QHG OF GADSDEN, INC. d/b/a GADSDEN REGIONAL MEDICAL CENTER 1007 GOODYEAR AVENUE GADSDEN, AL 35903,	§ § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 10-115
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department partially denied a State use tax refund for February 2005 through December 2006 requested by QHG of Gadsden, Inc., d/b/a Gadsden Regional Medical Center ("Taxpayer"). 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 May 27, 2010. The Taxpayer's representative, James Privett, attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer operated a hospital in Gadsden, Alabama during the period in issue. It petitioned the Department for a refund of State use tax for January 2005 through December 2007. The petition requested a refund of $96,284 in tax that had been paid on human tissue that was used for transplant surgery. The Department agreed that tax had been incorrectly paid on the tissue, and consequently, that the petition should be granted.

The Department audited the Taxpayer to confirm the amount of the tax overpaid on the tissue. The Department determined during the audit that the Taxpayer had failed to pay tax on certain food items that it had purchased for use either in feeding patients in the

hospital or for sale in the hospital cafeteria.[1] The Department reduced the refund by the amount of tax it deemed was due on the food, and subsequently issued the Taxpayer a reduced refund of $13,321.

The Department also changed the Taxpayer's petition period to February 2005 through December 2006 because a separate entity had operated the hospital for a part of the original petition period. According to the Taxpayer's January 5, 2010 appeal letter, the Taxpayer, QHG of Gadsden, Inc., operated the hospital from January 2005 through December 2006.[2] A separate entity, Gadsden Regional Medical Center, LLC, d/b/a Gadsden Regional Medical Center, operated the facility from January 2007 through December 2008. Gadsden Regional Medical Center apparently also petitioned the Department for a refund of the tax it paid on the human tissue after December 2006. That petition is being held pending this appeal. The Department explained at the May 27 hearing as follows:

> The original petition included January 1 of '05 through December 31 of '07. Those dates were changed to February of '05 through December of '06 and the reason for that, Judge, was that the hospital was purchased by someone else and so we had two different audit periods of time with two different owners. There was a portion of about $33,000 out of the $96,000 that has been allocated to another petition that is being held by Ms. McKnight in her office in Gadsden which is tied with this one, but it's for the other owners, the other purchasers and allocated to that one. So I'm just trying to explain where we ended up and why we got different dates than what was on the original petition.

T. at 4.

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[1] The food was actually prepared in the hospital cafeteria by another party, Morrisons Management Specialists, Inc., pursuant to a contract between the hospital and Morrisons.

[2] There is no evidence explaining why the Department removed January 2005 from the

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As indicated, it is undisputed that the tax paid on the human tissue was erroneously paid. Rather, the issue addressed by the parties at the May 27 hearing only involved whether and to what extent the Taxpayer may be liable for additional tax on the food items. The Administrative Law Division is, however, without jurisdiction to address that issue based on the Alabama Court of Civil Appeal's holding in *Rheem Mfg. Co. v. State, Dept. of Revenue*, 33 So. 3d 1 (Ala. Civ. App. 2009) cert. denied (Ala. S. Ct. 3/12/2009).

In *Rheem Manufacturing*, Rheem petitioned the Department for refunds of franchise tax based on its claims that (1) the franchise tax was unconstitutional, and (2) it was entitled to use an alternative apportionment method. The Department denied the petitions, and Rheem appealed to the Administrative Law Division.

Rheem raised a third issue, the push-down accounting issue, while the case was pending before the Administrative Law Division. The Department agreed at the time that the push-down accounting issue was the overriding issue and should be decided first. The parties briefed the issue, and the Division subsequently ruled that Rheem was entitled to refunds based on the push-down accounting issue. The Department appealed.

The Department argued for the first time on appeal that the Division did not have jurisdiction to decide the push-down accounting issue because Rheem had not raised the issue when it filed its refund petitions with the Department. The circuit court agreed, and held that Rheem could not be issued refunds based on the push-down accounting issue.

The Court of Civil Appeals affirmed. The Court held that in cases involving denied refunds, the Administrative Law Division could only address those issues raised by the

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Taxpayer's petition period.

taxpayer in the refund petition. Consequently, because Rheem had not raised the push-down accounting issue in its refund petitions, the Administrative Law Division did not have jurisdiction to review the issue on appeal.

In this case, the Taxpayer petitioned for a refund based on its sole claim that it had incorrectly paid tax on the human tissue. Based on *Rheem*, the Administrative Law Division only has jurisdiction to determine or review that issue on appeal. Because the Department concedes that tax was erroneously paid on the human tissue, the Taxpayer is entitled to a full refund of the tax it paid on the tissue, plus applicable interest.

Alabama law and the *Rheem* rationale also prohibit the Department from denying or reducing a refund that is otherwise due because the taxpayer may owe additional tax for reasons not relevant to the refund petition. The Department is thus prohibited from reducing the Taxpayer's refund in this case because some contingent tax may be due on the food items.

If the Department determines that a refund petition is due to be granted, the Department is authorized to refund the amount to the taxpayer. The Department may, however, reduce or offset the amount of the refund by any "outstanding final tax liability" owed by the taxpayer. Code of Ala. 1975, §40-2A-7(c)(4).

