

IEC ARAB ALABAMA, INC.	§	STATE OF ALABAMA
350 11th Street SW		DEPARTMENT OF REVENUE
Arab, AL 35016-1770,	§	ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. U. 98-507
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed IEC Arab Alabama, Inc. (“Taxpayer”) for State sellers use tax, State consumers use tax, and City of Arab use tax for January 1990 through December 1997.¹ The Taxpayer timely appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. It also paid the final assessments in full.

The parties agreed to hold the case in abeyance pending a final decision in *Monroe v. Valhalla Cemetery, Inc.*, 749 So.2d 470 (Ala. Civ. App. 1999). That case was finally decided when the U.S. Supreme Court denied certiorari on March 20, 2000. The parties subsequently agreed to hold the case in abeyance pending *Anthony Alexander v. State of Alabama*, U. 97-333 (Admin. Law Div. 1/8/98). After that case was resolved, the parties notified the Administrative Law Division that they were attempting to settle, and that the case should continue to be held in abeyance.

¹ Alabama law levies a single State use tax at Code of Ala. 1975, §40-23-61. The seller of property subject to use tax is liable to collect and remit the tax to the Department. See, Code of Ala. 1975, §§40-23-67 and 40-23-68. However, the purchaser is also liable if the tax is not paid to the seller. See, Code of Ala. 1975, §§40-23-61(d) and 40-23-68(d). If the Department assesses a seller for the use tax due, it designates the tax as “sellers use tax.” If it assesses the purchaser, it designates the tax as “consumers use tax.”

The parties notified the Administrative Law Division in November 2004 that they were unable to settle, and that they wanted to submit the case on a joint stipulation of facts.

The parties submitted a joint stipulation on February 17, 2005. Blake Madison represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

The Taxpayer raises three issues on appeal:

(1) Is the retroactive application of Act 97-301, as applied to the Taxpayer, unconstitutional as a denial of equal protection and due process;

(2) If the retroactive application of Act 97-301 is not unconstitutional, was the Department nonetheless barred from assessing the Taxpayer beyond the general three year statute of limitations at Code of Ala. 1975, §40-2A-7(b)(2); and,

(3) Should the penalties assessed by the Department be waived for reasonable cause?

FACTS

The Taxpayer manufactured computer components at its facility in Arab, Alabama during the period in issue. The Taxpayer purchased tangible property from various out-of-state vendors during that period. The vendors delivered the property to the Taxpayer's facility in Arab, Alabama. The Taxpayer did not file Alabama sales tax or use tax returns with the Department during the period. There is also no evidence that the Taxpayer paid sales and/or use tax to the out-of-state vendors when it purchased the property.

Before May 1997, Code of Ala. 1975, §40-23-62(1) exempted from the Alabama use tax all property that was subject to the Alabama sales tax, i.e., all tangible property sold at retail in Alabama. In May 1997, the Alabama Legislature enacted Act 97-301, which amended §40-23-62(1) to provide that the use tax exemption provided therein applied only

to property used, stored, or consumed in Alabama on which Alabama sales tax had been paid.² Section 3 of Act 97-301 provided that the amendment shall be effective for all open tax years.

Valhalla Cemetery and others filed a class action in Montgomery County Circuit Court claiming that the retroactive application of Act 97-301 was unconstitutional. The Circuit Court agreed. The Alabama Court of Civil Appeals reversed, holding that the retroactive provision was constitutional. *Valhalla Cemetery, supra*.

The Revenue Department audited the Taxpayer for use tax after Act 97-301 was enacted. Based on the retroactive provision in the Act, the Department assessed the Taxpayer for use tax on the property the Taxpayer had purchased from the out-of-state vendors and subsequently used in Alabama, and on which no Alabama tax had been paid. The Department assessed the Taxpayer back to 1990 because the Taxpayer had never filed Alabama use tax returns.

