

State and Local Tax Bulletin

October 21, 2011
Alabama Edition



BRADLEY ARANT
BOULT CUMMINGS
LLP

Class Action Suit Against Contract Auditing Firm Survives Motion To Dismiss

By Bruce P. Ely and J. Sims Rhyne, III

Upcoming Seminars Involving Members Of Our SALT Practice Group

October 23-28, 2011

New York University's 70th Institute on Federal Taxation will be held in New York City at the Grand Hyatt Hotel on October 23-28, 2011, and will also be held in San Francisco at The Fairmont Hotel from November 13-18, 2011. Bruce Ely will be speaking at the New York venue and Chris Grissom will be speaking at the San Francisco venue on "The Strained Relationship Between the Federal and State Taxation of Pass-Through Entities." For more information, please visit the NYU Continuing Education Department's website at www.scps.nyu.edu/ift.

November 4, 2011

Lorman Education Services' annual seminar on "Sales and Use Tax in Alabama" will be held at The Harbert Center in downtown Birmingham, Alabama. SALT Practice Group members Bruce Ely, Chris Grissom, Jimmy Long, and Will Thistle will be leading this comprehensive eight hour course. For more information, visit www.lorman.com.

The class action suit filed on behalf of many Alabama taxpayers against the largest contract auditing firm in the state and its 250 or so municipal and county government clients has survived its first major challenge, after almost two years of legal wrangling. On Wednesday, October 19, Jefferson County (Birmingham) Circuit Judge Robert Vance denied in large part the motion to dismiss filed by defendants PRA Government Services, LLC d/b/a Revenue Discovery Systems, RDS, and formerly, AlaTax. The taxpayer-plaintiffs allege in their amended complaint that RDS or its contract auditors committed multiple violations of the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act ("TBOR") as amended by the 1998 Local Tax Simplification Act, including: failing to notify taxpayers who had overpaid sales or use taxes of the procedures for filing a refund claim; failing to notify taxpayers of the right to an administrative appeal, in lieu of being forced to file an appeal in circuit court; failing to comply with auditor surety bonding requirements; entering into contingency fee auditing contracts with local governments; and compensating its employees and independent contractors through incentive bonuses based on tax collections or assessments.

In their amended complaint, the plaintiffs request several forms of relief: a declaratory judgment that RDS's contracts with its local government clients are void and unenforceable under TBOR; that RDS's practices are improper and violate various provisions of TBOR; and that any and all tax assessments, liens, levies, and collection performed in relation to RDS's "Tax Revenue Enhancement Agreements" are invalid and constitute unlawful takings. The plaintiffs also request an injunction against RDS from engaging in any conduct that the court finds to violate TBOR as well as a refund of all fees collected by RDS in violation of TBOR.

The amended complaint, Judge Vance ruled, provides detailed allegations "painting a real, definite, and present controversy" such that the declaratory judgments the taxpayer-plaintiffs seek are proper and should not be dismissed. Lead counsel for the taxpayers, Charles "Chip" McCallum III, of McCallum, Hoaglund, Cook & Irby, LLP, Vestavia Hills, responded to the favorable decision, saying, "The ruling means that Alabama businesses will have their day in court over these abusive practices."

RDS' President, Kennon Walthall, stated in the same October 21 *Birmingham News* article that "the suit is without merit and will be vigorously defended." RDS is represented by a major Birmingham law firm, Burr & Forman LLP, who argued that the circuit court lacked subject matter jurisdiction and that a private right of action for the taxpayer-plaintiffs does not exist under TBOR. *The risks for RDS here are extremely high under TBOR and the 1998 Act: potential forfeiture of monies paid to it by local government clients, suspension of its right to audit on behalf of local governments or revocation of its auditing contracts, imposition of Class A misdemeanor penalties, and other damages.*

Judge Vance rejected RDS's first argument that TBOR does not provide a private cause of action under which the plaintiffs can seek relief. This argument overlooked the fact that TBOR does provide certain rights to taxpayers, thereby giving them the ability to obtain a clarification of those rights under Alabama's declaratory judgment statute. Calling RDS's assertions that the plaintiffs cannot seek relief in the form of misdemeanor penalties, contract terminations, license revocations, or damages a "red herring," Judge Vance noted that those forms of relief were not at issue here.

