

Alabama ALJ Denies Sales Tax Refund Because Taxpayer Failed to Claim Credits on Returns

By Bruce P. Ely and James E. Long, Jr.

Bruce Ely and James Long, Jr., discuss the recent Alabama ruling in *Tellabs Operations, Inc. v. State Department of Revenue*.

Chief Administrative Law Judge Bill Thompson has held that a taxpayer that internally applied a sales tax credit to internally pay its monthly sales tax liabilities, and then filed monthly returns showing zero sales, zero liability, and zero credits claimed, failed to properly pay its liabilities by claiming the credits on its returns in the subject months. A subsequent refund petition was thus barred by the statute of limitations.¹

The taxpayer sold communications equipment to customers in Alabama. It computed and paid its Alabama sales tax on an accrual basis (although Ala. Code §40-23-8 allows it to instead report on the cash method). In June 2004, one of the taxpayer's customers provided an ADOR-issued sales and use tax exemption certificate. The taxpayer determined that it had overpaid approximately \$200,000 in Alabama sales tax on its *pre*-June 2004 sales to this customer (although the customer had not yet paid the taxpayer for the goods or any sales tax charged to the customer).

Instead of filing a petition for refund or claiming the overpaid amount as a credit on its subsequent monthly sales tax returns, the taxpayer maintained a running total of the overpaid amount as a sales tax credit on its internal bookkeeping system. The taxpayer "thereafter internally computed the tax due in each subsequent month, internally applied the running credit amount to zero-out the tax due, and then filed monthly sales tax returns with the Department from June 2004 forward showing zero sales, zero credits claimed, and zero tax due." Oddly, the taxpayer continued to incorrectly treat the sales to the exempt customer as taxable, and eventually filed a



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Bruce P. Ely is a Partner with the law firm of Bradley Arant Boult Cummings LLP. He can be reached at 205-521-8366 or bely@bab.com.

James E. Long, Jr., is an Associate with the law firm of Bradley Arant Boult Cummings LLP. He can be reached at 205-521-8626 or jelong@bab.com.

refund petition with the ADOR in October 2007 for sales taxes allegedly overpaid in September 2005. The ADOR denied the refund petition in January 2008, and the taxpayer appealed to the Administrative Law Division.

On appeal, the taxpayer argued that when it filed sale tax returns after May 2004, "it was in substance applying the prior overpayments as a credit to satisfy the tax due each month." As support, the taxpayer cited two cases involving overpaid individual income taxes that were carried over to a subsequent tax year, in which the Administrative Law Division held that the subsequent tax year's payment occurred when the credit was applied to satisfy the liability (and not when the tax was initially paid through withholding, as argued by the ADOR).²

Judge Thompson disagreed, holding that the "*Stephens* and *Brayman* rationale does not apply in this case, however, because the Taxpayer in this case never carried over and claimed the pre-June 2004 overpayments as a credit on its returns filed after May 2004. Internally computing the sales tax due in a month, internally applying a prior overpayment

to internally zero out the tax due, and then filing a zero return with the Department does not constitute a payment of the tax due for the month." Judge Thompson also rejected the taxpayer's argument that it complied with the ADOR's regulation and instructions for claiming a credit on sales tax returns because the taxpayer failed to claim or report the credit on any sales tax returns filed with the ADOR after May 2004. The internal credits maintained by the taxpayer did not satisfy the requirements for claiming a credit or filing a petition for a refund of overpaid sales taxes, and the refund petition filed in September 2007 was barred by the statute of limitations because the taxpayer did not pay any Alabama sales taxes after May 2004.

Judge Thompson disagreed, holding that the "*Stephens* and *Brayman* rationale does not apply in this case, however, because the Taxpayer in this case never carried over and claimed the pre-June 2004 overpayments as a credit on its returns filed after May 2004. Internally computing the sales tax due in a month, internally applying a prior overpayment to internally zero out the tax due, and then filing a zero return with the Department does not constitute a payment of the tax due for the month."

ENDNOTES

- 1 *Tellabs Operations, Inc. v. State Department of Revenue*, Admin. L. Div. Dkt No. S. 09-1107 (Final Order on Taxpayer's App. for Reh'g Apr. 18, 2011).
- 2 See *Stephens v. State of Alabama*, Admin. L. Div. Dkt. No. Inc. 96-127 (Apr. 12, 1996); *Brayman v. State of Alabama*, Admin. L. Div. Dkt. No. Inc. 95-411 (Mar. 5, 1996).

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