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Texas Tax Refunds and Traps

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In December 2010, the Texas Comptroller proposed changes to the administrative rules governing refund claims. Proposed Comptroller Rules 3.325 and 3.339 reflect a number of changes in the refund procedures in Texas during the last several years and illustrate the number of traps of which to be mindful in considering refund claims in Texas.¹

Procedural Remedies

The filing of a refund claim typically initiates an informal review by the Comptroller.² If any portion of the taxpayer's claim is denied, the Comptroller issues a letter denying the claim (in whole or in part) and stating that the taxpayer has 30 days to file a request for a refund hearing. This triggers a statutory deadline for submitting such request within the 30-day period.³ Following an adverse decision in such hearing (and after filing a motion for rehearing that is denied), the taxpayer has 30 days to file a refund lawsuit in Travis County District Court.⁴

We have seen several instances where the taxpayer may have technically failed to request a hearing within the 30-day period and the Comptroller asserted that the refund claim was barred. The Comptroller has taken this position even in situations in which the taxpayer told Comptroller personnel that it wished to pursue the claim and was assured the claim would be resolved in the context of a related audit. Accordingly, taxpayers should *always* request a refund hearing following the initial denial of a refund claim unless they wish to abandon the claim.

Pleading Requirements

A refund claim must be in writing and state fully and in detail each reason or ground on which the claim is based.⁵ Comptroller Rule 3.325(a)(4) lists information that must be submitted

¹ As of our publication deadline, it appears that the rules remain in the "proposed" stage.

² Texas Tax Code § 111.1042(a).

³ *Id.* § 111.009(b).

⁴ *Id.* §§ 112.001, 112.151(c).

⁵ *Id.* § 111.104(c).

with the claim, including information identifying the seller and local jurisdictions, as well as the invoice number, the date of purchase, a description of the item purchased, the basis for the refund, and the amount requested.⁶ The proposed rules keep essentially the same requirements, while adding additional requirements for refund claims made by permitted purchasers.⁷

Additionally, a taxpayer must be able to substantiate any refund request during the administrative hearing process. The Comptroller may issue notice that all evidence necessary to support the refund claim must be produced before a specified date no earlier than 180 days after the filing of the refund claim.⁸ Any evidence produced after the deadline will not be considered during an administrative hearing but can be heard at a judicial proceeding.⁹ Accordingly, while failure to comply with the substantiation deadline will not prevent a taxpayer from prevailing in district court, it effectively relegates the taxpayer to that remedy in order to have additional evidence heard.

Exclusive Remedy

Failure to comply with refund requirements prevents a taxpayer from being heard in district court. Texas courts have held that the refund statutes require a party to exhaust all administrative remedies prior to seeking judicial review of agency action.¹⁰ Prior to exhaustion of administrative remedies, the trial court lacks subject-matter jurisdiction.¹¹ Specifically, the taxpayer must submit a refund claim that complies with all pleading requirements; if dissatisfied with the decision on the claim, it must file a motion for rehearing. Additionally, a trial court does not have jurisdiction to hear additional claims improperly raised for the first time in a motion for rehearing before the Comptroller.¹² Thus, all refund requirements with regard to each specific claim must have been met in order for the trial court to have subject-matter jurisdiction over the specific claim.

The trial courts' lack of subject-matter jurisdiction prior to exhaustion of all administrative remedies generally prevents a purchaser from successfully filing suit against a seller for refund of collected tax. Texas courts have repeatedly held that because the statute provides a comprehensive administrative scheme and affords a remedy not provided at common

⁶ Comptroller Rule § 3.325.

⁷ Proposed Comptroller Rule § 3.325.

⁸ Texas Tax Code § 111.105(e).

⁹ *Id.*

¹⁰ *Combs v. Chevron, Inc.*, 319 S.W.3d 836, 844 (Tex. App.—Austin 2010, reh'g overruled); *Burgess v. Gallery Model Homes, Inc.*, 101 S.W.3d 550, 558 (Tex. App.—Houston [1st Dist.] 2003, pet. denied).

¹¹ *Gallery Model Homes*, 319 S.W.3d at 558.

¹² *Chevron*, 319 S.W.3d at 845.

law (the tax refund), the statutory provisions are mandatory and exclusive.¹³ Accordingly, a purchaser may not bring a refund suit against a seller. Rather, the purchaser's recourse lies against the Comptroller.

