

WILLIAM M. SLAUGHTER  
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BIRMINGHAM, AL 35223-2069,

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

Taxpayer,

§

DOCKET NO. INC. 09-579

v.

§

STATE OF ALABAMA  
DEPARTMENT OF REVENUE.

§

### **OPINION AND PRELIMINARY ORDER**

The Revenue Department assessed William M. Slaughter (individually “Taxpayer”) for 2004, 2005, 2006, and 2007 Alabama income tax. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on July 19, 2012. The Taxpayer and CPA Michael Hamner attended the hearing. Assistant Counsel Billy Young represented the Department.

The facts in this case are complicated.

The Taxpayer and his wife (together “Taxpayers”) filed a joint 1997 Alabama income tax return on November 25, 2003. They paid \$52,420 with the return, and also claimed a credit carryover of \$7,746 from their 1996 Alabama return. They had previously also claimed a credit carryover from their 1995 return to their 1996 return.

The Department disallowed the credit carryover from 1995 to 1996 because the Taxpayers had not filed their 1996 return within two years from the due date, citing the two year statute of limitations at §40-2A-7(c)(2)a. That statute provides in pertinent part that if an income tax return is not timely filed, a refund of income tax paid by estimated payments or withholding during the year must be claimed within two years from the due date of the return. The disallowed carryover from 1995 to 1996 resulted in no overpayment in 1996. The Department consequently disallowed the 1996 carryover claimed on the 1997 return,

and entered a preliminary assessment against the Taxpayers for the 1997 tax due.

The Taxpayers petitioned for a review of the preliminary assessment. The Department's Hearing Officer issued his report on July 1, 2004 granting the Taxpayers' petition and voiding the 1997 preliminary assessment. The report reads in pertinent part:

Within their petition, the taxpayers aver that the overpayment of 1996 taxes, based on an overpayment credit of 1995 taxes, formally disallowed for credit in a letter sent to the taxpayers by the department in December 2000, was improperly disallowed, and that the credit should be available to use against the 1997 assessment. I agree.

The treatment of overpayments credited to a subsequent year is not specifically guided by statute. There is no statutory authority specifying the method of crediting an overpayment to another year, nor for applying a particular statute of limitations. Chief Administrative Law Judge Bill Thompson has enumerated the legal parameters for this treatment in several cases since §40-2A-7 was created by the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act of 1992. (footnote omitted)

The cases referred to by the Hearing Officer are *Stephens v. State of Alabama*, Docket Inc. 96-127 (Admin. Law Div. 4/12/1996), and *Brayman v. State of Alabama*, Docket Inc. 95-411 (Admin. Law Div. 1/9/1996). Those cases are discussed below.

The Department subsequently assessed the Taxpayers for 2001, 2002, and 2003 income tax. The Taxpayers appealed to the Administrative Law Division, and the case was docketed as Inc. 06-504. While that appeal was pending, the Taxpayer filed a 2003 married, filing single Alabama return with the Department on August 15, 2006. The Department subsequently notified the Administrative Law Division that the 2001, 2002, and 2003 final assessments should be voided. The Administrative Law Division accordingly entered a Final Order voiding the final assessments.

The Taxpayer filed his 2004, 2005, 2006, and 2007 Alabama individual income tax returns in October 2008. The returns claimed amounts paid by withholding in each year, and also overpayments carried over from prior years. The amounts paid by withholding and carryover credits in the subject years are specified below. The Department allowed the withholdings claimed on the returns to partially pay the tax due in each year, but disallowed the credit carryovers. It accordingly entered the final assessments in issue for the remaining tax due in each year, plus penalties and interest.

The amounts paid by the Taxpayer by withholding, and the overpayments carried over and claimed by the Taxpayer on his 2003 through 2007 Alabama returns, are as follows:

On his 2003 return, the Taxpayer reported \$20,047 in withholding and a credit carryover of \$38,973 from the prior year, for a total amount paid of \$59,020. He had \$0 liability for the year, and elected on the return to apply the overpayment of \$59,020 toward his 2004 liability.

On his 2004 return, the Taxpayer reported \$30,000 in withholding and a credit carryover of \$59,020 from 2003, for a total amount paid of \$89,020. He reported a liability of \$32,653 for the year, and elected on the return to apply the net overpayment of \$56,367 to his 2005 liability.

