

TELLABS OPERATIONS, INC.
ATTN: SALES TAX DEPT.
1415 WEST DIEHL RD., MS 119§
NAPERVILLE, IL 60563,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer,

DOCKET NO. S. 09-1107

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

FINAL ORDER ON TAXPAYER'S APPLICATION FOR REHEARING

Tellabs Operations, Inc. ("Taxpayer") petitioned the Revenue Department for a refund of sales tax for September 2005. The Department denied the petition, and the Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on April 22, 2010. The Taxpayer was notified of the hearing by certified mail, but failed to appear. Assistant Counsel Wade Hope represented the Department.

A Final Order was entered on April 29, 2010 affirming the denial of the refund. The Taxpayer timely applied for a rehearing.¹ A second hearing was conducted on November 16, 2010. Paul Bogdanski, John Cannova, and Blake Madison represented the Taxpayer. Assistant Counsel Wade Hope again represented the Department.

ISSUE

The Department initially denied the refund because the Taxpayer's petition referenced a local jurisdiction sales tax that was not administered by the Department. The

¹ The Taxpayer indicated in its application for rehearing that it had not received notice of the April 22 hearing.

Taxpayer argued at the November 16 hearing, and the Department conceded, that the petition related to State sales tax. The parties also agreed at the hearing that the threshold issue was whether the Taxpayer had timely filed its refund petition within the statute of limitations for claiming a refund or a credit at Code of Ala. 1975, §40-2A-7(c)(2)a. That statute requires that a refund petition must be filed, or a credit allowed, within three years from when the return was filed or two years from when the tax was paid, whichever is later.

FACTS

The Taxpayer sold communications equipment to various customers in Alabama from 2003 through 2007. It filed Alabama sales tax returns and reported and paid the tax due on the sales through May 2004.

The Taxpayer computed and paid its Alabama sales tax on the accrual basis. That is, it invoiced its Alabama customers for the items sold to the customers in a month, including the applicable sales tax. It subsequently filed its sales tax return for the month and reported and remitted the tax due, even if it had not yet been paid by the customers.

Before June 2004, the Taxpayer sold various goods to Trillion Digital Corporation in Alabama. It invoiced Trillion for the items sold, plus sales tax. Consistent with its accrual method of reporting, it reported those sales on its monthly Alabama sales tax returns and paid the sales tax due as invoiced, before Trillion paid it for the goods.

In June 2004, Trillion provided the Taxpayer with a Department-issued sales and use tax exemption certificate. Relying on the exemption certificate, the Taxpayer determined that its pre-June 2004 sales to Trillion had been exempt.² It consequently

² The Department argues in its post-hearing brief at 4, that the Taxpayer's pre-June 2004
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determined that it had overpaid \$196,564.20 in State sales tax on its pre-June 2004 sales to Trillion, and concerning which Trillion had not remitted the tax to the Taxpayer. Instead of petitioning the Department for a refund of the amount overpaid, the Taxpayer maintained a running total of the overpaid amount as a sales tax credit on its internal bookkeeping system. It 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.

Taxpayer Exhibit A, a copy of which is attached, illustrates how the Taxpayer internally computed its Alabama sales tax liabilities/credits from January 2004 through February 2006. Per Exhibit A, the Taxpayer reported and remitted sales tax to the Department from January through May 2004. After receiving the exemption certificate from Trillion in June 2004, the Taxpayer showed a sales tax overpayment or “cumulative refund due” of \$196,564.20 on its internal accounting system. As indicated, that is the amount the Taxpayer claims it erroneously paid on its exempt sales to Trillion before June 2004.

