Refunds of Tax "Paid Under Protest" and Other Tax Refunds

Prepared by Trina Griffin, Research Division Revenue Laws Study Committee October 3, 2006

Objectives

- □Overview of federal and State tax refund procedures
- ☐ Background of the protest rule
 - Legislative history
 - Judicial Interpretation
- □ Issues for consideration

Refund Procedures

Federal Law

- 1. Refund for overpayment
- 2. Civil action
- 3. Protective refund claim

NC Law

- 1. Refund for overpayment
- 2. Payment under protest
- 3. Protective refund claim

1. Refund for Overpayment

Statute of Limitations

- A refund claim must be filed within 3 years of the filing deadline, provided the return was filed before the due date.
- If the return was filed after the due date, a refund claim must be filed not later than 3 years from the time the return was actually filed, or 2 years from the date the tax was paid, whichever is later.
- If no return was filed, the claim must be filed within 2 years of the date of payment.

Form & Content of Claim

- Must meet the following requirements:
 - In writing.
 - Demands a refund.
 - States the amount of the claim.
 - Sets forth in detail each ground claimed by the taxpayer sufficient to apprise IRS of the claim.
 - Contains supporting facts or evidence.
 - Signed under oath or penalty of perjury.

Scope of Refund Request

- The IRS may reconsider the entire return.
- Does not authorize additional assessment barred by S/O/L



2. Civil Action

Prerequisites

- Must file refund claim with IRS and wait 6 months.
- Pay to play.
- Proper forum is U.S. District Court or the U.S. Court of Federal Claims.
- Must use same legal theory as set forth in refund claim.

Statute of Limitations

- Within 2 years from:
 - -notice of disallowance, OR
 - -the date the taxpayer waived notification of disallowance of claim.

3. Protective Refund Claim

Authorized by regulation

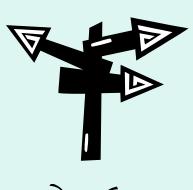
 Used when the right to refund is contingent on future events that may not be resolved until statute of limitations has expired

• File before expiration of the refund claim period.



Requirements

- 1. Must identify and describe the contingencies affecting the claim.
- 2. Must be sufficiently clear and definite to alert the IRS as to the essential nature of the claim.
- 3. Must identify specific year or years for which the refund is claimed.







Refund Procedures

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- **☑** Refund for overpayment
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1. Refund for Overpayment

(G.S. 105-266.1)

When is it used?

- Excessive
- Incorrect
- NOT for challenging legality of tax

What is the procedure?

(G.S. 105-266.1)



File amended return or written letter requesting refund

Statute of Limitations

- The later of the following:
 - -Within 3 years after the date for filing of return

OR

-Within 6 months after payment of tax

What is the procedure?

(G.S. 105-266.1)

STEP 1 Fi

File amended return or written letter requesting refund

STEP 2

Departmental review

STEP 3

Request for hearing

STEP 4

Hearing within 90 days

STEP 5

Within 90 days after notification of hearing decision, taxpayer may either:

- Petition for administrative review before the TRB
- Bring a civil action

STEP 6

Appeal

2. Payment Under Protest

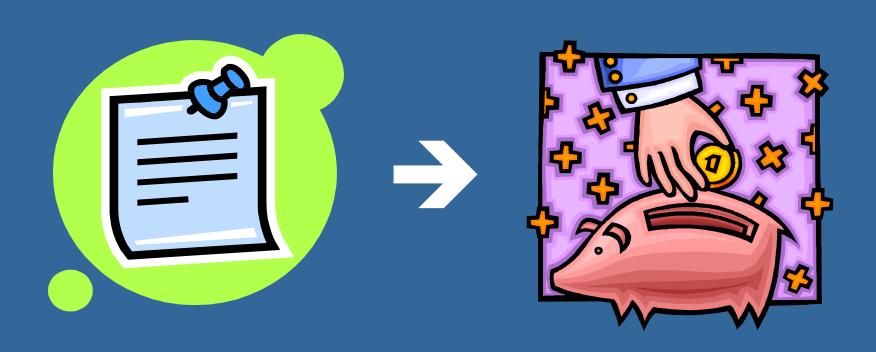
(G.S. 105-267)

- ✓When is it used?
- ✓ What is the purpose?
- ✓ What is the procedure?

When is it used?

- For overpayments or for challenging legality of tax.
- "If upon trial, it is determined that all or part of the tax was levied or assessed for an <u>illegal</u> or <u>unauthorized</u> purpose, or was for any reason <u>invalid</u> or <u>excessive</u>. . ."
- Statute does not mention "unconstitutional."

What is the purpose?



What is the procedure?



Written request within 3 years after payment of tax.

STEP 2

90-day waiting period.

STEP 3

Aggrieved taxpayer may file suit within 3 years after the expiration of the 90-day period.

Protective Refund Claim

• Requirements:

- Filed before the expiration of the statutory refund claim period.
- Identifies and describes the contingencies affecting the claim.
- Is sufficiently clear and definite to alert the Dept. as to the essential nature of the claim.
- Identifies the tax schedule and the specific year for which the protective claim is filed.

