identified 799 tax modules containing a net operating loss carryback. Net operating loss carrybacks are required to be reported to the JCT for review under I.R.C. § 6405(b).³⁷ These carrybacks are handled differently than other JCT cases in that the refund is paid out to the taxpayer first, then the case is examined or surveyed. If at the conclusion of the examination the refund amount is still over the dollar criteria in I.R.C. § 6405, it is at that point sent to the JCT for review. The majority of the 799 tax modules were either waiting to be examined, in the process of being examined, or were examined and the carryback amount was lowered below JCT dollar criteria. However, we found:

- 47 carrybacks that the W&I Division AM function failed to refer to the Examination functions, and therefore they were not examined, surveyed after assignment, or sent to the JCT.
- 18 carrybacks for which the W&I Division AM function was unable to determine if they were properly referred to the Examination functions.

When these carrybacks were brought to the AM function's attention, they took immediate corrective action.

Management Action: The W&I Division AM function added a reminder to IRM 21.5.9.4.7(7) to follow established guidance for forwarding tentative applications fitting JCT criteria to CAT-A when the tentative application has been push coded awaiting the posting of the loss year return. In addition, an alert was issued to remind the carryback assistants to forward all cases fitting JCT criteria to CAT-A, and applicable sites were notified of the cases that were not properly forwarded.

³⁵ We multiplied the number of each module for each return type with the corresponding percentage resulting in additional tax assessed from Figure 2, and then applied the average recommended additional tax per return in order to calculate this figure.

³⁶ Internal Revenue Service Progress Update, Fiscal Year 2019, Putting Taxpayers First, p. 25.

³⁷ I.R.C. § 6405(b) requires: "Any credit or refund allowed or made under section 6411 shall be made without regard to the provisions of subsection (a) of this section. In any such case, if the credit or refund, reduced by any deficiency in such tax thereafter assessed and by deficiencies in any other tax resulting from adjustments reflected in the determination of the credit or refund, is in excess of \$2,000,000 (\$5,000,000 in the case of a C corporation), there shall be submitted to such committee a report containing the matter specified in subsection (a) at such time after the making of the credit or refund as the Secretary shall determine the correct amount of the tax."



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We also reviewed the remaining 3,644 tax modules (4,443 minus 799) without a carryback and identified 27 tax modules containing amended returns that were not examined, surveyed after assignment, or sent to the JCT despite meeting JCT CAT-A case criteria. For the majority of these cases, management indicated that they were not properly referred to the Examination functions as JCT CAT-A cases. The IRS has not indicated whether any type of corrective action has been taken.

The Commissioners, LB&I and SB/SE Divisions, should:

Recommendation 1: Assess the compliance risk of the large-dollar original return refund claims that exceed I.R.C. § 6405 dollar criteria that are not required to be examined and are not subject to the JCT review process due to Treasury Regulation § 301.6402-4(a), relative to other tax returns, and allocate examination resources accordingly.

Management's Response: The IRS disagreed with this recommendation. Management responded that their compliance work is aimed at identifying and addressing noncompliance (and thereby ensuring that taxpayers pay the correct amount of tax), and they allocate their examination resources in a manner that is balanced across all compliance programs and which account for resource constraints and organizational goals and priorities. In general, the size of a refund by itself is not solely determinative of whether there is or is not noncompliance. Indeed, taxpayers often make overpayments to minimize the risk of estimated tax penalties.

Original returns are scored for risk utilizing objective algorithms such as the Discriminant Function and the Discriminate Analysis System. As part of the risking calculus to identify noncompliance, the Discriminant Function and the Discriminate Analysis System (as well as the RAs) consider large, unusual, and questionable items - which are items on a tax return that appear to create the largest risk of noncompliance. Further, the IRM sets out a manual review process for refunds exceeding a specified amount.

Office of Audit Comment: The intent of this recommendation was to ensure that refunds that are not legally required to go to the JCT, but meet the large refund threshold, are effectively assessed for compliance risk. Of the 4,443 tax modules we identified that were not sent to the JCT, but that had at least one refund in excess of \$2 million (\$5 million for C corporations), we found 1,664 tax modules that were not referred to or selected for examination in which the refunds all appear to be the result of originally filed returns. The existing criteria to select original returns for examination based strictly on the potential need for JCT review would not identify these returns, and they were not identified through the IRS's algorithms. In addition, the IRS has procedures in place that require all Business Master File refunds *****2***** to be reviewed by the Examination function; however, this dollar amount is much higher than the dollar criteria in I.R.C. § 6405. Given the number of cases with large dollar refunds and the IRS's decreasing audit rates (currently less than ½ percent for individual returns), we believe the IRS should reexamine whether taxpayers claiming large-dollar refunds (in excess of \$2 million or \$5 million for C corporations) on original returns warrant additional attention.