The Taxpayer thereafter internally carried over the credit and internally “paid” the July 2004 tax due of \$15,626.54, which reduced the cumulative refund due on Exhibit A to \$180,937.65.

sales to Trillion were not exempt because the Department did not issue the exemption certificate until June 2004. “The Certificate of Exemption issued to Trillion Corporation was only valid for the period beginning May 2004 and going forward. The Certificate of Exemption did not apply to any sales made to Trillion Corporation prior to May 2004.” But an exemption certificate does not, in itself, create an exemption. Rather, it only formally notifies a purchaser’s vendors that the purchaser is entitled to purchase certain items sales and use tax free. Consequently, if the Taxpayer’s pre-June 2004 sales to Trillion were in

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The August 2004 entry on Exhibit A shows a sales tax refund to the customer, presumably Trillion, of \$130,979.98, which, according to the Taxpayer, correspondingly increased its cumulative refund due from the Department to \$311,917.63. A Taxpayer witness testified at the November 16 hearing that the Taxpayer “generated another credit carryforward in August of ’04.” (T. 25) Although not explained at the hearing, the Taxpayer presumably generated the August 2004 “credit” of \$130,979.98 by issuing credit memos giving Trillion credit for sales tax previously invoiced in June and July 2004.³ The August 2004 “credit” could not relate to the sales tax invoiced to Trillion before June 2004 because the initial “cumulative refund due” of \$196,564.20, as reflected on the June 2004 entry on Exhibit A, represented the sales tax invoiced to Trillion through May 2004.

From September 2004 through August 2005, the Taxpayer internally computed the sales tax due in each month, including tax on its monthly sales to Trillion. It applied the running overpayment to internally eliminate the amount owed in each month. It then filed monthly sales tax returns for those months showing zero sales, zero credits claimed, and zero tax due.

The September 2005 entry on Exhibit A indicates that the Taxpayer refunded \$168,068.11 in sales tax to Trillion in the month. As indicated, the Taxpayer had erroneously continued to treat its post-May 2004 sales to Trillion as taxable when it

fact statutorily exempt, it is irrelevant that the exemption certificate had not yet been issued.
³ As discussed below, the Taxpayer continued invoicing Trillion for sales tax even after receiving the Trillion exemption certificate in June 2004. It also erroneously continued treating the Trillion sales as taxable when it internally computed its monthly sales tax liabilities after June 2004.

internally computed the sales tax due in each month. In September 2005, the Taxpayer issued credit memos to Trillion for \$168,068.11 in sales tax it had previously invoiced to Trillion in June, July, and August 2005.⁴ The Taxpayer treated that credit amount as a refund to Trillion, and also as an additional overpayment to the Department.

Through February 2006, the Taxpayer's internal books, per Exhibit A, showed a cumulative refund due of \$134,441.16. The Taxpayer reorganized later in 2006. It thereafter determined that it would not be able to utilize the existing cumulative overpayment to offset any subsequent sales tax due. It thus petitioned the Department in October 2007 for a refund of sales tax allegedly overpaid in September 2005. The Department denied the petition in January 2008. This appeal followed.

The Taxpayer's refund petition claimed a refund of \$137,708. The Taxpayer indicated at the November 16 hearing that the correct refund due was \$134,441.16, or the cumulative refund balance shown for February 2006 on Exhibit A. The Taxpayer now claims in its post-hearing brief at 5, that it is only claiming a refund of \$119,769.96 relating to its alleged overpayments in September and November 2005. That amount was calculated by subtracting the outstanding \$14,671.20 credit available for carryover in August 2005, as shown on Exhibit A, from the final February 2006 credit available amount of \$134,441.16, again as shown on Exhibit A.

⁴ The September 2005 credit memos and corresponding June, July, and August 2005 invoices previously issued to Trillion are summarized on Taxpayer Exhibit B, and were submitted as Taxpayer Exhibit C.

ANALYSIS

The Taxpayer contends that when it filed its monthly sales tax returns after May 2004, it was in substance applying the prior overpayments as a credit to satisfy the tax due in each month. “Each time that Tellabs filed a return, the carryover amount constituted tax paid in that subsequent period,” Taxpayer’s post-hearing brief at 4. The Taxpayer cites *Stephens v. State of Alabama*, Docket Inc. 96-127 (Admin. Law Div. Final Order on Rehearing 4/12/1996) and *Brayman v. State of Alabama*, Docket Inc. 95-411 (Admin. Law Div. Final Order on Rehearing 3/5/1996) in support of its position.