On his 2005 return, the Taxpayer reported \$35,000 in withholding and a credit carryover of \$56,367 from 2004, for a total amount paid of \$91,367. He reported a liability of \$40,397, and elected on the return to apply the net overpayment of \$50,970 to his 2006 liability.

On his 2006 return, the Taxpayer reported \$100,000 as paid with an extension to file the return, and a credit carryover of \$50,970 from 2005, for a total amount paid of \$150,970. He reported a liability of \$123,496, and elected on the return to apply the net overpayment of \$27,474 to his 2007 liability.

On his 2007 return, the Taxpayer reported \$10,000 in withholding and a credit carryover of \$27,474 from 2006, for a total amount paid of \$37,474. He reported a liability of \$37,260, and elected on the return to apply the overpayment of \$214 to his 2008 liability.

The Department allowed the amounts paid by withholding in the subject years. It disallowed the amounts carried over to each subsequent year because it treated those amounts as estimated payments in the subsequent years that were not claimed within the two year statute at §40-2A-7(c)(2)a.

The Taxpayer argues that the credit carryovers claimed in the subject years should be allowed based on the rationale of *Stephens* and *Brayman*. I agree.

In *Stephens*, the taxpayers elected on their 1991 return to carryover \$5,000 overpaid in that year as a credit to their 1992 liability. The taxpayers also paid \$2,718 in withholding in 1992. The taxpayers filed their 1992 return on October 12, 1995 and reported tax due of \$948, which resulted in an overpayment of \$6,770 (\$7,718 paid less tax due of \$948) in the year. They elected on the 1992 return to receive a refund of \$1,770, and to apply the remaining \$5,000 overpayment to their 1993 liability.

The Department denied both the claimed 1992 refund and the requested credit carryover to 1993 because they were not timely claimed pursuant to §40-2A-7(c)(2)a. In substance, the Department treated the claimed carryover credit from 1991 to 1992 as an

estimated payment in 1992, in which case, according to the Department, the two year statute for claiming a refund or credit at §40-2A-7(c)(2)a. applied.

The Administrative Law Division held that the amount withheld from the taxpayer's wages in 1992 could not be refunded or applied as a credit because it was not claimed within the applicable two year statute for taxes overpaid by withholding. It also held, however, that the credit carryover from 1991 to 1992 was not an estimated tax payment within the purview of the statute of limitations, and consequently, the two year statute did not apply. The Final Order in *Stephens* cites the prior holding in *Brayman*, and reads in pertinent part as follows:

The specific issue in this case is whether the Taxpayers paid their 1992 taxes by withholding or estimated payment. The \$2,718.50 withheld in 1992 was obviously paid through withholding. A refund of that amount is thus barred by the two year statute. However, as explained below, the \$5,000.00 credited from 1991 to 1992 was not an "estimated payment" within the context of the statute. Rather, the amount credited to 1992 should be deemed paid when the 1992 return was filed and the credit applied, in which case the refund of that amount (or credit carryover) was timely claimed.

This same issue was decided in *Brayman v. State*, Admin. Law Docket Inc. 95-411, decided January 9, 1996. The Final Order in *Brayman* reads in pertinent part as follows:

The Department argues that because the Taxpayers' 1992 return was not timely filed, then 40-2A-7(c)(2)a. requires that any amount overpaid for that year must be claimed within two years from when the tax was paid. The statute further provides that taxes paid by withholding or estimated payments are deemed paid on the original due date of the return. The Department treated the credit carryover from 1991 to 1992 as an estimated payment. The Department thus argues that the taxes paid either through withholding and estimated payment for 1992 must be deemed paid on April 15, 1993, the due date of the 1992 return. Consequently, the amount cannot now be refunded or credited because the Taxpayers failed to apply for a refund or credit within two years from that date.

To begin, I agree that §40-2A-7(c)(2)a., as amended by Act 95-607, is controlling in this case. The effective date of Act 95-607 was July 31, 1995. The Taxpayers requested the refund and credit in issue on their 1992 return, which was not filed until August 18, 1995 (October 12, 1995 in this case), after the effective date of Act 95-607.

