JUDY DANIELS 1620 GEORGIA ROAD WETUMPKA, AL 36092-5433,	§ §	STATE OF ALABAMA ALABAMA TAX TRIBUNAL
		DOCKET NO. INC. 14-819
Taxpayer,	§	
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Alabama Revenue Department assessed Judy Daniels ("Taxpayer") for 2004 through 2009 income tax. The Taxpayer appealed to the Department's Administrative Law Division, now the Tax Tribunal, pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on November 20, 2014. Will Sellers represented the Taxpayer. Assistant Counsel Ralph Clements represented the Department.

The Taxpayer pled guilty to first degree theft of property in the Circuit Court of Montgomery County, Alabama on March 21, 2011. Specifically, the Taxpayer admitted to embezzling money from her employer from 2004 until her crime was uncovered in July 2009. The Taxpayer had been accused of embezzling over $1,450,000. A forensic audit of the employer's books by an independent accounting firm showed, however, that the Taxpayer had taken $171,022.

An employee in the Department's Income Tax Division clipped an article from the May 25, 2011 edition of the *Prattville Progress* newspaper concerning the Taxpayer's guilty plea. The employee wrote the Taxpayer's social security number on the article. The Department later obtained a copy of the forensic audit of the Taxpayer's employer, which showed that the Taxpayer had embezzled $21,027.95 in 2004, $18,531.60 in 2005, $45,664.73 in 2006, $43,265.82 in 2007, $36,434.72 in 2008, and $6,077.66 in 2009.

The Department sent the Taxpayer and her husband a 2011 billing notice in December 2013 for $66,920.72. The Taxpayer's representative protested the notice by letter dated January 2, 2014. The Department subsequently entered a 2011 preliminary assessment for $9,181.94 against the couple, jointly, on February 19, 2014.[1] It later entered preliminary assessments against the couple, jointly, for 2005, 2006, 2007, 2008, and 2009 on May 19, 2014, and a 2004 preliminary assessment against the couple on June 3, 2014. None of the above preliminary assessments have been made final.

The Taxpayer's representative at some point requested innocent spouse relief for the Taxpayer's husband. The Department did not formally grant the husband innocent spouse relief. It did, however, enter 2004, 2005, 2006, 2007, 2008, and 2009 preliminary assessments against the Taxpayer, individually, on June 13, 2014.[2] It entered final assessments against the Taxpayer, individually, for 2004 on July 24, 2014, and for 2005 through 2009 on August 19, 2014. This appeal followed.

The Taxpayer argues on appeal that the Department failed to timely enter the preliminary assessments against the Taxpayer, individually, within the time required by Code of Ala. 1975, §40-2A-7(b)(2).

The Department contends that because the joint returns filed by the Taxpayer and her husband for the subject years were fraudulent, the Department timely entered the

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[1] It is not known how the Department computed the amount due in the billing notice. The tax due on the preliminary assessment was based on the $171,022 embezzled by the Taxpayer from 2004 until 2009.

[2] A copy of a 2004 preliminary assessment against the Taxpayer, individually, is not in evidence. But because the Department subsequently entered a 2004 final assessment against the Taxpayer, individually, it is assumed that a 2004 preliminary assessment was also entered on or about June 2013.

preliminary assessments against the Taxpayer pursuant to Code of Ala. 1975, §40-2A-7(b)(2)a. That statute allows the Department to enter a preliminary assessment at any time "if a false or fraudulent return is filed with the intent to evade tax." It further claims that the preliminary assessments for 2007 and 2008 were also timely entered pursuant to Code of Ala. 1975, §40-2A-7(b)(2)b., which allows the Department six years to assess tax if a taxpayer omits more than 25 percent of the taxable base from a return.

The joint returns filed by the Taxpayer and her husband for the subject years were fraudulent because the Taxpayer was obviously aware that the joint returns failed to include the taxable income she had embezzled from her employer. The issue is, however, whether the holding in *New Joy Young Restaurant, Inc. v. State Dept. of Revenue*, 667 So.2d 1384, cert. denied 667 So.2d 1391 (Ala. 1995), applies. As explained below, the Alabama Court of Civil Appeals held in *New Joy Young* that in tax cases involving fraud, the general two year statute of limitations at Code of Ala. 1975, §6-2-3 for bringing a civil fraud action in circuit court applies, and consequently, if the Department is otherwise time-barred from assessing tax, the Department must assess tax in fraud cases within two years from when the fraud is or could reasonably have been discovered.

