UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

FREDRICK PERKINS and ALICE J. PERKINS, *Plaintiffs,* *v.* UNITED STATES OF AMERICA, *Defendant.*	:	No. 1:16-cv-00495-LJV-HBS

RESPONSE TO PLAINTIFFS' MEMORANDUM REGARDING VARIANCE

Respectfully Submitted,

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During discovery, the United States learned that Plaintiffs Fredrick and Alice J. Perkins had inadvertently under-reported their 2010 gross income by at least $250,000. While the United States did not ask on summary judgment to recover tax on that unreported income, the previously-unreported income compels the conclusion that Plaintiffs cannot satisfy their burden of proof unless they vary from their IRS claim to establish additional deductions. Plaintiffs' recovery under 26 U.S.C. § 7422 now requires proof of two theories: (1) the income from their company's gravel sales was tax exempt; and (2) they incurred additional business expenses in 2010. Only one of these grounds was raised in Plaintiffs' administrative claim to the IRS.

Plaintiffs' admitted reliance on $291,116 in new deductions to justify a refund violates the variance doctrine. Under that well-established doctrine, the Court is without jurisdiction to consider a theory of refund or credit that was not first raised in an administrative claim with the IRS. Plaintiffs have not satisfied their "heavy burden" to show waiver of the IRS's specificity requirements, so the Court lacks subject matter jurisdiction to consider the new theory for relief. Even if Plaintiffs' gravel income was tax-exempt, they are not entitled to a refund. Accordingly, the Magistrate Judge erred in recommending that the Court deny the United States' motion for summary judgment, and judgment should be entered for the United States.

I. *Response to Sections A & B – Subject Matter Jurisdiction*

Plaintiffs continue to misconstrue the United States' objection, which faulted the Report and Recommendation's reliance on a new theory for refund and factual submissions that Plaintiffs never presented to the IRS. As previously explained, *see* Doc. No. 92 at 2 n.1, the United States *does not* contend either that the Court is without jurisdiction to consider this refund suit or that the Amended Complaint varied with Plaintiffs' administrative claim to the IRS. The United States also does not "argue the gross income and deductible business expenses should

have been central to the Perkinses' 2010 tax refund claim." Doc. No. 96 at 10. Plaintiffs maintained before the IRS, as they do in their Amended Complaint, only that their gravel income is tax exempt. Therefore, we contend that any other bases for refund – including the deductibility of newly-asserted business expenses – cannot be raised now.

Plaintiffs' musings about "the Government's uncompromising view of the variance doctrine," Doc. No. 96 at 8, are entirely based on a misunderstanding of the United States' position. The United States objected on the basis of variance to Plaintiffs' belated submission of expenses as new grounds for refund, the Magistrate Judge's reliance on new evidence of expenses as raising material fact disputes, and Plaintiffs' intent to rely at trial on the unexhausted theory. The variance doctrine compels that the United States has not waived sovereign immunity for, and the Court has no jurisdiction to consider, their undeniably new theory. And Plaintiffs cannot prevail without the new theory or the purported evidence supporting it.

Notwithstanding Plaintiffs' obfuscation, "[w]ith respect to income taxes it is settled by authorities too numerous for complete citation that a taxpayer who brings suit after a claim for refund has been denied can rely for recovery only on grounds presented to or considered by the Commissioner." *Samara v. United States*, 129 F.2d 594, 597-98 (2d Cir. 1942). That is true not only regarding the contents of a refund complaint, but also at trial. *Id.* ("New facts which the Commissioner has had no opportunity to pass upon cannot, in our opinion, be adduced at the trial."); *see also Magnone v. United States*, 902 F.2d 192, 193 (2d Cir. 1990) ("[U]nder the prior-claim rule, a taxpayer must bring the claim for refund to the IRS as a prerequisite to jurisdiction for the suit in federal court. Consequently, in pursuing such a suit, a taxpayer may not raise different grounds than those brought to the IRS."); *Scovill Mfg. Co. v. Fitzpatrick*, 215 F.2d 567, 569 (2d Cir. 1954) (citing cases) (a claimant under § 7422 "may not raise a wholly new factual

basis for his claim at the later trial, but he also may not shift the legal theory of his claim"). A taxpayer seeking a refund must have included within her claim all specific bases that she later relies upon in federal court. *Magnone*, 902 F.2d at 193; *see also Madonia v. United States*, 1985 WL 5711, at *3 (W.D.N.Y. Dec. 30, 1985).