Applying §40-2A-7(c)(2)a., as amended, I agree with the Department that the Taxpayers failed to timely claim a refund or credit of the tax withheld during 1992. However, I disagree with the Department concerning the amount overpaid in 1991 that was carried over as a credit to 1992.

The Taxpayers paid \$4,087.00 (\$2,718.50 in this case) through withholding in 1992. Section 40-2A-7(c)(2)a. clearly provides that if a return is not timely filed, then tax overpaid by withholding during the year must be claimed within two years from the original due date of the return. Because the Taxpayers failed to claim the amount withheld during 1992 within two years from the return due date, April 15, 1993, that amount cannot now be refunded or allowed as a credit pursuant to §40-2A-7(c)(2)a.

Concerning the amount carried over from 1991 as a credit to 1992, the Department characterizes that amount as an estimated payment, which it claims must also be treated the same as tax paid through withholding pursuant to §40-2A-7(c)(2)a. I disagree. The credit should not be treated as an estimated payment.

"Estimated payment" is a term of art relating to the declaration of quarterly estimated tax payments provided for in Code of Ala. 1975, §§40-18-82 and 40-18-83. Those sections require generally that if a taxpayer has sufficient non-wage income during a year, he must report and make estimated quarterly payments during the year. Clearly, an amount overpaid in one year that is carried over as a credit to a subsequent year is not an estimated payment within that context. There is no estimated liability to which the credit can be applied. Consequently, the 1991 credit used to pay the 1992 liability should not be deemed paid on the original due date of the 1992 return. Rather, tax overpaid in one year that is carried over as a credit to a subsequent year should be treated as paid when the subsequent year's return is filed and the

taxpayer's liability for that year is initially declared. *Ameel v. U.S.*, 426 F.2d 1270 (1970).

*Brayman*, at page 2.

The Department applied for a rehearing in *Brayman*, and a Final Order Denying Application For Rehearing was issued on March 26, 1996. That Order reads in pertinent part as follows:

The Department argues that the amount must be treated as an estimated tax payment because the Alabama return refers to the credit as an "estimated tax". Line 30 of the return reads - "Amount of line 29 (amount overpaid) to be applied to your 1992 estimated tax." But the fact that the return uses the term "estimated tax" does not mean that the amount is an "estimated payment" within the scope of §40-2A-7(c)(2)a. The Department's own instructions concerning Line 30 of the return (see, page 2 of Department's Application for Rehearing) also contradicts the Department's position in this case - "The amount entered on this line (Line 30) can only be claimed as a credit on your 1992 Alabama return." (emphasis added).

Section 40-2A-7(c)(2)a. was amended by Act 95-607 to rectify a specific loophole. Prior to Act 95-607, if a taxpayer overpaid income tax through withholding or estimated payments during the subject year, then the taxpayer had a full three years from when his return was filed to claim a refund of those amounts, even if the return was filed late. Act 95-607 added the "deemed paid" language relating to withholding and estimated tax payments to eliminate the loophole. Clearly, the amendment was intended to apply only to tax withheld during the subject year pursuant to Code of Ala. 1975, §§40-18-70 et seq. and tax paid by estimated payments during the subject year pursuant to Code of Ala. 1975, §§40-18-82 and 40-18-83. An amount overpaid in a prior year and carried over as a credit to a subsequent year is not an estimated payment within the meaning of §40-2A-7(c)(2)a.

*Brayman*, at page 1.

*Stephens* at 2 – 4.

*Stephens* and *Brayman* hold that when a taxpayer overpays income tax in a year and elects on that year's return to apply all or a part of the overpayment to the next year's liability, the taxpayer has in substance claimed or declared the overpayment as a credit toward the next year's liability. The credit amount is subsequently deemed paid when the next year's return is filed and the credit is applied to pay the tax due in that year.

In this case, the Taxpayer paid \$30,000 in withholding in 2004 and claimed a credit carryover of \$59,020 from 2003 on his 2004 return. The return reported tax due of \$32,653. The Department allowed the \$30,000 paid by withholding to partially offset the reported tax due, but disallowed the credit carryover of \$59,020. It consequently assessed the Taxpayer for the remaining tax due of \$2,653 (\$32,653 liability less \$30,000 paid by withholding), plus a 10 percent late filing penalty and interest.

