QHG OF GADSDEN, INC. d/b/a GADSDEN REGIONAL MEDICAL CENTER 1007 GOODYEAR AVENUE GADSDEN, AL 35903,	§ § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 10-115
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

PRELIMINARY ORDER ON DEPARTMENT'S APPLICATION FOR REHEARING

This appeal involves a partially denied State use tax refund requested by QHG of Gadsden, Inc., d/b/a Gadsden Regional Medical Center ("Taxpayer") for February 2005 through December 2006. The Taxpayer operated a hospital in Gadsden, Alabama during the period in issue. It petitioned the Department for a refund of use tax that it had paid on human tissue used in transplant surgeries. The Department agreed that the tax on the tissue had been erroneously paid, but reduced or offset the refund by an amount of use tax it claimed the Taxpayer owed on food used at the hospital during the subject period. The Taxpayer appealed.

A hearing was conducted on May 27, 2010. Assistant Counsel Wade Hope represented the Department. James Privett represented the Taxpayer. The Administrative Law Division entered a Final Order on July 8, 2010 which held that the refund should be granted in full because the Department could not offset an otherwise due refund with an unrelated amount of tax that may be owed by the Taxpayer for the same tax period.

The Department timely applied for a rehearing. After careful review, the application is granted based on the language in Code of Ala. 1975, §40-2A-13(c).

Section 40-2A-13 was enacted in 1998 as part of the Local Tax Procedures Act of 1998, Act 98-191. That Act amended portions of the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act ("TBR/URPA"), §40-2A-1 et seq., and also added various provisions that, in substance, made many of the Revenue Department-related procedures in the TBR/URPA also applicable to self-administered county and municipal governments.

Section 40-2A-13 addresses generally the authority and limitations on the Department and self-administered counties and municipalities concerning the examination of a taxpayer's records. Section 40-2A-13(c) specifies that the Department and self-administered counties and municipalities shall promulgate regulations concerning the second examination of a taxpayer's records consistent with those followed by the IRS. It also further provides that a second examination shall be allowed in certain enumerated circumstances. The circumstance relevant to this case is §40-2A-13(c)(iii), which provides that a second examination may be allowed to "verify a direct or joint petition for refund claim and to determine if there is any offsetting tax liability to be credited against or that may exceed the refund claim. . . ."

I had never reviewed §40-2A-13 before this case because I was not involved in drafting Act 98-191, and the statute has not been in issue before the Administrative Law Division since its enactment. Having carefully reviewed the statute, and specifically §40-2A-13(c)(iii), it is clear that the Alabama Legislature intended or envisioned that if a taxpayer petitions for a refund, the Department is authorized to audit the taxpayer and offset or eliminate the refund if it is determined that the taxpayer otherwise owes additional tax for the applicable period. Consequently, I now agree that the Department is authorized to offset the refund due on the human tissue in this case with any additional use tax the

Taxpayer may owe on the food used in the hospital. The Administrative Law Division will address that issue and issue an appropriate Order in due course.

The July 8 Final Order also held that a refund could only be offset by an "outstanding final tax liability." Code of Ala. 1975, §40-2A-7(c)(4). As discussed above, if a taxpayer petitions for a refund, the Department is authorized to audit the taxpayer for the type of tax and period involved in the petition to determine the amount of refund due, if any. Once the refund amount is determined, the Department is further allowed to offset the refund by any "outstanding final tax liability." The July 8 Final Order, at 3, defined that phrase as "an accrued liability in the form of a final assessment from which a statutory appeal is no longer allowed, or a liability that has been affirmed on appeal by the Administrative Law Division or by a circuit or appellate court in Alabama and from which no further appeal can be taken."

The Department argues in its application for rehearing that the Division's definition of "outstanding final tax liablity" does not take into account admitted liabilities. The Department's application for rehearing reads in pertinent part as follows, at 3:

> The Administrative Law Division's misplaced reliance on *Rheem* results in consequences that certainly no one in the ADOR could foresee. For example, if the Final Order is not modified, the Administrative Law Division's Order would result in the ADOR not being able to use admitted liabilities to offset an income tax refund in another year without entering a final assessment for the unpaid tax. Likewise, monthly sales tax returns filed without remittance of the tax could not be used to offset a refund without a final assessment being entered. It is submitted that the "outstanding final tax liability" interpretation does not take into account situations involving admitted liabilities. It results in an unnecessary and time consuming expense to require the ADOR to go through the complete assessment process in order to reduce refunds by admitted liabilities. The Taxpayers are forced to wait until the entire process is over with before receiving net refund amounts to which they are entitled. Because a final assessment would have to be entered, the refund cannot be reduced by the admitted final liability until after all appeal rights have been exhausted. This is a ridiculous result.

Although the term “admitted liability” is not defined by the Alabama Revenue Code, Title 40, Code 1975, it unquestionably includes an amount reported by a taxpayer as tax due on a return. But an amount reported by a taxpayer as due on a return, while an admitted liability, is not an outstanding final tax liability within the purview of §40-2A-7(c)(4). As indicated, for an amount reported as due on a return to become a final tax liability, the Department must finally assess the tax due and the time for appeal must expire.