As Plaintiffs concede, "[i]n their administrative claim, the Perkinses focused on the treaty exemption and the unlawful assessment and collection of a tax based on the income generated by Alice from the sale of sand and gravel from the treaty-protected lands of the Seneca Nation." Doc. No. 96 at 10. Their refund claim did not allege that they were entitled to deduct the business expenses they now must rely upon. *See* Doc. No. 7 at 10-12 (refund claim). Plaintiffs did not claim any additional deductions from their 2010 income until they sought summary judgment on May 18, 2018. The newly-alleged expenses plainly were not "derived from or … integral to the ground timely raised in the refund claim." Doc. No. 96 at 11 (quoting *Cencast Servs., L.P. v. United States*, 94 Fed. Cl. 425, 440 (2010)). Accordingly, Plaintiffs' reliance on purported expenses that were not identified in their IRS claim runs afoul of the variance doctrine.

II. *Response to Section C - Variance is Jurisdictional, and Was Not Waived*

Plaintiffs falsely, and improperly,[1] accuse the United States of having "misled the Court by asserting the substantial variance doctrine is a jurisdictional defense that may be raised at any time." Doc. No. 96 at 5. Plaintiffs' quarrel seems to be with the Supreme Court and Second Circuit, rather than the United States. Citing those courts, the Western District has explained, "[t]he rule of substantial variance as contained in 26 U.S.C. § 7422(a) and its explanatory

[1] Plaintiffs' repeated, unprofessional, attacks on the character and veracity of the undersigned counsel for the Government constitute "undignified and discourteous conduct" that violate 3.3(f)(2) of the New York Rules of Professional Conduct, made applicable to this proceeding by W.D.N.Y. Local Rule 83.3(a).

regulations *precludes this Court from exercising jurisdiction* over an issue not first raised in the claim for refund." *Madonia*, 1985 WL 5711, at *3 (citing cases) (emphasis added). That is, the variance doctrine is jurisdictional. *Id.*; *see also, e.g., El Paso CGP Co., L.L.C. v. United States*, 748 F.3d 225, 228 (5th Cir. 2014); *Estate of Bird v. United States,* 534 F.2d 1214, 1219 (6th Cir. 1976); *Carione v. United States*, 291 F. Supp.2d 141, 148 (E.D.N.Y. 2003); *Stern v. United States*, 949 F. Supp. 145, 151 (E.D.N.Y. 1996).

Moreover, "[t]he objection that a federal court lacks subject-matter jurisdiction, *see* Fed. R. Civ. P. 12(b)(1), may be raised by a party, or by a court on its own initiative, at any stage in the litigation, even after trial and the entry of judgment." *Arbaugh v. Y&H Corp*., 546 U.S. 500, 506 (2006) (citing *Kontrick v. Ryan,* 540 U.S. 443, 455 & FED. R. CIV. P. 12(h)(3)); *see also, e.g., Jo v. JPMC Specialty Mortg., LLC*., 248 F. Supp. 2d 417, 422 (W.D.N.Y. 2017).

Subject matter jurisdiction is not waivable. *Carione*, 291 F. Supp. 2d at 145 (quoting *Lyndonville Sav. Bank & Trust Co. v. Lussier*, 211 F.3d 697, 700-01 (2d Cir. 2000)). Accordingly, federal courts have rebuffed taxpayers' attempts to bar as untimely the United States' invocation of variance in refund suits. *See, e.g., Quarty v. United States,* 170 F.3d 961, 973 (9th Cir. 1999); *Cencast Servs.,* 94 Fed. Cl. at 448; *Trantina v. United States*, 381 F. Supp. 2d 1100, 1104-05 (D. Ariz. 2005).

