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TAXES 07/14/20

IRS Respects Do-Over, Unwound Transaction Has No Tax Impact

If you sell your house but in six months refund the money and take back the house did you ever sell it? If you buy stock but the company refunds your money, was it two transactions or none? Going back to square one may sound simple, but the tax system is rigid and rarely simple. And the annual tax return filing requirement means in most cases every tax year stands on its own. Fortunately, the IRS agrees that some transactions can be unwound and that tax effects can be ignored. But to pretend a deal never happened you must meet two tough conditions: (1) Each party must go back to its position before the transaction as if it never occurred. Rescission isn't a one-sided deal. (2) The go-back must occur in the same tax year as the deal. See [Revenue Ruling 80-58](#).

It's this timing rule that's usually the problem. Say you sell your house and the buyer claims the house is infected with mold. The dispute is unlikely to be resolved immediately. Often that means a subsequent tax year. To the IRS, each tax year must stand on its own. Some taxpayers who don't meet the IRS's strict same-year timing rule may argue that a rescission qualifies as long as the

transaction is unwound before they've reported the transaction on their tax return.



Example: You sell your car to your brother-in-law for \$25,000 in September 2011. He has some problems so gives you the car back in May 2012 and you refund the money. Although your 2011 tax return was due April 15th, you went on extension, so you haven't yet filed when you take the car back. When you file your 2011 return in August 2012, can you treat this sale as never having occurred? The IRS says no, but some advisers *might* say yes.

IRS More Liberal? Even the IRS may be loosening up. In several rulings, the IRS has approved rescissions even though one could argue that the parties didn't exactly go back to square one. For example, in [IRS Letter Ruling 200952036](#), a partnership was converted into a corporation, and then was converted back to a limited liability company (LLC). The partners

didn't *entirely* go back to square one. After all, when the smoke cleared they were members of an LLC not partners in a partnership. An LLC is not exactly the same as a partnership. Nevertheless, the IRS treated the transaction as rescinded and having no tax affect.

Caution. Any rescission involves at least two parties. Even in the simple car example, what if your brother-in-law has already filed his 2011 tax return before the rescission, perhaps even depreciating or writing off the car? In more complicated deals, there may be many parties. For more about rescission, see: [I Love Rescission](#).

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