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Recommendation 2: Take additional corrective actions on the carryback and amended return cases that were not examined or sent to the JCT for review as legally required to ensure that they are sent to the JCT.

Management's Response: The IRS agreed with this recommendation. For cases in which the statute of limitations remains open, the IRS will coordinate with the JCT to determine the appropriate approach for these returns.

The Examination Functions Are Not Ensuring That All Cases Are Sent to the Joint Committee on Taxation When Required

Once a return is sent to the Examination functions as a potential JCT case, it goes through the classification process. A classifier's job is to look at the return to ensure that it warrants examination. Classifiers have the option to either accept the return as filed (meaning it will not be examined) or select the return for examination. Both LB&I and SB/SE Division classifiers have told us that if they receive a CAT-A return that meets JCT case criteria, they are not allowed to accept the return as filed. All of the JCT CAT-A cases must be sent to be worked by an RA, and only the RA is allowed to survey the case without an examination (and in those instances, a JCT report is still completed and the refund information is sent to the JCT). Therefore, all JCT CAT-A referrals should be selected by classifiers and either examined or surveyed after assignment.

In our review of the 799 tax modules containing a carryback, which were found in the population of 4,443 tax modules that were not sent to the JCT, but had at least one refund in excess of \$2 million (\$5 million for C corporations), we identified 11 instances in which the W&I Division AM function properly referred the case to the Examination functions as meeting JCT CAT-A criteria, but the classifier accepted the return as filed. Therefore, these 11 carrybacks were not examined and were not sent to the JCT as required under I.R.C. § 6405(b).

Examination teams are responsible for identifying all JCT cases in their inventory, whether based on the return information in the case as submitted or when the case qualifies for JCT review as the result of an examination. The examination team must ensure that all returns in the case file are labeled with the project code 0077 to indicate that it is a JCT case.³⁸ Examination cases in project code 0077 are allowed to be surveyed only after assignment or examined, and all must go to the JCT. If during the course of an examination the RA determines a case is no longer a JCT case, the RA is to remove project code 0077 and put the case into a different project code, if another one is applicable. Project code 0077 takes precedence over other project codes that may be applicable to the case.

However, in our review of the population of 4,443 tax modules that were not sent to the JCT, but that had at least one refund in excess of \$2 million (\$5 million for C corporations), we identified 67 tax modules with an open examination that were potential JCT cases but not coded 0077 as required. When these were brought to the IRS's attention, the examination team updated the code in most cases. We additionally identified three tax modules with project code 0077 that were surveyed but not sent to the JCT for review. IRS management informed us that these cases were incorrectly coded with project code 0077 and did not actually meet the criteria for a JCT review.

³⁸ IRM 4.36.3.2.1 (Sept. 22, 2015).



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IRS management knows how many potential JCT cases are currently in the Examination functions' inventories by querying for the project code 0077, and they currently have no other way to make that determination. When JCT cases do not have the project code 0077, IRS management does not know how many potential JCT cases are in their inventory. Therefore, when cases are not properly coded, it affects the reliability of the inventory numbers, as well as the IRS's ability to comply with I.R.C. § 6405. The amount JCT inventory affects the resource needs of the JCR team and, if that information is accurate, it can be used by the JCR team for planning purposes.

During our conversations with IRS management about these cases, there was a difference of opinion between the LB&I and SB/SE Divisions as to whether the JCT project code took precedence over other codes that could be applicable to the examination. LB&I Division management was adamant that it does, whereas SB/SE Division management believed otherwise. While we later received written clarification that the 0077 project code does take precedence over other codes, this is not clearly stated within IRS procedures.

The RA working the case is responsible for determining whether a case falls under the JCT's jurisdiction. The fact that a return or examination must be reported to the JCT does not alter the nature of the examination that may be conducted, nor does it limit the RA's ability to survey the return if this action is deemed appropriate.³⁹ JCT cases may be surveyed after assignment if the returns would normally have been surveyed before or after assignment during a regular examination except for the fact that the returns require JCT review.⁴⁰ The examination team can survey some or all of the returns, but must still refer the case to the JCR team to be sent to the JCT.

It is the responsibility of the examination team to determine if, at the conclusion of the examination, a case meets JCT criteria and ensure that the case is forwarded to the JCR team to send to the JCT. In order to send a case to the JCR team, the Joint Committee Electronic Referral form is required to be prepared and submitted by the examination team.⁴¹ Therefore, the only way that the JCR team can send a case to the JCT is if it is first referred to them by the examination team.

