

STATE OF ALABAMA  
DEPARTMENT OF REVENUE,

vs.

SHOE STATION, INC.  
450 Bel Air Boulevard  
Mobile, AL 36606,

Taxpayer.

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 93-233

THIRD FINAL ORDER  
ON APPLICATION FOR REHEARING

The Department assessed income tax against Shoe Station, Inc. ("Taxpayer") for the year 1987. The Taxpayer appealed the assessment, and also claimed a refund for the subject year.

The case was originally submitted for decision on a joint stipulation of facts. A Final Order was entered on November 8, 1993 granting the refund to the Taxpayer. The Department applied for a rehearing. A Final Order On Application For Rehearing was entered on December 16, 1993 reversing the original Final Order and denying the refund.

The Taxpayer subsequently applied for a rehearing. A Second Final Order On Application For Rehearing was entered on January 5, 1994, again denying the refund and also upholding the final assessment in issue in the amount of \$9,020.09. The Taxpayer again applied for a rehearing. A hearing was conducted in the matter on May 11, 1994. Michael E. Ballard, Dan Simms and Kim McConkey appeared for the Taxpayer. Assistant counsel Duncan Crow represented the Department.

The relevant facts in this case are as follows:

(1) The Taxpayer filed its original 1987 Alabama income tax return on March 16, 1988. The Taxpayer paid the reported additional tax due of \$5,332.00.

(2) The IRS audited the Taxpayer and entered into a closing agreement with the Taxpayer on March 27, 1991.

(3) The Taxpayer subsequently filed an amended 1987 Alabama return on May 16, 1991. The amended return omitted or did not include miscellaneous expenses of \$13,930.00 claimed on the original Alabama return but which were subsequently disallowed by the IRS. By not claiming the expenses, taxable income on the amended return was thus increased by \$13,930.00. The amended return also included additional income of \$50,407.00 reflecting an inventory adjustment. Total additional income reported on the amended return was \$64,337.00 (\$13,930.00 plus \$50,407.00).

The amended return also claimed an additional federal tax deduction of \$175,173.00. Of that amount, \$5,293.00 related to additional federal tax paid per the IRS audit. The remaining \$169,880.00 did not relate to the IRS audit, but rather had been erroneously omitted from the Taxpayer's original 1987 return.

(4) The Department initially accepted the amended return as filed and issued a refund of \$5,542.00 as claimed on the return.

(5) The Department subsequently audited the amended return and made two adjustments. First, the inventory adjustment of \$50,407.00 included as income on the amended return was omitted.

That adjustment is undisputed by the Taxpayer. Second, the Department disallowed the claimed federal income tax deduction in the amount of \$169,880.00 because that portion was not related to the IRS audit.

The Department's adjustments resulted in additional taxable income of \$119,473.00 (\$169,880.00 minus \$50,407.00). That net adjustment was added to taxable income of \$285,808.00 as reported on the amended return, which resulted in a corrected taxable income of \$405,281.00 (\$119,473.00 plus \$285,808.00). Tax due on that amount at 5% was \$20,264.00. The Taxpayer was credited for \$14,500.00 previously withheld, plus \$5,332.00 paid with the original return, which resulted in a net tax due of \$432.00 (\$20,264.00 minus \$14,500.00 and \$5,332.00 equals \$432.00). The refund of \$5,542.00 previously issued as a result of the amended 1987 return was then added back to arrive at a total tax due of \$5,974.00 (\$5,542.00 plus \$432.00) .

(6) The Department entered a preliminary assessment on April 20, 1992 for the additional tax due of \$5,974.00, plus interest of \$2,627.24, for a total assessment of \$8,601.24. The final assessment in issue for \$9,020.09 was entered on April 16, 1993 based on the preliminary assessment plus additional interest.

The Taxpayer's position and basis for relief is set out in the Taxpayer's April 11, 1994 brief, as follows:

The statute of limitations on the 1987 Alabama tax return was extended from March 16, 1991 to June 15, 1991 because a federal waiver to

extend the statute was signed by the IRS and the taxpayer, extending the time to make changes to the 1987 tax return through June 15, 1991. The 1987 IRS audit changes were accepted by the chief of the Birmingham appeals office on March 27, 1991, which is 11 days after the original statute of limitations had expired. If the taxpayer had not signed the federal waiver to leave the 1987 tax return open until June 15, 1991, the IRS could not have left the 1987 tax return open after March 16, 1991. It is our understanding that the Alabama Department of Revenue has one year from the notification of IRS audit adjustments to enter a preliminary assessment for the IRS audit adjustments. The preliminary assessment that was entered on April 20, 1992 was within one year of notification, but the preliminary assessment's adjustments were a direct result of the Department of Revenue disallowing the correction of the federal income tax deduction, not the IRS audit adjustments. By processing the 1987 Alabama amended tax return; refunding \$5,542 in tax; reviewing the amended tax return in 1992; and not disallowing the IRS audit adjustments, the Department of Revenue accepted the IRS audit adjustments. By accepting the IRS audit adjustments, the Department of Revenue had to also accept the federal waiver to extend the statute of limitations until June 15, 1991. Otherwise, the Department of Revenue would have no authority to extend the statute of limitations to be able to accept the IRS audit report that had been closed after March 16, 1991. In addition, by accepting the federal waiver, the Department of Revenue also accepted all the provisions inherent by law in the federal waiver. Per IRC Sections 6511(C) and 6511(B), the federal waiver also allows the taxpayer to apply for a credit or refund during the extended period of any tax previously paid.

After a careful review of the facts, the Taxpayer's arguments, and the applicable law, the Department's assessment is affirmed.

The federal waiver referred to by the Taxpayer is irrelevant for Alabama tax purposes. Rather, the Department had one year from the date it was notified of the IRS adjustments in which to assess additional tax against the Taxpayer.<sup>1</sup> The Department was notified of the IRS adjustments when the amended return was filed on May 16, 1991. The Department thus timely entered the preliminary assessment in issue on April 20, 1992, within one year from receipt of the amended return.

The special one year IRS statute of limitations also requires that any tax assessed (or refund issued) must be based only on changes resulting from the IRS audit. The Department thus properly disallowed the federal tax paid deduction of \$169,880.00 because that deduction did not result from the IRS audit. The Department also properly omitted the \$50,407.00 inventory adjustment from the amended return because again it did not result from the IRS audit.

The Taxpayer had originally claimed miscellaneous expenses of \$13,930.00 on its original return which were disallowed by the IRS.

The Taxpayer in effect incorporated that IRS adjustment into its amended return by not claiming the expenses on the amended return.

The Department thus was not required to adjust the amended return

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The special one year IRS information statute of limitations was initially contained at Code of Ala. 1975, §40-18-45. That section was repealed effective October 1992 and was replaced by Code of Ala. 1975, §40-2A-7(b)(2)g, which in substance contains the same one year statute of limitations.

concerning the disallowed expenses because the Taxpayer had in effect already done so.

The Taxpayer's liability as computed by the Department reflects only those changes resulting from the IRS audit. The Department thus acted in accordance with the special one year IRS statute of limitations set out at Code of Ala. 1975, §40-2A-7(b)(2)g. The final assessment in issue is accordingly affirmed. Judgment is entered against the Taxpayer in the amount of \$9,020.09, plus additional interest computed from April 16, 1993.

This Third Final Order On Application For Rehearing may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §§40-2A-9(f) and (g).

Entered on November 7, 1994.

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BILL THOMPSON  
Chief Administrative Law Judge