

Filing a Claim for Refund of Overpaid Tax

By Kevin M. Flynn

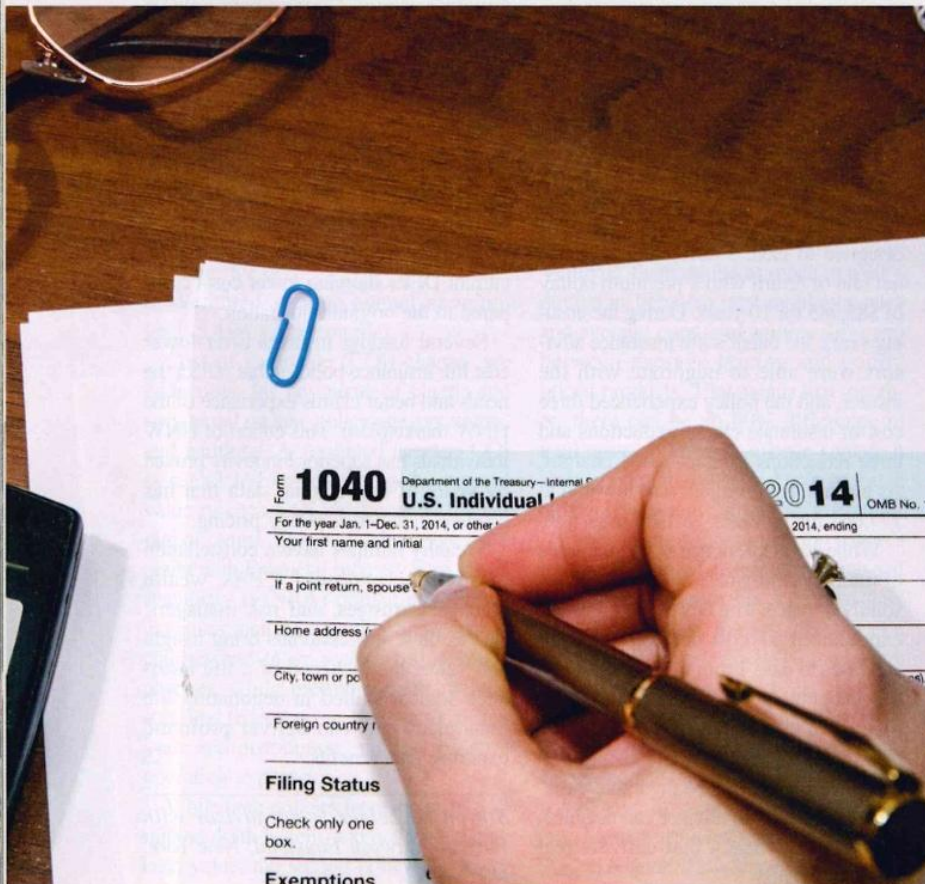
Filing a claim for refund of overpaid tax involves much more than just submitting an amended return to the IRS with an explanatory statement that more than the correct amount of tax was paid. The refund claim, if denied, will form the basis of any suit for a refund commenced in a federal district court or the U.S. Court of Federal Claims. In

such litigation, the sufficiency of the refund claim will be tested, and a professional may find out too late that more care should have been used in preparing the claim.

Mechanics of the Claim

Under Internal Revenue Code (IRC) section 6511(a), a claim for refund of an overpayment of any tax must be filed within three years from the time the return in question was filed or within two years from the date the tax was paid, whichever is later. The amount of overpaid tax refundable under IRC section 6511(b) is limited to the portion of the tax paid during the three-year period immediately preceding the claim, plus any extension of time for filing the return. If the claim is filed after the three-year period, the refund is limited to the portion of tax paid in the two years immediately preceding the claim.

Claims for refund of individual and corporation income tax must be filed on Forms 1040X and 1120X, respectively. Claims for refund of employment tax should be filed on Form 941-X. The IRS provides forms for refund claims of other types of taxes, but if no specific form exists, the claim should be filed on Form 843. The claim should include a computation of the overpaid tax, unless the practitioner is only filing a “protective” claim, where the amount of the refund is unascertainable on the date that the claim is filed. It is also advisable to include a statement with the claim that



the taxpayer is entitled to interest “as provided by law” on the principal amount of the tax overpayment.