In *New Joy Young*, the Department audited the taxpayer, a restaurant, for sales tax for January 1983 through May 1986. The Department subsequently assessed the taxpayer for sales tax, penalty, and interest for May through December 1983. The Department later waived the penalty, and the taxpayer paid the tax and interest due for the above period in October 2006.

The Department took no further action against the taxpayer until the Spring of 1991, when it assessed the taxpayer for January 1984 through May 1986. The taxpayer

appealed to the Department's Administrative Law Division. The Division found that the taxpayer had fraudulently filed sales tax returns during the period in issue, and consequently, that the Department had timely entered the preliminary assessment against the taxpayer pursuant to Code of Ala. 1975, §40-23-18(b), now §40-2A-7(b)(2)a. The Department subsequently entered a final assessment against the taxpayer for the tax due, plus interest and the 50 percent fraud penalty.

The taxpayer appealed to the Jefferson County Circuit Court, which affirmed the Administrative Law Division. The Court of Civil Appeals reversed. That Court's opinion reads in part as follows:

> Joy Young contends, among other things, that the statute of limitations enacted by the legislature in § 6-2-3, Ala. Code 1975, bars the Department's sales tax assessment in this case. Because this is a matter of first impression before this court, we elect to address this issue first.
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> Absent any fraud, the Department's claim would have been barred by the three-year statute of limitations set forth in § 40-23-18(b), Ala. Code 1975, which provides:
>
>> Any notice, provided for by this division, of an amount due under this division shall be given or any action in court for the collection of such amount shall be begun within three years of the due date of such amount; provided, that in the case of a false or *fraudulent return* with intent to evade payment of taxes imposed by this division … the tax may be assessed or a proceeding in court for the collection of such tax may be begun at any time. (Emphasis added.)
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> Clearly, § 40-23-18(b) created a bar against giving notice or beginning an action in court under this division after three years from the due date of such amount; provided, however, that an action based on a fraudulent return may be begun at any time after the three-year bar.
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>> Section 6-2-3, Ala. Code 1975, provides:
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>> In actions seeking relief on the ground of fraud where the statute has created a bar, the claim must not be considered as having accrued until the discovery by the aggrieved party of

> the fact constituting the fraud, after which he must have two years within which to prosecute his action.

Both § 40-23-18(b) and § 6-2-3 deal with fraudulent acts. "Sections of the Code dealing with the same subject matter are in pari materia. As a general rule, such statutes should be construed together to ascertain the meaning and intent of each." *Locke v. Wheat*, 350 So. 2d 451, 453 (Ala. 1977) (citations omitted). "Our obligation is to construe these provisions 'in favor of each other to form one harmonious plan,' if it is possible to do so." *Opinion of the Justices*, 599 So. 2d 1166, 1168 (Ala. 1992) (quoting *Ex parte Coffee County Comm'n*, 583 So. 2d 985, 988 (Ala. 1991) (citation omitted)).

In enacting § 40-23-18(b), the legislature's obvious intent was to bar the Department from assessing additional tax after the expiration of three years from the due date; provided, however, that if the Department discovered fraud, the tax could be assessed or an action in court could be begun at any time. In enacting § 6-2-3, the legislature's obvious intent was to give the aggrieved party two years from the discovery of the fraud within which to prosecute a fraud action where a statute had otherwise created a bar.

We are obliged to construe the provisions of § 40-23-18(b) and § 6-2-3 in favor of each other to form one harmonious statute of limitations by which the Department may operate. *Opinion of the Justices*, *supra*. In construing § 40-23-18(b) and § 6-2-3 in pari materia, we find that § 6-2-3 applies in sales tax cases involving a false or fraudulent return. We, therefore, hold that in the case of a false or fraudulent return with intent to evade payment of taxes, the tax may be assessed or a proceeding in court may be begun at any time; however, if the tax is assessed or a proceeding is begun outside the three-year limitation imposed by § 40-23-18(b), that action must be begun within two years from the time the fraud is deemed to have been discovered. *See*, *Gray v. Liberty Nat'l Life Ins. Co.*, 623 So. 2d 1156 (Ala. 1993); *Dickens v. SouthTrust Bank of Alabama, N.A.*, 570 So. 2d 610 (Ala. 1990); *Lader v. Lowder Realty Better Homes & Gardens*, 512 So. 2d 1331 (Ala. 1987). It would be illogical to hold that once the Department discovers fraud, it could wait indefinitely, accruing interest pursuant to § 40-1-44, before beginning an action to collect the taxes. This would be contrary to legislative intent and manifestly unfair, especially to the state agencies dependent upon the prompt payment and collection of state sales tax.