Statute of Limitations

A refund claim must be filed before the later of four years after the tax becomes due and payable or six months after a jeopardy or deficiency determination becomes final.¹⁴ A tax becomes due and payable the day after the last day on which a payment is required.¹⁵ Reliance on incorrect advice from the Comptroller does not estop the Comptroller from asserting the statute of limitations as a bar.¹⁶ Further, an assessment against the taxpayer on unrelated issues does not extend the limitations period on refund claims for other deductions from prior returns.¹⁷ However, there are some very limited exceptions to the limitations period.

Certain events will toll the statute of limitations, extending the time to make a refund claim. The limitations period is tolled upon a payment under protest if a lawsuit is timely filed, during the period of any judicial proceeding in a court of competent jurisdiction, and for the period an administrative redetermination or refund hearing is pending before the Comptroller.¹⁸ Just as the limitations period is tolled only following a payment under protest if a lawsuit is timely filed, the period during which the Comptroller informally reviews the claim tolls the statute of limitations, but only if a request for a refund hearing is timely filed.¹⁹ For all of these instances, the limitations period is suspended only as to contested issues.

Additionally, a taxpayer may not refile a refund claim for the same transaction or item, tax type, period, and ground or reason that was previously denied by the Comptroller.²⁰ This prevents the taxpayer from extending the limitations period by filing duplicative claims.

The “Prior Collection” Rule

Under Texas law, “[n]o taxes, penalties, or interest may be refunded to a person who has collected the taxes from another person unless the person has refunded all the taxes and interest

¹³ See *Rahmes v. Louis Shanks of Texas, Inc.*, 2005 WL 3331620 (Tex. App.—Austin Dec. 9, 2005, no pet.); *Gallery Model Homes*, 319 S.W.3d 550; *Serna v. H.E. Butt Grocery Co.*, 21 S.W.3d 330 (Tex. App.—San Antonio 2000, no pet.).

¹⁴ Texas Tax Code § 111.104(d).

¹⁵ *Id.* § 111.204.

¹⁶ *S & H Mktg. Group, Inc. v. Sharp*, 951 S.W.2d 265 (Tex. App.—Austin 1997, no writ.).

¹⁷ *El Paso Natural Gas Co. v. Strayhorn*, 208 S.W.3d 676 (Tex. App.—Texarkana 2006, no pet.).

¹⁸ Texas Tax Code § 111.207.

¹⁹ *Id.* § 111.1042(d).

²⁰ *Id.* § 111.107(b).

to the person from whom the taxes were collected.”²¹ Presumably, this provision was added to prevent a seller from obtaining a windfall by recovering a refund from the Comptroller when the seller had already collected the same taxes from a buyer. This makes sense for trust fund taxes, such as the sales tax, where the seller collects the tax from the buyer, acting as an agent of the state. If a seller wrongfully collects tax on a nontaxable sale and remits the tax to the state, a refund of the tax would be a windfall to the seller unless the seller also refunds the tax to the purchaser.

However, in resisting some refund claims in recent years, the Texas Comptroller and Attorney General have claimed this provision applies even when no amount was charged as a tax to the buyer. That defensive theory has received some acceptance by the courts. In *Strayhorn v. Raytheon E-Systems, Inc.*, the taxpayer sought a refund of sales tax paid to the Comptroller on its purchase of overhead items allocated as “indirect costs” to several federal contracts.²² The taxpayer did not charge “tax” to the federal government in the traditional sense.²³ Nevertheless, the court of appeals remanded the case for a determination of whether Raytheon had in fact collected tax from the federal government, presumably theoretically through the prices charged to the federal government.²⁴ The Texas Attorney General and Comptroller made a similar argument in a case involving tobacco-products taxes imposed on the vendor but theoretically collected from buyers through the sales price.²⁵ The Austin Court of Appeals recently rejected a similar “prior collection” argument in a case involving another federal contractor.²⁶

The above examples show some of the common traps of which taxpayers need to be mindful when making Texas refund claims. Failure to exhaust administrative remedies and to comply precisely with administrative procedures can result in taxpayers’ forfeiting valid refund claims. Guidance from those familiar with refund requirements can ensure that taxpayers do not lose claims through procedural traps.



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²¹ *Id.* § 111.104(f).

²² 101 S.W.3d 558, 561 (Tex. App.–Austin 2003, pet. denied).

²³ *Id.*

²⁴ *Id.* at 570.

²⁵ *McLane Co. v. Strayhorn*, 148 S.W.3d 644 (Tex. App.–Austin 2004, pet. denied).

²⁶ *Combs v. Health Care Servs. Corp.*, No. 03-09-00617-CV, 2011 Tex. App. Lexis 2081 (Tex. App.–Austin March 16, 2011, no pet. hist.).