In our review of the population of 4,443 tax modules that were not sent to the JCT, but that had at least one refund in excess of \$2 million (\$5 million for C corporations), we identified:

- 28 tax modules meeting JCT review criteria that were not examined or surveyed after assignment, and therefore not sent to the JCT for review even though they were properly referred to the Examination functions, and properly selected for examination by the classifiers.
- 47 tax modules meeting JCT review criteria that were examined, but the RA failed to refer the case to the JCR team at the conclusion of the examination; therefore, the case was not sent to the JCT for review.⁴²
- 8 tax modules that were examined or surveyed after assignment for which the IRS indicated that the refund was not required to be reported to the JCT because it is due to

³⁹ IRM 4.36.1.4 (Sept. 21, 2015).

⁴⁰ IRM 4.36.3.4 (Sept. 22, 2015).

⁴¹ IRM 4.36.3.3.1 (Sept. 22, 2015).

⁴² For eight of these 47 tax modules, the IRS did not agree that these cases met JCT criteria; however, the IRS failed to provide us with a sufficient explanation for its position.



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a refundable credit. It is unclear whether Treasury Regulation § 6402-4(a) requires reporting in this situation.

Not all cases that meet JCT criteria are being examined and sent to the JCT; therefore, the IRS is not always in compliance with I.R.C. § 6405. This is likely due to the lack of oversight for the overall process. There is no group or function in the IRS with program oversight of the process as a whole, running reports, or checking the Examination functions' inventories to ensure that all the returns are being properly sent to the JCT. We questioned IRS management as to whether there is any person or group that ensures returns are being sent to the JCT when required and provides any type of oversight of the whole process, and we were told that the responsibility falls on the Examination functions' teams. There is no one providing overall program oversight of the entire process.

Recommendation 3: The Commissioner, LB&I Division, should assign oversight responsibilities to a specific group or function for the overall JCT process to ensure that cases are sent to the JCT when required and procedures (such as placing the correct project code on the exam) are being followed.

Management's Response: The IRS agreed with this recommendation. The IRS's JCR Program is tasked with oversight responsibility for the preparation of cases that are subject to JCT review. The JCR is in the process of reviewing and updating the Joint Committee procedures outlined in the IRM to strengthen the controls over the process for identifying and submitting returns to the JCT.

Recommendation 4: The Commissioners, SB/SE and LB&I Divisions, should take corrective actions on all cases that were legally required to go to the JCT for review but did not to ensure that they are sent to the JCT for review.

Management's Response: The IRS agreed with this recommendation. For cases in which the statute of limitations remains open, the IRS will coordinate with the JCT to determine the appropriate approach for these returns.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the effectiveness of the IRS's efforts to examine returns with refunds in excess of \$2 million (\$5 million for C corporations) and report to the JCT on such refunds. To accomplish this objective, we:

- Identified IRS procedures, processes, and reports related to I.R.C. § 6405 and JCT cases.
 - Researched and reviewed applicable IRM sections.
 - Interviewed W&I, LB&I, and SB/SE Divisions' employees to learn about their role as it pertains to JCT cases.
 - Researched the extent of IRS-wide oversight of the process to ensure that all cases are properly being sent to the JCT.
 - Determined what types of refunds are sent to the JCT based on the criteria in I.R.C. § 6405. This included interviews with both IRS Office of Chief Counsel and the LB&I Division's JCR team to discuss their interpretation of the law, as well as what types of refunds are currently being reported to the JCT as per current IRS procedures.
- Determined if all returns meeting the criteria in I.R.C. § 6405 are sent to the JCT, and identified the various scenarios/reasons that exist as to why certain returns are not sent to the JCT.
 - Completed data analysis on the population of tax modules that contain at least one refund that posted to the module during Fiscal Years 2016, 2017, or 2018 that meets the dollar criteria of I.R.C. § 6405 to determine if the IRS properly examined and reported the refunds to the JCT, when required.
 - Discussed refunds that were not sent to the JCT with IRS management to obtain their input as to whether they should have been sent and the reason why they were not sent.

Performance of This Review

This review was performed with information obtained from the IRS National Headquarters located in Washington, D.C., and at the Philadelphia, Pennsylvania, and Ogden, Utah, campuses in the LB&I, SB/SE, and W&I Divisions during the period September 2018 through January 2020. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Mathew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Phyllis Heald London, Director; Richard Viscusi, Audit Manager; Nicole DeBernardi, Lead Auditor; and Jon-Michael Socaris, Senior Auditor.



