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Secrets Of Tax Refunds, Do-Overs, And Boomerang Cash On Your Taxes

Can you undo something on your taxes? No, I don't mean an amended tax return exactly. Rather, what about going back to square one, undoing the deal, giving the money back. Does that work for tax purposes? Say you sell your house, and six months' later you refund the money and take back the house.

For tax purposes, did you ever sell it, and do you put it on your tax return? Or, suppose you buy stock, but the company later refunds your money. Was it two transactions or none? Going back to square one may *sound* simple, but the tax system is rigid. It involves an annual accounting period 365 days long. Fortunately, the IRS agrees that some transactions can be unwound and that tax effects can be ignored. To pretend a deal never happened, you must meet two tough conditions:

- *Each* party must go back to its position *before* the transaction as if it never occurred. Rescission isn't a one-sided deal.
- 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. That usually 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 be tempted to 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 2014. He has some problems so gives the car back in May 2015 and you refund the money. Although your 2014 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 2014 return in August 2015, can you treat this sale as never having occurred? The IRS says no, but some advisers *might* say yes. You may call it a do-over in the schoolyard or on the athletic field, but the pertinent legal doctrine is *rescission*. Going back to square one may sound simple, but many legal entanglements must be unraveled.

The IRS has generally maintained a consistent position on this issue. However, 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: when the smoke cleared they

were members of an LLC not partners in a partnership. Even though an LLC is not exactly the same as a partnership, the IRS agreed to treat the transaction as rescinded and having no tax affect.

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