However, administrative exhaustion may be established for purposes of § 7422 where the IRS has investigated the merits of a taxpayer's claim and acted upon it, thus waiving formal compliance with specificity requirements of Treasury Regulation § 301.6402-2(b)(1), and providing a federal court with jurisdiction. *Quarty*, 170 F.3d at 973. To establish that the IRS has waived the bar on variance, "[t]he showing should be *unmistakable* that the Commissioner has in fact seen fit to dispense with his formal requirements and to examine the merits of the

claim. It is not enough that in some roundabout way the facts supporting the claim may have reached him." *Angelus Milling Co. v. C.I.R.*, 325 U.S. 293, 297 (1945) (emphasis added). "[A] taxpayer asserting a waiver bears a heavy burden of proving such a waiver." *Mallette Bros. Constr. Co. v. United States*, 695 F.2d 145, 156 (5th Cir. 1983). "[T]he Commissioner's attention should have been focused on the merits of the particular dispute. The evidence should be clear that the Commissioner understood the specific claim that was made even though there was a departure from form in its submission." *Angelus Milling*, 325 U.S. at 297-98.

Here, Plaintiffs' contention that the United States abandoned its variance argument is baseless. The IRS could not have considered the merits of Plaintiffs' new theory for refund since it was first raised in Plaintiffs' summary judgment motion on May 18, 2018 – nearly 1,000 days after they filed their administrative claim and three months after the United States requested an explanation of evidence that they significantly underreported their business income.[2] Until their motion, Plaintiffs never suggested that the IRS had incorrectly denied them *any* deductible expenses for 2010. The IRS cannot be faulted for failing to investigate Plaintiffs' newly-asserted business expenses when Plaintiffs themselves filed a refund claim stating that their adjusted gross income was ($144,253) – the amount that they reported on their original 2010 Form 1040 and that was adopted by the IRS in its examination of that tax return. *See* Doc. No. 60-13 at 1.

Plaintiffs certainly do not satisfy their "heavy burden" of showing that the IRS investigated these newly-asserted expenses. Instead, Plaintiffs rely on two irrelevant cases

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[2] Despite repeated requests, Plaintiffs did not explain any basis for a refund after the additional income was discovered. *See* Doc. No. 42 at 6-7. Plaintiffs' first assertion of additional deductible business expenses was contained in their May 2018 motion for summary judgment. Some – but not all – of the unauthenticated documents they relied upon for that new theory of refund were provided in bulk during discovery. *See* Doc. No. 70 at 4 (identifying certain documents that were first disclosed in May 2018).

standing for the unremarkable proposition that, when *responding* to a defendant's motion for summary judgment, a civil plaintiff who does not identify material issues of fact to support all claims raised in her complaint may be deemed to have abandoned those claims. *See Taylor v. City of New York,* 269 F. Supp. 2d 68, 75 (E.D.N.Y. 2003) (faulting plaintiff for failing to address motion for summary judgment of four state-law claims raised in his complaint); *Jackson v. Fed. Express,* 766 F.3d 189, 195 (2d Cir. 2014) (arguing that summary judgment should be denied as to some claims, while not mentioning others, may be deemed an abandonment of the unmentioned claims). Those cases permit (but do not require) a court to consider *a plaintiff's claims* waived or abandoned when they are not fully briefed when opposing to a defendant's summary judgment motion. *See Wecare Holdings, LLC v. Bedminster Int'l, Ltd.*, 2009 WL 604877, at *8 (W.D.N.Y. Mar. 9, 2009) (citing cases).

Here, however, the United States opposed Plaintiffs' summary judgment motion in all respects, specifically arguing that Plaintiffs did not establish that they were entitled to a refund. *See* Doc. No. 71 at 19-28. That is, the United States absolutely addressed all of Plaintiffs' asserted bases for summary judgment. It submitted extensive argument and pointed to specific evidence to show that Plaintiffs failed to prove as a matter of undisputed fact that their expenses exceeded their taxable income. *Id.* The United States also moved to strike the mountain of inadmissible evidence that Plaintiffs submitted in support of their motion. *See* Doc. No. 70. In any case, the Magistrate Judge correctly recommended denial of Plaintiffs' motion, and the United States does not object to that portion of the Report and Recommendation.