Having held that § 6-2-3 applies in sales tax cases, we must now determine when the Department was deemed to have discovered any alleged fraud on the part of Joy Young.

> Fraud is deemed to have been discovered when it ought to have been discovered. Facts which provoke inquiry in the mind

> of a man of reasonable prudence, and which, if followed up, would have led to a discovery of the fraud, constitute sufficient evidence of discovery. *Johnson v. Shenandoah Life Ins. Co.*, 291 Ala. 389, 397, 281 So. 2d 636, 643 (1973) (quoted with approval in *Rumford v. Valley Pest Control, Inc.*, 629 So. 2d 623, 628 (Ala. 1993); *Ryan v. Charles Townsend Ford, Inc.*, 409 So. 2d 784, 786 (Ala. 1981)). See also *Dickens*, *supra*, and *Lader*, *supra*.

New Joy Young, 667 So.2d at 1387, 1388.

The Court in *New Joy Young* found that the Department had effectively discovered the fraud during its audit in 1986. Because the Department had not assessed the taxpayer within two years from discovering the fraud in 1986, and had not otherwise timely assessed the taxpayer, the Court voided the final assessment in issue.

The Department argues that *New Joy Young* does not apply in this case based on Section 81 of Act 92-186, which the Alabama Legislature enacted in 1992. A uniform statute of limitations for assessing all taxes administered by the Revenue Department, now codified at §40-2A-7(b)(2), was included in the above Act, including the unlimited statute of limitations for assessing tax in fraud cases at §40-2A-7(b)(2)a.

Section 81 of Act 92-186 provided that "[all] other laws or parts of laws which conflict with this act are hereby repealed." The Department argues that based on the above language, §6-2-3 is repealed to the extent that it conflicts with §40-2A-7(b)(2)a. "The Department's position is that any conflict that would otherwise occur between Sections 6-2-3 and 40-2A-7(b)(2)a. is resolved in favor of the Department's statute of limitations (in this case an unlimited statute due to fraud), because to the extent section 6-2-3 conflicts with 40-2A-7(b)(2)a., section 6-2-3 was repealed by Section 81 of the Taxpayer Bill of Rights." November 25, 2014 e-mail from Department attorney. I disagree.

As discussed, the Court of Civil Appeals held in substance in *New Joy Young* that §§6-2-3 and 40-2A-7(b)(2)a. did not conflict, but rather, should be construed in para materia and "in favor of each other to form one harmonious statute of limitations by which the Department may operate." In my opinion, §6-2-3 and §40-2A-7(b)(2)a. clearly conflict, and the latter should control in assessing tax in fraud cases, but the Court held otherwise in *New Joy Young*, and that holding is still the law of the land and cannot be ignored.[3] The inclusion of §40-2A-7(b)(2)a. in Act 92-186 thus did not repeal §6-2-3.

[3] I respectfully but strongly disagree with the Court's holding in *New Joy Young* for the reasons stated in Judge Thigpen's dissent, among others. Section 6-2-3 is a general statute that governs when an aggrieved party must bring an action in a civil fraud case. That section should in no way be read in conjunction with §40-2A-7(b)(2)a., which is a specific statute governing when the Revenue Department may assess tax in fraud cases. A specific statute of limitations governing the assessment of tax in fraud cases should control over the general statute of limitations for bringing a civil fraud action in circuit court. "In the event of a conflict between two statutes, a specific statute relating to a specific subject is regarded as an exception to, and will prevail over, a general statute relating to a broad subject." *Ex parte Jones Mfg. Co.*, 589 So.2d 208, 211 (Ala. 1991).