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Validity and Reliability of Data From Computer-Based Systems

We performed tests to assess the reliability of data obtained from various tables on the Treasury Inspector General for Tax Administration's Data Center Warehouse (the Individual and Business Master Files, the Audit Information Management System, and the Appeals Centralized Database System), and data provided to us from the JCR team for this review. We evaluated the data by running queries on the population to ensure that the data met our criteria and no information was missing or incomplete, and discussed the data with knowledgeable agency officials. We determined that the data were sufficiently reliable and could be used to meet the objective of this audit.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the W&I, LB&I, and SB/SE Divisions' policies, procedures, and practices related to ensuring that returns with refunds meeting JCT review criteria are properly identified and referred to the Examination functions, selected for examination, and referred to the JCR team to be sent to the JCT. We evaluated these controls by interviewing IRS management and employees in all three Divisions, as well as conducting data analysis.



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Appendix II

Management's Response to the Draft Report



COMMISSIONER
LARGE BUSINESS AND
INTERNATIONAL DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

May 14, 2020

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT
MICHAEL E. McKENNEY

FROM:

Douglas W. O'Donnell 
Commissioner, Large Business and International Division

SUBJECT:

Draft Audit Report – Large Dollar Refunds Are Not Always Examined and Sent to the Joint Committee on Taxation (Audit # 2018-30-038)

Thank you for the opportunity to review and comment on the draft report referenced above. Section 6405 of the Code provides the Joint Committee on Taxation (JCT) with a pre-refund review mechanism (6405(a)) and a post-refund review mechanism (6405(b)) for certain types of refunds issued by the IRS. Both review mechanisms enable JCT to evaluate whether provisions of the tax law operate as intended.

In general, Section 6405(a) provides JCT with oversight (as opposed to approval) authority over certain refunds of income, estate and gift taxes, and certain excise taxes in excess of \$5,000,000 for C Corporations and \$2,000,000 for all other cases. Section 6405(b) deals with credits or refunds, in excess of these same dollar thresholds, but related to tentative carryback and refund adjustments. The regulations under Section 6405 set forth the scope for the provision, as well as the exceptions to the JCT review.

The draft report notes that the Treasury regulations limit the number of returns subject to JCT review and implies that high dollar refunds equate to high risk and that, outside of the JCT review process, the IRS does not have a process to assess that compliance risk. We note, however, that Treasury regulations interpret the statutory provisions within the Code and are the result of a formal rulemaking process with opportunity for public comment. Moreover, the totality of our compliance work is aimed at identifying and addressing noncompliance (and thereby, ensuring that taxpayers pay the correct amount of tax). In general, the size of a refund by itself is not solely determinative of whether there is or isn't noncompliance. Indeed, taxpayers often make overpayments to minimize the risk of estimated tax penalties.

Original returns are scored for risk utilizing objective algorithms such as the Discriminant Function (DIF) and the Discriminate Analysis System (DAS). As part of the



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risking calculus to identify noncompliance, DIF and DAS (as well as IRS revenue agents) consider large, unusual, and questionable items – which are items on a tax return that appear to create the largest risk of noncompliance. Further, the IRM sets out a manual review process for refunds exceeding a specified amount.

We appreciate TIGTA's thorough review of our Joint Committee Review (JCR) Program, and some of your recommendations support our efforts to further strengthen our processes. We are currently working on updates to the Internal Revenue Manual, as well as enhancing our inventory management system to strengthen the monitoring of JCR cases. Also, with the recent passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, we are mindful of the potential for increase in refunds subject to the JCT review process and are focused on whether we can streamline IRS processes to expedite the timeframes.

Attached is a detailed response outlining the corrective actions that the LB&I Division will take to address your recommendations. If you have any questions, please contact me, or members of your staff may contact Barbara Harris, Director, Northeastern Compliance Practice Area, at 212-298-2048.

Attachment



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RECOMMENDATION 1:

The Commissioners, LB&I and SB/SE Divisions, should assess the compliance risk of the large-dollar original return refund claims that exceed I.R.C. § 6405's dollar criteria that are not required to be examined and are not subject to the JCT review process due to Treasury Regulation § 301.6402-4(a), relative to other tax returns, and allocate examination resources accordingly.

CORRECTIVE ACTIONS:

Our compliance work is aimed at identifying and addressing noncompliance (and thereby ensuring that taxpayers pay the correct amount of tax), and we allocate our examination resources in a manner that is balanced across all compliance programs and which accounts for resource constraints and organizational goals and priorities. In general, the size of a refund by itself is not solely determinative of whether there is or isn't noncompliance. Indeed, taxpayers often make overpayments to minimize the risk of estimated tax penalties.