Pursuant to *Stephens* and *Brayman*, the \$59,020 credit carryover to 2004 should be deemed paid when the 2004 return was filed, and thus should be allowed to offset the remaining tax due of \$2,653. The balance of \$46,367 overpaid in 2004 should also be allowed as a credit carryover to the 2005 return. The above rationale also applies to the subsequent credit carryovers claimed on the 2006 and 2007 returns. Because the credit carryovers were sufficient to pay the remaining tax due in each year, the tax due in those years was paid in full.

The Taxpayer's 2004 and 2005 returns were not filed within two years from the original due dates of the returns. As indicated, §40-2A-7(c)(2)a. specifies that if a return is not timely filed, tax overpaid by withholding must be claimed within two years from the original due date of the return. The two year statute at §40-2A-7(c)(2)a. does not apply to



the tax withheld in 2004 and 2005, however, because that section only applies to any amount *overpaid* by withholding. The \$30,000 and \$35,000 withheld in 2004 and 2005, respectively, did not result in overpayments in those years. Rather, the amounts were correctly applied by the Department to partially pay the reported tax due of \$32,653 and \$40,397 in 2004 and 2005, respectively. The \$100,000 paid with the Taxpayer's extension to file his 2006 return was also timely claimed within the general three year statute at §40-2A-7(c)(2)a., and must also be allowed.

The above holding is supported by the rule of statutory construction that a taxing statute must be construed for the taxpayer and against the government. *Scott & Scott, Inc. v. City of Mountainbrook*, 844 So.2d 577 (Ala. 2002); *Alabama Farm Bureau Mutual Cas. Ins. Co. v. City of Hartselle*, 460 So.2d 1219 (Ala. 1984). And while a statute of limitations barring the assessment and collection of taxes otherwise due must be construed in favor of the government, see *Badaracco v. CIR*, 104 S. Ct. 756, 761 (1986), conversely a statute of limitations barring a refund of overpaid tax must be construed for the taxpayer and against the government. The above holding also follows the Legislature's mandate that Chapter 2A of Title 40, Code 1975, which contains the statute of limitations relating to refunds and credits, "shall be liberally construed to allow substantial justice." Code of Ala. 1975, §40-2A-2(1)a.

As stated by the Department's own Hearing Officer in his report concerning the 1997 preliminary assessment entered against the Taxpayers – "The treatment of overpayments credited to a subsequent year is not specifically guided by statute. There is no statute specifying the method of crediting an overpayment to another year, nor for applying a

particular statute of limitations.” Because the application of the prior year overpayments to the next year’s liability is not barred by a statute of limitations, they must be allowed.

As indicated, the tax due in the subject years was paid in full when the Taxpayer filed the returns for those years and applied the prior overpayments in October 2008. The tax due as shown on the final assessments in issue is due to be voided.

The remaining issue is whether the Department correctly assessed interest and the late filing penalties. Interest is due on any tax not paid by the due date. Code of Ala. 1975, §40-1-44. As discussed, the overpaid amounts carried over to each year in issue were deemed paid for statute of limitations purposes when the returns were filed in October 2008. Consequently, the amounts must also be deemed paid in October 2008 for interest purposes. The Taxpayer thus owes interest on the tax assessed for each year from the due date of the each year’s return until the tax was deemed paid in October 2008.<sup>1</sup>

Code of Ala. 1975, §40-2A-11(a) levies a late filing penalty if a return is not filed by the due date. The penalty is the greater of 10 percent of any additional tax required to be paid with the return, or \$50. The penalty applies in this case because the Taxpayer filed his 2004 through 2007 returns after the due date. The Department also correctly assessed the Taxpayer for 10 percent of the tax that was due and deemed paid when the returns were filed in October 2008.

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<sup>1</sup> The final assessments in issue include interest computed through the dates the final assessments were entered, which were March 30, 2009 concerning the 2004 final assessment, May 11, 2009 concerning the 2007 final assessment, and May 26, 2009 concerning the 2005 and 2006 final assessments. As indicated, the Taxpayer owes interest only through October 2008.

The Department should recompute the interest due as indicated above and notify the Administrative Law Division of the interest due for each year. A Final Order will then be entered for the interest and penalties due.

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

Entered February 6, 2013.

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BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: Warren W. Young, Esq.  
Michael Hamner, CPA  
Kim Peterson