It is also clear that the majority of the Court in *New Joy Young* was upset by the fact that the Department inexplicably waited five years after discovering the fraud to assess the taxpayer. "It would be illogical to hold that once the Department discovers fraud, it could wait indefinitely, accruing interest pursuant to §40-1-44, before beginning an action to collect the taxes. This would be contrary to legislative intent and manifestly unfair, ..." *New Joy Young*, 667 So.2d at 1388. The Court thus reached an equitable result by holding that §6-2-3 should be read in para materia with §40-2A-7(b)(2)a. The Alabama Supreme Court denied certiorari in the case, but did so with the following caveat – "In denying the petition for writ of certiorari, this Court does not wish to be understood as approving all the language, reasons, or statements of law in the Court of Civil Appeals' opinion." I read the above statement to mean that the Supreme Court agreed with the Court of Civil Appeals' equitable result, but not its legal analysis.

Alabama's courts also do not favor the repeal of an existing statute by implication. "Repeal by implication is not favored . . . Implied repeal is essentially a question of determining the legislative intent as expressed in the statutes." *Ala. Dept. of Revenue v. The National Peanut Festival Assn., Inc.*, 11 So.3d 821, 829 (Ala. Civ. App. 2008). There is no indication that by reenacting the unlimited statute of limitations for assessing tax in fraud cases, i.e., including §40-2A-7(b)(2)a., in Act 92-186, the Legislature intended to repeal the general statute of limitations for bringing a civil fraud action in circuit court.

Because the rationale of *New Joy Young* applies, the next question is when did the Department discover the Taxpayer's fraud. "Fraud is deemed to have been discovered when it ought to have been discovered. Facts which provoke inquiry in the mind of a man of reasonable prudence, and which, if followed up, would have led to a discovery of fraud, constitutes sufficient evidence of discovery." *New Joy Young*, 667 So.2d at 1388, quoting *Johnson v. Shenandoah Life Ins. Co.*, 629 So.2d 623 (Ala. 1993).

An employee in the Department's Income Tax Division clipped an article in the May 25, 2011 edition of the *Prattville Progress* newspaper about the Taxpayer pleading guilty to theft of property. It is not known exactly when the employee saw the article, but the Department concedes that "in any event, it was not long after" the article ran in the paper on May 25, 2011. November 20, 2014 e-mail from Department attorney. It thus could be argued that the Department should have reasonably discovered the Taxpayer's fraud when or soon after the employee learned that the Taxpayer had pled guilty to embezzlement because if the employee had followed up, she could have learned that the embezzled income had not been reported on the Taxpayer's joint returns for the subject years.

The Department argues that if *New Joy Young* applies, the two year statute at §6-2-3 began running when the Taxpayer's conviction became final and unappealable on July 26, 2011, two weeks after the Court of Criminal Appeals dismissed her appeal on July 12, 2011. But whether the fraud was discovered or deemed discovered when the employee read the newspaper article or when the Taxpayer's conviction became final, in either case, the discovery occurred on or before July 2011. Consequently, the two year statute at §6-2-3 had expired before the Department entered the preliminary assessments in June 2014 that resulted in the final assessments in issue. The Department thus did not timely enter the preliminary assessments pursuant to §40-2A-7(b)(2)a.

The Department also contends that the 2007 and 2008 preliminary assessments were timely entered pursuant to the six year statute of limitations at §40-2A-7(b)(2)b. I agree concerning 2008, but not 2007.

The Taxpayer and her husband reported gross income of $60,554 on their joint 2008 Alabama return. The return omitted $36,435 that the Taxpayer had embezzled in that year, which clearly constitutes an omission well over the 25 percent threshold by which the six year statute at §40-2A-7(b)(2)b. is triggered. The Department thus had six years from the due date of the 2008 return, or until April 15, 2015, to assess the Taxpayer for 2008. The 2008 preliminary assessment entered against the Taxpayer, individually, on June 13, 2014 was thus timely.

The Department also argues that the 2007 preliminary assessment was also timely entered within the six year statute, as follows:

> This is also true of the 2007 year. The Daniels' 2007 adjusted gross income, as reported, was $58,855 (the taxable base). When corrected to show the result of her embezzlement, the true AGI for 2007 was $102,121, a

> difference of $43,266. This is 73.5% of the taxable base, clearly above the 25% threshold to extend the statute to 6 years. 2007 returns were due April 15, 2008. Six years later is April 15, 2014. The notice of preliminary assessment to which the liability relates was sent February 19, 2014. Although the preliminary assessment was sent regarding the 2011 year, at the taxpayer's request, the years and amounts were recomputed and arose instead in 2004 through 2009, and so the preliminary assessment for 2011 sent of February 19 relates back to the 2007 year.