Original returns are scored for risk utilizing objective algorithms such as the Discriminant Function (DIF) and the Discriminate Analysis System (DAS). As part of the risking calculus to identify noncompliance, DIF and DAS (as well as revenue agents) consider large, unusual, and questionable items – which are items on a tax return that appear to create the largest risk of noncompliance. Further, the IRM sets out a manual review process for refunds exceeding a specified amount.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL(S):

N/A

CORRECTIVE ACTION(S) MONITORING PLAN:

N/A

RECOMMENDATION 2:

The Commissioners, LB&I and SB/SE Divisions, should take additional corrective actions on the carryback and amended return cases that were not examined or sent to the JCT for review as legally required to ensure that they are sent to the JCT.

CORRECTIVE ACTIONS:

For cases where the statute of limitations remains open, we will coordinate with JCT to determine the appropriate approach for these returns.

IMPLEMENTATION DATE:

February 15, 2021

RESPONSIBLE OFFICIAL(S):

Director, LB&I, Northeastern Compliance Practice Area.



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CORRECTIVE ACTION(S) MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3:

The Commissioner, LB&I Division, should assign oversight responsibilities to a specific group or function for the overall JCT process to ensure that cases are sent to the JCT when required and procedures (such as placing the correct project code on the exam) are being followed.

CORRECTIVE ACTIONS:

The IRS' Joint Committee Review (JCR) Program is tasked with oversight responsibility for the preparation of cases that are subject to JCT review. JCR is in the process of reviewing and updating the Joint Committee procedures outlined in the Internal Revenue Manual, to strengthen the controls over the process for identifying and submitting returns to JCT.

IMPLEMENTATION DATE:

February 15, 2021

RESPONSIBLE OFFICIAL(S):

Director, LB&I, Northeastern Compliance Practice Area

CORRECTIVE ACTION(S) MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4:

The Commissioners, SB/SE and LB&I Divisions, should take corrective actions on all cases that were legally required to go to the JCT for review but did not to ensure that they are sent to the JCT for review.

CORRECTIVE ACTIONS:

For cases where the statute of limitations remains open, we will coordinate with JCT to determine the appropriate approach for these returns.

IMPLEMENTATION DATE:

February 15, 2021

RESPONSIBLE OFFICIAL(S):

Director, LB&I, Northeastern Compliance Practice Area.

CORRECTIVE ACTION(S) MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.



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Appendix III

Glossary of Terms

Term	Definition
Accounts Management	The organization within the W&I Division responsible for taxpayer relations by answering tax law/account inquiries and adjusting tax accounts. In addition, it is responsible for providing taxpayers with information on the status of their returns/refunds and for resolving the majority of issues and questions to settle their accounts.
Appeals Centralized Database System	An application used by employees in the Office of Appeals to create, maintain, and close an Appeals case inventory item throughout its lifecycle.
Audit Information Management System	A computer system used by IRS Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Data Book	The Data Book (or IRS Data Book) is published annually by the IRS and contains statistical tables and organizational information on a fiscal year basis. It provides information on activities conducted by the IRS such as taxes collected, enforcement, taxpayer assistance, budget, workforce, and other selected activities.
Data Center Warehouse	An online database maintained by the Treasury Inspector General for Tax Administration. The Data Center Warehouse pulls data from IRS system resources, such as IRS Collection files and IRS Examination files, for Treasury Inspector General for Tax Administration access.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Internal Revenue Code	The codified collection of U.S. laws on income, estate and gift, employment, and excise taxes plus administrative and procedural provisions.
Internal Revenue Manual	The primary, official source of instructions to staff relating to the organization, administration, and operation of the IRS.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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Project Code	Project codes are four-digit codes used on the Audit Information Management System to identify a special program to which an examination belongs.
Revenue Agent	Employees in the Examination functions that conduct face-to-face examinations of more complex tax returns such as businesses, partnerships, corporations, and specialty taxes, <i>e.g.</i> , excise tax returns.
Small Business/Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Submission Processing	The data processing arm of the IRS. The sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Tax Period	Refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Appendix IV

Abbreviations

AM	Accounts Management
CAT-A	Category-A
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
JCR	Joint Committee Review
JCT	Joint Committee on Taxation
LB&I	Large Business and International
MFT	Master File Tax
RA	Revenue Agent
SB/SE	Small Business/Self-Employed
SP	Submission Processing
W&I	Wage and Investment