² The Legislature enacted Act 97-301 in response to the Administrative Law Division's decision in *Bluegrass Bit Co., Inc. v. State of Alabama*, U. 96-294 and S. 96-287 (Admin. Law Div. 1/16/97). In *Bluegrass Bit*, the Administrative Law Division pointed out, for the third time, a loophole in Alabama's sales and use tax structure. The loophole occurred when an out-of-state seller without nexus with Alabama made a retail sale in Alabama. Because the retail sale was closed in Alabama, it was subject to Alabama sales tax pursuant to Code of Ala. 1975, §40-23-2(1). But Alabama sales tax could not be assessed because the out-of-state seller lacked nexus with Alabama, and the Department cannot assess a purchaser for unpaid sales tax. Alabama use tax also could not be assessed because the property was exempt from use tax pursuant to §40-23-62(1), as it read before amended by Act 97-301. Consequently, the transaction was in effect tax-free. As indicated, Act 97-301 closed the loophole by amending §40-23-62(1) to exempt from the use tax only property on which Alabama sales tax has been paid.

Issue (1). Is the retroactive application of Act 97-301 unconstitutional as applied to the Taxpayer?

The Taxpayer argues that retroactively applying Act 97-301 in the instant case would constitute a denial of equal protection and due process because the Act is being applied back seven years. The Taxpayer cites *U.S. v. Carlton*, 114 S.Ct. 2018 (1994) and *U.S. v. Darusmont*, 101 S.Ct. 549 (1981) in support of its case. However, in *Valhalla Cemetery*, the Court of Appeals relied on those same cases in holding that the retroactive application of Act 97-301 was not unconstitutional. *Valhalla Cemetery*, 749 So.2d at 473.

The Taxpayer argues that the Court in *Valhalla Cemetery* did not fully grasp that the Act could be applied retroactively for as many as seven years, as in this case. The Court did state in *Valhalla Cemetery* that "Act 97-301 is retroactive for two to three years." *Valhalla Cemetery*, 749 So.2d at 474. It also held, however, that the retroactive application of a statute for eight years had been upheld. See again, *Valhalla Cemetery*, 749 So.2d at 474. In any case, as discussed below concerning Issue (2), the period for which Act 97-301 can be applied retroactively concerning the Taxpayer is less than three years.

Issue (2). Is the Department barred from assessing the Taxpayer beyond the general three year statute at §40-2A-7(b)(2)?

Generally, the Department must assess tax "within three years from the due date of the return, or three years from when the return is filed with the department, whichever is later, . . ." Section 40-2A-7(b)(2). However, a preliminary assessment may be entered at any time "if no return is filed as required . . ." Section 40-2A-7(b)(2)a.

In this case, the Department, presumably relying on subparagraph (b)(2)a.,

assessed the Taxpayer back to 1990 because the Taxpayer had never filed use tax returns with the Department. However, the open-ended statute of limitations in subparagraph (b)(2)a. applies only if a taxpayer is required to file a return and fails to do so. The Taxpayer in this case was not required to file use tax returns before Act 97-301 was enacted because the subject property was exempt from use tax pursuant to §40-23-62(1). Consequently, because the Taxpayer was not required to file use tax returns before May 1997, the open-ended statute in subparagraph (b)(2)a. does not apply. See, *Alexander v. State of Alabama*, U. 97-333 (Admin. Law Div. 1/9/98). Rather, the general three year statute applies.

The Department entered the preliminary assessments against the Taxpayer on September 11, 1998. The Department thus timely assessed the Taxpayer for the use tax due from August 1995 through December 1997.³ The tax due before August 1995 is time-barred.

Issue (3). Should the assessed penalties be waived for reasonable cause?

The Department assessed the Taxpayer for the 10 percent failure to file return penalty levied at Code of Ala. 1975, §40-2A-11(a) and the 5 percent negligence penalty levied at §40-2A-11(c). The Taxpayer argues that the penalties should be waived for reasonable cause pursuant to §40-2A-11(h).

³ The August 1995 return was due September 20, 1995, which was within 3 years from when the preliminary assessments were entered on September 11, 1998.

As discussed, the Taxpayer was not required to file Alabama use tax returns before May 1997. It is also understandable that the Taxpayer may not have been aware that use tax returns were due after Act 97-301 was enacted. Under the circumstances, the penalties are waived for reasonable cause.

The Department is directed to recompute the Taxpayer's State and City of Arab use tax liabilities for August 1995 through December 1997, plus interest. It should also notify the Administrative Law Division of the State and City of Arab refunds due the Taxpayer. A Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days from the date the Final Order is entered pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered May 19, 2005.

BILL THOMPSON
Chief Administrative Law Judge