November 20, 2014 e-mail from Department attorney.

I agree that the Taxpayer omitted more than 25 percent from her 2007 return, and consequently, that the Department had until April 15, 2014 to assess the Taxpayer for that year. But contrary to the Department's claim, the 2007 preliminary assessment relating to the 2007 final assessment in issue was not entered until June 13, 2014, after the six year statute had expired.

The February 19, 2014 preliminary assessment referred to in the above November 20, 2014 e-mail was for the tax year 2011. That preliminary assessment was based on the full amount embezzled by the Taxpayer from 2004 until July 2009. But the fact that the Department improperly included the money taken by the Taxpayer in 2007 in computing the tax due for 2011 does not make the 2011 preliminary assessment "relate back to the 2007 tax year," and become a 2007 preliminary assessment.

In *Knight v. State of Alabama*, Docket Inc. 99-431 (Admin. Law Div. 6/23/2000), the Department had erroneously entered an assessment for the 1996 tax year, instead of the correct 1995 tax year. The Administrative Law Division Division denied the Department's request to change the assessment period to 1995, as follows:

> Due process requires that a final assessment must include the name of the taxpayer or taxpayers, the type of tax assessed, the tax period or periods involved, and the amount owed. See also, Department Reg. 810-14-1-.15. The amount of an assessment can be increased or decreased on appeal to

> reflect the correct tax due. Code of Ala. 1975, §40-2A-7(b)(5)d.1. Other than the amount, however, the other substantive components of a final assessment cannot be "corrected" on appeal. Specifically, the listing of a wrong tax period on an assessment is grounds for dismissal of the assessment. *Stallard v. U.S.*, 12 F.3d 489 (1994) ("And accurately ascertaining the correct tax period is more than a mere 'technicality.'") Consequently, the final assessment of 1996 income tax cannot be substantively changed to a final assessment of 1995 tax.

Knight at 2.

Likewise, in this case, the 2011 preliminary assessment cannot be substantively changed to a 2007 preliminary assessment for purposes of the statute of limitations provisions in §40-2A-7(b)(2). Because the 2007 preliminary assessment was entered after the six year statute had expired, that assessment was time-barred.

The preliminary assessments that resulted in the final assessments in issue were not entered within the general three year statute in §40-2A-7(b)(2), or within the fraudulent return statute at subparagraph a. of the above statute, or within any other period allowed by the above statute, except for the tax year 2008. As explained, the preliminary assessment for 2008 was timely entered. The final assessment for that year is accordingly affirmed in the amount of $2,334.35, plus interest from the date the final assessment was entered, August 19, 2014.[4] The final assessments for 2004, 2005, 2006, 2007, and 2009 are voided.[5] Judgment is entered accordingly.

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[4] For whatever reason, the Department assessed the Taxpayer for only the ten percent negligence penalty on the 2008 final assessment, and no penalties were included in the other final assessments in issue.

[5] The 2004 through 2009 preliminary assessments entered against the Taxpayer and her husband, jointly, were also entered after the limitations periods in §40-2A-7(b)(2), except for the joint 2008 preliminary assessment. The basis for both 2008 preliminary assessments was the money embezzled by the Taxpayer in that year. Consequently, because the 2008 final assessment against the Taxpayer has been affirmed, the joint 2008 preliminary assessment is without basis.

I must reiterate that I respectfully but strongly disagree with the Court's rationale in *New Joy Young*. I understand the Court's concern that the Department inexplicably delayed assessing the taxpayer in *New Joy Young*, and thus increased the interest owed by the taxpayer, but a taxpayer that willfully files a fraudulent return, i.e., a person with unclean hands, is not entitled to equitable treatment. See generally, *Saudi Basic Industries Corporation v. Exxonmobil Corporation*, 401 F. Supp. 2d 383 (2005). In any case, if the Department unduly delays in assessing a tax, the taxpayer can petition the Department's Taxpayer Advocate for an abatement of the interest that accrued due to that undue delay. Code of Ala. 1975, §40-2A-4(b)(1)c. But for the holding in *New Joy Young*, I would have held that the preliminary assessments were timely entered pursuant to §40-2A-7(b)(2)a., and that the ensuing final assessments should be affirmed.

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

Entered February 26, 2015.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Ralph M. Clements, III, Esq.
William B. Sellers, Esq.