Grounds for the Claim

The heart of the claim for refund is the statement of the legal and factual bases supporting the claim. This statement takes on critical significance because a refund suit, if one ensues, must be premised on the same reasons contained in the claim. It should be viewed like a legal pleading filed in court, but one that cannot be amended after the statute of limitations for filing the claim has expired.

Treasury Regulations section 301.6402-2(b)(1) makes clear the importance of an accurate and comprehensive description of the grounds and supporting facts for the claim: “No refund ... will be allowed after the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a ... refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund.”

Under the regulations, the grounds for the refund contained in the claim are the legal bases for the claim. For example, a refund claim involving a foreign currency loss might state that the taxpayer erroneously treated the loss from trading in a foreign currency as a capital loss instead of an ordinary loss. The facts the taxpayer relies on to support the basis for the claim—in this example, the taxpayer’s right to an ordinary loss—must be presented in sufficient detail to notify the IRS of the evidence relied upon by the taxpayer.

The “grounds” and “facts” elements of Treasury Regulations section 301.6404-2(b)(1), and the case law that interprets them, make clear that the burden is on the taxpayer to provide the IRS with sufficient notice of the bases for the claim so the IRS can investigate the claim on its merits. With this in mind, the facts should be complete and legal arguments should be presented to support the claim. The practitioner should also follow the holding in *U.S. v. Kales* [314 U.S. 186, 195-96 (1941)], which states that in some cases it is advisable to make alternative and even inconsistent arguments in the claim in order to adequately put the IRS on notice.

The Variance Doctrine

The “variance” or “substantial variance” doctrine is a judicially created rule that significantly limits a federal court’s jurisdiction in a refund suit, oftentimes to the surprise and heartache of a taxpayer. The doctrine provides that once the statute of limitations for filing a refund claim has expired, a taxpayer generally cannot assert grounds for a refund in court

that vary legally or factually from the administrative claim for refund filed by the taxpayer. As such, the doctrine trumps the general rule in federal courts that amendments to pleadings will be freely granted.

The purpose of the variance doctrine is to prevent surprise to the IRS and to ensure that the agency will not be forced to litigate an issue in court that it did not have an opportunity to audit at the administrative level. The operation of the variance rule is demonstrated in the case of *Cencast Services, L.P. v. U.S.* [729 F.3d 1352 (Fed. Cir. 2013)]. In *Cencast*, the company, a payroll service provider, filed a refund claim for an overpayment of employment taxes disputing which entity was the “common law employer” obligated to withhold and remit payroll taxes for a group of employees. At trial, *Cencast* also sought to argue that some of the workers in question were in fact independent contractors, and therefore no employment taxes were due on the payments made to them. The court rejected *Cencast*’s independent contractor argument under the variance doctrine and found that the status of the workers as independent contractors was outside the scope of the refund claim that the company had filed.

Amendment and Waiver

There are two important exceptions to the variance doctrine. The first is a rule that allows a taxpayer to amend a refund claim any time *before* it has been rejected by the IRS or the statute of limitations for filing the claim has expired. This commonly occurs when a new professional advisor takes over a case and raises a new theory for the refund or finds that the facts set forth in the claim should be supplemented.

The second exception, the waiver doctrine, can operate to cure an otherwise deficient claim. For example, if a taxpayer can prove that the IRS considered a ground that either the taxpayer or the IRS raised and that was not included within the refund claim, the waiver doctrine will apply. Under these circumstances, courts typically find that it would be unfair to allow the IRS to argue that the claim was incomplete when it actually examined the omitted issue on the merits.

Carefulness, Completeness, Success

Claim for refunds should be prepared with thoroughness and care. The grounds for the claim must be complete and the facts must be set forth in detail. The goal should be to put the IRS on notice of the bases for the refund, even if it means making alternative and inconsistent arguments. A refund claim prepared in this manner is likely to withstand any challenge by the IRS as to its sufficiency. □

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