In both *Stephens* and *Brayman*, the taxpayers had overpaid income tax in a prior year. They elected to carryover and apply the overpayment as a credit on a subsequent year’s return. The Department argued that the tax had been paid when it was initially remitted (by withholding or otherwise) in the prior year, and was thus deemed paid for refund purposes on the due date of the prior year’s return. The Administrative Law Division disagreed, holding that when the overpayment was carried over and claimed as a credit on the subsequent year’s return, the application of the credit to satisfy the tax due in the subsequent year constituted a payment of the subsequent year’s tax at that time.

As explained in the Final Order, the credit amount carried over to each subsequent year was "paid" when the subsequent year's return was filed by the Taxpayers. The credit was applied as tax paid in that year, and lost its identity as a credit from a prior year at that time. The process then repeated itself. In short, the amount paid by credit in 1992 is not the same tax initially overpaid in 1988 through 1990, as argued by the Department. Each credit carried over to a subsequent year constitutes tax paid in that subsequent year.

Stephens, Final Order Denying Application for Rehearing at 3.

The Taxpayer argues in its post-hearing brief at 4, that “[l]ike the taxpayers in the *Stephens* and *Brayman* cases, Tellabs carried over a credit from one tax period to the next. Each time that Tellabs filed a return, it carried over the credit to the next period. Each time Tellabs filed its monthly sales tax return, the carryover amount constituted tax paid in that subsequent period, just as it did for Mr. and Mrs. Stephens and Mr. and Mrs. Brayman. . . .” I disagree.

Stephens and *Brayman* correctly held that when a tax credit is carried over and claimed on a subsequent return, the applied credit constitutes tax paid to satisfy the amount due in the subsequent tax period. 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.

The Taxpayer argues in its post-hearing brief at p. 6, that its position is supported by Dept. Reg. 810-13-1-.16(4), which provides that if a taxpayer overpays tax, “the taxpayer may either elect to have the overpayment applied against the liability for the next reporting period or may apply for a refund. . . .” As indicated, however, to have an overpayment applied as a credit to the next or a later period, a taxpayer must file a return for the next or later period and claim the prior overpayment as a credit on the return.⁵ The Taxpayer

⁵ The refund statute of limitations at §40-2A-7(c)(2)a. requires that a credit may be “allowed” within the applicable period. But to be allowed by the Department, a taxpayer must either claim the credit on a subsequent return, or the Department must be notified of
(continued)

failed to do so.

The Taxpayer also asserts, again on p. 6 of its post-hearing brief, that “the Department did not provide additional guidance to taxpayers concerning . . . how to handle large credits on sales tax returns. There was no proscribed (sic) method to track or report the sales tax credit carryover.” I again disagree.

Alabama’s sales tax return requires that a retailer must report gross sales, the tax due on those sales, and also any credit claimed against the reported tax due. The Taxpayer thus had a prescribed method for claiming the credit on its monthly returns after May 2004. The Taxpayer also could have, as it did, maintain internal records showing the credit claimed in each month, and also the remaining credit balance available for carryover.

The Department would then have known that the Taxpayer was claiming a credit in each month, and could have audited the Taxpayer’s books, if deemed necessary, to determine if the credit was being correctly carried over and applied.

The Taxpayer’s refund petition claims an alleged “overpayment” of sales tax in September 2005. As discussed, the Taxpayer asserts that by issuing credit memos in September 2005 giving Trillion credit for sales tax previously invoiced to Trillion in June, July, and August 2005, it in substance refunded \$168,068.11 in sales tax to Trillion in the month. It further contends that the credit memos resulted in an overpayment to the Department in the month that entitles it to a corresponding refund of that amount.

or otherwise learn that a credit is due. Because the Taxpayer failed to claim credits on its post-May 2004 returns, the Department did not and could not have known that the Taxpayer had previously overpaid its sales tax and was due a credit. Consequently, no credit could be allowed.

