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Board of Tax Appeals Finds Taxpayer Entitled to Refund Where Internal Revenue Service Mistakenly Withheld Portion of Federal Refund and Remitted the Funds to Kentucky

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In *Helton v. Department of Revenue*, Kentucky Board of Tax Appeals No. K12-R-11, Order No. K-23078 (June 26, 2013), the Board of Tax Appeals considered the interplay between KRS 141.180(5), which prohibits a refund of taxes voluntarily paid to the state treasury in certain circumstances, and KRS 134.580, Kentucky's refund statute.

In 2007, taxpayer Lisa Helton filed joint federal and state tax returns with her now ex-husband. Ms. Helton was later assessed for unpaid federal and state income tax for the 2007 year. Ms. Helton filed an innocent spouse claim with the Internal Revenue Service, and she later entered into a stipulated judgment with the IRS in U.S. Tax Court stating that Ms. Helton owed no income tax for the 2007 taxable year pursuant to IRC 6015(f). Under IRC 6015(f), the Secretary of Treasury may relieve a taxpayer from any unpaid tax or deficiency where it would be inequitable to hold the taxpayer liable for the amount due.

Pursuant to KRS 141.180(4)(a), a husband or wife shall be relieved of Kentucky tax liability if "[t]he spouse has been relieved of liability for federal income tax . . . for the same taxable year by the Internal Revenue Service under Section 6015 of the Internal Revenue Code." Although Ms. Helton had been relieved of federal income tax liability, she mistakenly was not relieved of liability for Kentucky taxes for 2007. In 2012, the IRS offset a federal income tax refund due to Ms. Helton by the amount of $822.09, the amount Ms. Helton would have owed Kentucky in 2007 had she not entered into the stipulated judgment relieving her of federal tax liability. Although Ms. Helton contacted the Department of Revenue and notified the Department of her stipulated judgment with the IRS, the Department issued a final ruling denying her refund request.

On appeal, the Department did not deny that Ms. Helton *should* have been relieved of Kentucky income tax liability for 2007, but the Department claimed that the 2007 debt had already been collected (by way of the 2012 IRS offset) by the time Ms. Helton notified the Department of the stipulated judgment. Therefore, according to the Department, Ms. Helton was not entitled to a refund of $822.09, as KRS 141.180(5) prevents the Department from refunding money already collected.[1]

[1] KRS 141.180(5) states that any relief granted to a spouse pursuant to KRS 141.180(4)(a) "shall not result in a tax overpayment to the spouse requesting relief."

The Board of Tax Appeals disagreed, finding that the Department's interpretation of KRS 141.180(5) was overbroad as applied to Ms. Helton's case. The Board also found that the Department's interpretation conflicted with Kentucky's refund statute, KRS 134.580. KRS 134.580(2) provides that "[w]hen money has been paid into the State Treasury in payment of any state taxes . . . whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds to the person who paid the tax . . . of any overpayment of tax and any payment where no tax was due."

The Board recognized that KRS 141.180(5) prohibits the refund of taxes voluntarily paid by a spouse, even though it is later determined that the spouse is entitled to relief from those taxes pursuant to IRC 6015(f). Ms. Helton, however, never voluntarily paid the Kentucky taxes assessed in 2007. Instead, the IRS withheld a portion of Ms. Helton's federal refund and remitted that amount to the Kentucky treasury. This amount was remitted in error, and was made involuntarily on behalf of Ms. Helton. The Board concluded that Ms. Helton was entitled to a refund of $822.09 plus applicable interest pursuant to KRS 134.580(4).