RDS's next argument, that the plaintiffs must exhaust their administrative remedies before bringing a claim in court for declaratory relief, was also rejected. The court, quoting the recent Alabama Supreme Court decision in *City of Huntsville v. COLSA Corp.*, 2011 WL 1334397 (Ala. Apr. 8, 2011), stated that, "it is the appeal from an *effective* final assessment that confers upon the courts subject-matter jurisdiction to entertain the case in the first instance." Furthermore, the court found that this comported with the plaintiffs' assertion that Alabama Code § 40-2A-7(b)(5) creates an appeal process designed to review only whether the amount of the assessment was correct, with the premise being that the assessment process itself was valid (one of the key issues raised by the taxpayers).

Judge Vance also rejected RDS's argument that "it makes no sense to assert that the central legal challenges [Plaintiffs] assert . . . cannot be entertained in a judicial appeal under § 40-2A-7." Whether or not it makes sense, Judge Vance stated, the conclusion that the plaintiffs did not have to exhaust their administrative remedies under § 40-2A-7 in these circumstances appears to be mandated by the Supreme Court's ruling in *COLSA*.

Judge Vance next turned to RDS's due process arguments. RDS argued that the plaintiffs' due process claims must be dismissed because RDS is a private contractor rather than an arm of the government. The plaintiffs countered by pointing out that RDS acts as an agent for the taxing authorities, therefore bringing it within the scope of Alabama's due process protections. Citing U.S. Supreme Court precedent, Judge Vance agreed and refused to dismiss those counts.

The court did dismiss Count Eight of the amended complaint, which alleged a breach of contract claim, because the court found that the plaintiffs may not base any claim on a third-party beneficiary theory. Count Fifteen, dealing with appeals and refunds under TBOR, was also dismissed because of the previous conclusion of the court that an appeal under Alabama Code § 40-2A-7 was not the proper vehicle for a challenge under the *COLSA* decision.

We are advised by counsel for the taxpayer-plaintiffs that their next step will be official certification of the class, including which business taxpayers should be members. Both the Alabama and multistate business community as well as local governments are watching this case closely. If you have any questions regarding this lawsuit or its potential impact on your client or company, please contact [Bruce Ely](#), [Chris Grissom](#), [Jimmy Long](#), or [Will Thistle](#).

Bradley Arant Boulton Cummings LLP Office Locations:

ALABAMA One Federal Place 1819 Fifth Avenue North Birmingham, AL 35203 (205) 521-8000 200 Clinton Avenue West, Suite 900 Huntsville, AL 35801 (256) 517-5100 The Alabama Center for Commerce 401 Adams Avenue, Suite 780 Montgomery, AL 36104 (334) 956-7700	MISSISSIPPI 188 E. Capitol Street, Suite 400 Jackson, MS 39201 (601) 948-8000 NORTH CAROLINA 100 North Tryon Street, Suite 2690 Charlotte, NC 28202 (704) 332-8842 TENNESSEE 1600 Division Street, Suite 700 Nashville, TN 37203 (615) 244-2582
WASHINGTON, DC 1615 L Street, N.W., Suite 1350 Washington, DC 20036 (202) 393-7150	

This newsletter is sent to our friends as a courtesy of Bradley Arant Boulton Cummings LLP. If you would prefer not to receive future emails of this type, please contact Jerry Young at jyoung@babbc.com.

This newsletter is a periodic publication of Bradley Arant Boulton Cummings LLP and should not be construed as legal advice or legal opinions on any specific facts or circumstances. The contents are intended for general information only, and you are urged to consult your own lawyer or other tax advisor concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our practice group.

The Alabama State Bar requires the following disclosure: "No representation is made that the quality of the legal services to be performed is greater than the quality of legal services performed by other lawyers."
©2011 Bradley Arant Boulton Cummings LLP

SALT Practice Group:

Bruce P. Ely, Chair
(205) 521-8366
bely@babbc.com

Brett R. Carter
Vice-Chair
(615) 252-2383
bcarter@babbc.com

Joseph W. Gibbs
(615) 252-2317
jgibbs@babbc.com

W. Stanley Gregory
(334) 956-7604
sgregory@babbc.com

Christopher R. Grissom
(205) 521-8514
cgrissom@babbc.com

K. Wood Herren
(205) 521-8505
wherren@babbc.com

Emil Hirsch
(202) 719-8211
ehirsch@babbc.com

James E. Long, Jr.
(205) 521-8626
jelong@babbc.com

Patricia Head Moskal
(615) 252-2369
pmoskal@babbc.com

Brian S. Shelton
(615) 252-2313
bshelton@babbc.com

William T. Thistle, II
(205) 521-8985
wthistle@babbc.com

Robert D. Thorington
(334) 956-7609
rthorington@babbc.com

Robert C. Walthall
(205) 521-8308
rwalthall@babbc.com

Stephen M. Wilson
(601) 592-9957
swilson@babbc.com