I do not understand how invoicing a customer for sales tax, and then later issuing credit memos to the customer removing the sales tax, constitutes a refund to the customer. The customer in this case, Trillion, never paid sales tax to the Taxpayer that could be refunded. The credit memos simply adjusted or corrected for internal bookkeeping purposes the amount owed by Trillion.

I also do not understand how the Taxpayer's issuance of the credit memos in September 2005 resulted in an additional \$168,068.11 in sales tax overpaid to the Department in that month. Even if the Taxpayer is correct (and it is not) that its internal bookkeeping procedures constituted tax paid to the Department in each month by application of the internal credit carryover, the amount would have been "paid" in each month the internal credit was applied to satisfy the tax due, not in September 2005, when the credit memos were issued.

In summary, the Taxpayer actually overpaid \$196,564.20 in sales tax to the Department on its sales to Trillion before June 2004.⁶ The Taxpayer had three years from when the pre-June returns were filed, and the tax erroneously paid, to either petition for a refund of the amounts overpaid, or to later file returns and claim credits for the amounts overpaid. It failed to do so. If the Taxpayer had reported its gross sales and the tax due on its returns after May 2004, and then claimed a credit on the returns to satisfy the reported amounts due, the tax due in those months would have, per the *Stephens* and *Brayman* rationale, been paid by application of the credits. The Taxpayer would then have

⁶ This assumes that the sales were exempt and that the Taxpayer's computations are correct.

had three years from when those “credit paid” returns were filed and the tax paid to petition for a refund or claim a credit for any amounts that may have been erroneously reported and paid with those returns.⁷ But the Taxpayer failed to claim any of the pre-June 2004 overpayments as a credit on its returns after May 2004. Consequently, because the Taxpayer never paid any sales tax to the Department after May 2004, either directly or by claiming a credit to satisfy the tax due on a return filed with the Department, a refund of the tax overpaid before June 2004 is now time-barred. And no refund is due for September 2005 or any other month after May 2004 because, as explained, the Taxpayer paid no sales tax to the Department after May 2004.

It is unfortunate that the Taxpayer cannot recover the \$196,564.20 in sales tax it overpaid on its pre-June 2004 Trillion sales, but as a licensed Alabama retailer, it was required to file sales tax returns and include such information on the returns as required by the Department. Code of Ala. 1975, §40-23-7.⁸ The Department requires that a retailer must report on its sales tax returns, among other things, gross sales, the tax due, and importantly, the amount of any claimed credit. The Taxpayer failed to do so in this case at

⁷ For example, if the Taxpayer had reported its December 2004 sales to Trillion as taxable on its return for that month, then paid the tax due by claiming a credit on the return for the pre-June 2004 overpayments, the Taxpayer would have erroneously paid the tax relating to the Trillion sales. It then would have had three years from the January 20, 2005 due date of the December 2004 return to claim a refund or credit for the tax overpaid.

⁸ The Alabama Supreme Court has held that zero or “blank” returns such as those filed by the Taxpayer after May 2004 are in substance not returns as required by Alabama law. “In the instant case, the appellant’s ‘blank’ return of January 5, 1971 did not contain any of the items required by the statute. The ‘blank’ return cannot be considered a return within the provisions (of Alabama law).” *Radue v. Bradshaw*, 268 So.2d 760, 761 (1962).

its own peril.

The April 29, 2010 Final Order affirming the Department's denial of the Taxpayer's refund petition is affirmed.

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

Entered April 18, 2011.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

attachment (Exhibit A)

cc: J. Wade Hope, Esq.
Paul G. Bogdanski, CPA
Blake A. Madison, Esq.
Joe Cowen
Ashley Moon