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 - Legislative history
 - Judicial interpretation
- □ Issues for consideration

Legislative History

- General Assembly first authorized the use of a tax injunction in 1865.
- Beginning in 1927, the statute has required that the taxpayer pay the tax prior to filing suit.
- For over 65 years, the statute of limitations was 30 days.
- 1996 = extended to 1 year
- 1999 = extended to 3 years

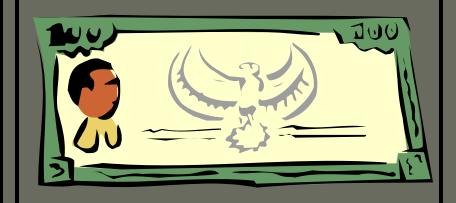
Judicial Interpretation

Bailey I & II and Swanson Taxation of State and local employee retirement benefits



Fulton and Smith

Taxation of intangibles



Bailey Background

State retirement income

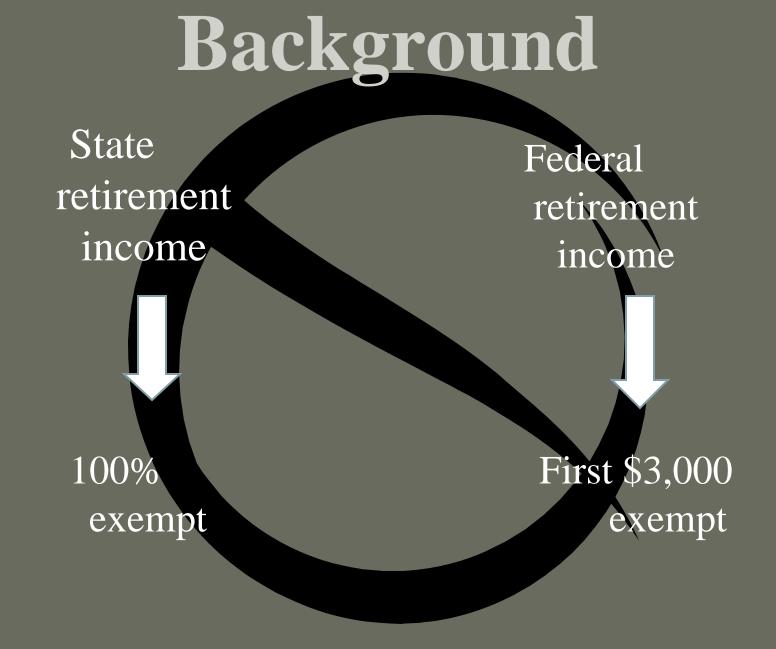


100% exempt

Federal retirement income



First \$3,000 exempt



Bailey I (1992)

- Plaintiffs =
 - State and local employees
 - Vested in retirement system prior to August 12, 1989 (effective date of act repealing 100% exemption)
 - Had not filed protest prior to lawsuit



CASE DISMISSED

Swanson (1994)



- <u>Swanson</u> plaintiffs =
 - Federal employees seeking refund of taxes paid on retirement benefits
 - "Class demand letter" filed under G.S. 105-267.



CASE DISMISSED

Bailey II Case (1998)

- Plaintiffs = State and local retirees who had each complied with protest requirements
- Result = UNCONSTITIONAL impairment of contract
- Remedy = Refunds for all State and local retirees who vested prior to Aug. 12, 1989, regardless of whether they filed protest.



Bailey II Case (1998)

- Holding While claims of illegal or improper taxation are subject to the procedural requirements of G.S. 105-267, it is only to the extent necessary to provide the State with the notice sufficient to protect fiscal stability.
- Two Justices dissented from the Court's analysis of G.S. 105-267.

Intangibles Tax Case

- NC imposed intangibles tax on ownership of corporate stock.
- "Taxable percentage deduction" Exemption for the proportion of stock equal to proportion of business conducted in NC.
- Fulton argued deduction violates Commerce Clause by discriminating against out-of-state companies.

Intangibles Tax Case

• 1996 = USSC held the intangibles tax was unconstitutional and remanded case to NC Supreme Court to "fashion a remedy."



- 1997 = NC Supreme Court severed deduction from law and left rest intact.
- 1997 = General Assembly passed 2 acts; one forgiving tax liability and one authorizing refunds.

Smith Case (1998)

• The Court held that the legislative act granting refunds only to those who had filed a timely protest violated the uniformity requirement of the North Carolina Constitution.

Where Are We After <u>Bailey II</u>?

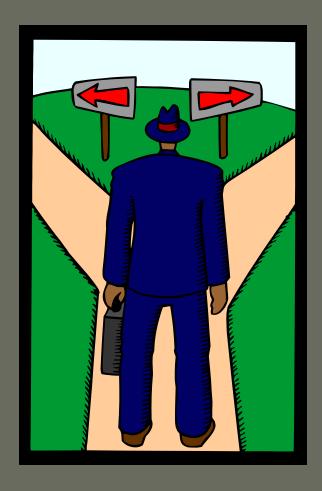
• Until 1998, the law was settled with regard to the validity of G.S. 105-267.



Where Are We After Bailey II?

VS.

The holding of Bailey II is limited to its unique set of facts.



The protest rule is dead

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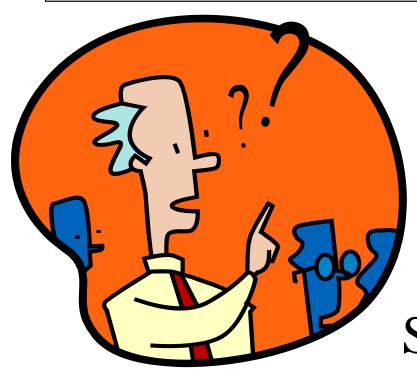
Issues for Consideration



Questions to Consider

- Does it serve the purpose for which it was originally intended?
- Should taxpayers have to take some sort of action to preserve their claim with regard to an improper tax?

Questions to Consider



Form?

Content?

Statute of limitations?

Should it be limited to

unconstitutional elements of a tax?

Who should be covered?

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The End