Plaintiffs again confuse the issue by urging that the United States should have raised variance in its own summary judgment motion. That is illogical. At the time of the United States' May 18, 2018 summary judgment motion, Plaintiffs had not identified *any* additional

business expenses that they believed they had incurred, nor had they alerted the United States that they would be presenting an entirely new theory of recovery in their own motion. The United States established that summary judgment was appropriate, in part, because Plaintiffs would not be entitled to a refund *even if they succeeded on their claim that $184,552 of gravel income was tax exempt.* *See* Doc. No. 60-1 at 39-42. Even in response, Plaintiffs did not argue that they had incurred any additional expenses, and they did not cite the unauthenticated evidence of $291,116 in previously-unreported expenses. *See* Doc. No. 70. So when the Magistrate Judge recommended denying the United States' motion based upon that new evidence, *see* Doc. No. 84 at 23-31, the United States timely objected, stating that the Court does not have jurisdiction to consider the new evidence, or theory of refund, due to the variance doctrine. *See* Doc. No. 85 at 3-6.

III. *Response to Section D – Setoff is Not at Issue Here*

Plaintiffs' argument that they are permitted to rely on a new theory of refund to respond to United States' setoff defense is meritless. Plaintiffs must prove that they overpaid their taxes to satisfy their trial burden in this refund action. *See Lewis v. Reynolds*, 284 U.S. 281, 283 (1932). Because they clearly cannot do so, the United States moved for summary judgment, in part, on that basis. *See* Doc. No. 60. The United States did not seek summary judgment on its affirmative defense of setoff, because setoff does not apply where a taxpayer is not entitled to a refund. Setoff is irrelevant to the United States' assertion of variance here, and does not permit Plaintiffs to raise a new theory of recovery to prove their case-in-chief.

"The ordinary use of the term 'setoff' in tax refund cases refers to the Government's ability to reduce a taxpayer's recovery on its refund claim by other amounts owed to the Government for the same tax year." *Cencast Servs.,* 94 Fed. Cl. at 441. If a taxpayer establishes entitlement to a refund on one ground, the Government may reduce the taxpayer's refund by the

amount owed on a separate ground for the same tax year. *Id.* (citing *Lewis*, 284 U.S. at 283). A taxpayer then may raise a counter-setoff if the Government raised a new issue that could not have been asserted as grounds for its refund during the administrative claim. *Id.* "A plaintiff must be allowed to assert a counter-setoff after the Government inserts a new issue into the litigation because the Government *creates* the variance between the taxpayer's administrative refund claim and the claims before the court." *Id.* at 442 (emphasis in original).

However, holding Plaintiffs to their basic evidentiary burden obviously is not a "new legal theory." It does not require "asking the Court to adjust the Perkinses' taxable income to include the under-reported gross income[.]" Doc. No. 96 at 18. Instead, Plaintiffs must show that they are due a refund – even if their gravel income is tax exempt – without resorting to a theory that was not part of their IRS claim. As the Southern District of New York explained, reliance on new evidence to show entitlement to a refund does not implicate setoff at all:

> In reality, all the government has done, and all it needed to do to raise the issue, was to deny the plaintiff's allegations concerning her taxable income for the years in question. This denial brought into play the plaintiff's burden of proving her taxable income for those years, not merely her returns, as elements of her case, which includes her right to recover and the amount she should recover.

Zeeman v. United States, 275 F. Supp. 235, 255-56 (S.D.N.Y. 1967) (citing *Commissioner v. Van Bergh*, 209 F.2d 23, 25 (2nd Cir. 1954)). It is *Plaintiffs'* fundamental burden to show that they overpaid their taxes – and they cannot do so without resorting to a new theory. Accordingly, they cannot prevail here, whether or not the United States asserts a setoff defense.

Conclusion

Plaintiffs cannot establish their burden unless they rely upon new grounds for relief – $291,116 in purported deductions from their 2010 income that they did not identify until May 2018. Such variance is prohibited, and well-established precedent bars the Court's jurisdiction to consider Plaintiffs' new theory for a refund.

CERTIFICATE OF SERVICE

I certify that on April 21, 2020, I filed the foregoing *Response to Plaintiffs' Memorandum Regarding Variance* with the Clerk of Court using the CM/ECF system, which will send notice of this filing to all parties registered to receive such notice.

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