The assessment procedure is, however, streamlined for reported or admitted liabilities. Code of Ala. 1975, §40-2A-7(b)(1)b. provides that “[w]here the amount of tax or value reported on a return is undisputed by the department . . ., the department may immediately enter a final assessment for the amount of tax or value, plus applicable penalty and interest, ...” Thus, if a taxpayer admits a liablity on a return, the Department must still assess the taxpayer, but can directly enter a final assessment. The taxpayer is still entitled to appeal the final assessment, however, for whatever reason, and the liability does not become an “outstanding final tax liability“ until the final assessment can no longer be appealed.

I agree that requiring the Department to assess an admitted liability is administratively burdensome and somewhat time consuming, although being allowed to directly enter a final assessment in such cases considerably shortens the period required for the liability to become final. That is, however, the current procedure required by Alabama law. Section 40-2A-7(c)(4) may be amended to provide that a refund due may also be offset by any “admitted liability reported on a return,” but the statute does not currently include that language.

As a practical matter, if a taxpayer is due a refund but also owes other tax that has

not been assessed, or, if assessed, is not final, the Department may, of course, notify the taxpayer that it intends to withhold the refund until the liability becomes final. The Department could also allow the taxpayer to agree in writing to the amount of the contingent liability, waive all appeal rights, and allow the Department to immediately issue the net refund due. The above procedure would eliminate the Department's concern that a net refund could not be issued until all appeal rights concerning the contingent liability have expired and the liability becomes final.

To summarize, if a taxpayer petitions for a refund, the Department may audit the taxpayer for the type of tax and period involved to determine the correct amount of refund due, if any. If the refund is denied in whole or in part, or deemed denied, and the taxpayer appeals to the Administrative Law Division, the Division only has authority or jurisdiction to address those issues raised by the taxpayer in the refund petition, or, as in this case, raised by the Department pursuant to its audit or review of the petition. *Rheem Mfg. Co. v. State, Dept. of Revenue*, 33 So.3d 1 (Ala. Civ. App. 2009) cert. denied (Ala. S. Ct. 3/12/2009).[1]

The Department may also, before issuing the net refund due for the type of tax and period involved, reduce or offset the refund by any outstanding final tax liability otherwise

[1] I still construe *Rheem* as holding that once a denied or reduced refund is appealed to the Administrative Law Division, the Division cannot address an issue not previously raised by the parties. This is, in my opinion, unfortunate because in hundreds of cases decided before *Rheem*, one or both parties raised additional issues relevant to the taxpayer's liablity after the case was appealed to the Division. The Division always considered those issues in deciding the case, with the end goal of finding the taxpayer's correct liability for the period in issue. The Department never objected to the Division addressing and deciding all relevant issues, and the Department itself had raised additional issues in numerous cases on appeal. Even in *Rheem*, the Department initially agreed for the Division to hear and decide the push-down accounting issue. Only on appeal did the Department for the first time argue that the Division did not have jurisdiction to decide the issue.

owed by the taxpayer. For offset purposes, an outstanding final tax liability may involve any type tax owed by the taxpayer and administered by the Department. For example, if a taxpayer is entitled to a $1,000 sales tax refund for November 2008, the Department may offset the refund with a $500 final, unappealed from 2004 income tax final assessment previously entered against the taxpayer.

Finally, the Department asserts in its application for rehearing, at 3, that "it is well known that the Administrative Law Division does not agree with the decision in the *Rheem* case." I understand and respect the Court's rationale in *Rheem*, although it is unfortunate that the Court was apparently unaware that since the TBR/URPA was enacted in 1992, and in fact since the Administrative Law Division was created in 1983, the Department had always construed the governing statutes as allowing the Division to decide all relevant issues on appeal, including those issues raised after the appeal was filed. The longstanding and consistent interpretation of a statute by the agency charged with its administration, the Department in this case, is entitled to great weight. *Patterson v. Emerald Mt. Expressway Bridge, LLC,* 856 So.2d 826, 833 (Ala. Civ. App. 2002), citing *Yelverton's, Inc. v. Jefferson County*, 742 So.2d 1216 (Ala. Civ. App. 1997).

In any case, my concern with the *Rheem* decision, as discussed above in n. 1, is that it prohibits the Division from deciding all relevant issues on appeal for the purpose of deciding a taxpayer's correct liability for the period. Code of Ala. 1975, §40-2A-2(1)a. provides that Chapter 2A of Title 40, Code 1975, "shall be liberally construed to allow substantial justice." The statute that establishes the authority of the administrative law judge, Code of Ala. 1975, §40-2A-9(a), specifies that the section "should be liberally construed to provide for the fair, efficient, and complete resolution of all matters in dispute." Substantial justice and a complete resolution of a taxpayer's appeal can only be reached if all relevant issues are addressed for the purpose of finding a taxpayer's true and correct liability. The Division can no longer do so in certain circumstances based on *Rheem*.

The July 8, 2010 Final Order is voided. The Administrative Law Division will decide in due course the Taxpayer's liability for use tax on the food used at its hospital in Gadsden during the subject period. An appropriate Opinion and Preliminary Order or Final Order will then be entered. The Division may, upon further study, require one or both parties to file briefs on the food issue, or, if deemed necessary, a second hearing will be conducted in the matter.

The Division has been notified that the Department has entered a use tax preliminary assessment against the Taxpayer for the use tax that it claims that the Taxpayer owes on the food used during the period in issue. Because the Division will address that issue in this case, it is hoped that the Department will hold the preliminary assessment in abeyance pending this case. The parties are encouraged to further discuss the Taxpayer's liability on the food for purposes of settling the issue.

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

Entered August 24, 2010.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: J. Wade Hope, Esq.
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