

## **Refund Claims- A Look At The Substantial Variance Rule.**

Before filing suit for a refund, the taxpayer must make an administrative claim. The Treasury Regulations that govern refund claims require that a taxpayer set forth each of the grounds for a credit or a refund, along with “facts sufficient to apprise the Commissioner of the exact basis thereof.” Treas. Reg. § 301.6402-2(b). Courts have construed this to create a “substantial variance rule,” barring a taxpayer from presenting claims in a refund suit that vary substantially from what was presented as an administrative claim.

The reference in the regulation to “facts sufficient to apprise the Commissioner of the exact basis” for the refund claim creates a potential problem: can a taxpayer provide additional evidence in court that was not presented as part of a refund claim? In *Bayer Corporation v. United States*, 2012 U.S. Dist. LEXIS 134716 (W.D. Pa. Sept. 20, 2012), the Western District of Pennsylvania addressed this question. At issue were qualified research credits sought by Bayer. Bayer had hired a major accounting firm to do a study of its research expenditures to support its entitlement to the relevant credits. When the study was presented to the IRS as part of its audit of a refund claim, it summarized the qualified research expenditures that Bayer had made by cost center, not by business component; the IRS, however, did not request additional information. *Id.*, slip op. at \*5-\*9.

The business component that credits relate to was relevant, because section 41(d)(2)(A) of the Code directs that the statutory test for qualified research be applied to each business component separately. Before it filed its refund suit, Bayer did not do any analysis to determine its ability to tie particular expenditures to particular business components. After a discovery dispute, Bayer was required to develop the information in an interrogatory response.

Next the government, having forced Bayer to develop evidence that tied its research expenditures to particular business components, sought summary judgment, arguing that Bayer was guilty of a substantial variance. The Western District rejected this assertion. First, it noted that there was no indication that Bayer sought to introduce new legal theories into the case. *Id.* at \*17. Moreover the Court also held that Bayer was not attempting to vary the factual basis for its claim, distinguishing *Lockheed Martin Corp. v. United States*, 210 F.3d 1366 (Fed.Cir.2000). 2012 U.S. Dist. LEXIS 134716, slip op. at \*23. In the Court’s view, *Lockheed Martin* involved a taxpayer who sought to add new items to a refund claim once it had filed suit. Bayer, in contrast, was merely providing additional evidence to support the claim it has previously made:

the Government will not be permitted to demand a list of business components for the first time in this Court and then object based on the substantial variance rule to Bayer's need to gather significant, additional evidence to comply with the demand when the QRE credits underlying Bayer's refund claim have not changed.

*Id.* (footnote omitted). This is a good result for Bayer and a good outcome for taxpayers generally. Still it would be wise to develop sufficient evidentiary support for the refund claim before it is filed with the IRS, as another court might reach a different conclusion.

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