The phrase "outstanding final tax liability" is not defined by Alabama law. But the term may reasonably be construed as an accrued liability in the form of a final assessment from which a statutory appeal is no longer allowed, or a liability that has been affirmed on appeal by the Administrative Law Division or by a circuit or appellate court in Alabama and

from which no further appeal can be taken.[3] The Department can thus reduce or offset a refund otherwise due a taxpayer by any outstanding final assessment or court judgment amount owed by the taxpayer from which no further appeal can be taken.[4]

The Department is not, however, authorized to reduce or offset a refund that is otherwise due based on a contingent liability that may be owed by the taxpayer. To begin, *Rheem* holds that the propriety of a taxpayer's refund petition must be determined from the issues raised by the taxpayer in the refund petition. Consequently, if a taxpayer claims that a tax was overpaid for a particular reason, and the Department agrees, the refund must be granted, subject of course, to being offset by any outstanding final tax liability owed by the taxpayer.

And because §40-2A-7(c)(4) specifies that an otherwise due refund can only be offset by an "outstanding final tax liability," it necessarily follows that the refund cannot be offset by a contingent liability that the Department claims may be due. The Department can audit a taxpayer's refund petition to verify the amount of the tax erroneously overpaid by the taxpayer, if any, but the Department cannot per the audit determine that the taxpayer may have underpaid or failed to pay tax for another reason, and thereafter reduce or offset

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[3] 26 U.S.C. §6402 allows the IRS to offset or apply a federal income tax overpayment to satisfy certain debts owed by the taxpayer, including "a past-due, legally enforceable State income tax obligation. . . ." 26 U.S.C. §6402(e). The above phrase is defined at §6402(e)(5) as a debt resulting from a judgment of a court or an administrative determination which is no longer subject to judicial review, or an assessed tax for which the time for redetermination has expired. The above definition is identical in substance to the definition of "outstanding final tax liability" stated above.

[4] Section 40-2A-7(a)(4) does not limit the offset provision to a particular type of tax. Thus, if a taxpayer is due a $1,000 income tax refund, but has a $500 outstanding final sales tax liability, the Department may offset the income tax refund to satisfy the sales tax due.

the refund based on that claimed or contingent liability.

The Department may, of course, assess a taxpayer for any additional tax found to be due pursuant to an audit, but it must do so pursuant to the assessment procedures set out in the Uniform Revenue Procedures Act, Code of Ala. 1975, §40-2A-7, et seq. This was explained by the Administrative Law Division in *HealthSouth Corporation, et seq. v. State of Alabama*, BIT. 08-1021 (Admin. Law Div. F.O. 7/16/2009), which was decided shortly after the *Rheem* decision, and which addressed some of the practical consequences of the *Rheem* rationale. The Final Order in that case reads in pertinent part as follows:

> Since the Uniform Revenue Procedures Act, Code of Ala. 1975, §40-2A-7 et seq., was enacted in 1992, and indeed since the Administrative Law Division was created and began hearing appeals in 1983, the Division has always taken the position that when a taxpayer appealed to the Division, the Division's duty was to determine the taxpayer's correct liability for the tax and period in issue. Consequently, once a taxpayer appealed a final assessment or denied refund to the Division, all issues that were relevant to the taxpayer's correct liability for the period would be reviewed. For example, assume that a taxpayer filed an amended income tax return and claimed a refund based on an additional $10,000 charitable deduction. The Department denied the refund, and the taxpayer appealed. On appeal, the Division had always, before *Rheem*, considered all issues relevant to the taxpayer's correct liability for the year in deciding the amount of refund due, if any. Consequently, if on appeal it was discovered that the taxpayer was entitled to another previously unclaimed deduction, or that another claimed deduction should be disallowed, or that the taxpayer had failed to report some income on the return, those issues, whether detrimental or beneficial to the taxpayer, would also be addressed, again with the end goal of determining the taxpayer's correct liability for the period.
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> With the *Rheem* decision, however, the Division's ability to determine a taxpayer's correct liability is hindered. Again using the $10,000 disallowed charitable deduction example, what if on appeal the Department discovered that the taxpayer had underreported income by $10,000. Such "additional issues" have been raised by both taxpayers and the Department in hundreds of appeals before the Division since 1983, and before *Rheem*, the Division had in all cases considered the additional issue or issues in arriving at the correct tax due. In the above example, if the Division determined that the disputed $10,000 deduction claimed by the taxpayer should be allowed, it

> would have been offset by the $10,000 in unreported income. No refund would be due, and the taxpayer would have paid the correct tax due, no more, no less.
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> But post-*Rheem*, the Division only has the jurisdiction to hear the issue or issues raised by the taxpayer in the refund petition, i.e., the disallowed $10,000 charitable deduction in the above example. Consequently, even if the $10,000 in unreported income was discovered while the appeal was pending, the Administrative Law Division could not consider that issue in deciding the case. Rather, the taxpayer would be allowed the deduction and the resulting refund. The Department could, of course, assess the taxpayer for additional tax based on the unreported income, but in many instances the statute of limitations for doing so will have expired (just as the statute for petitioning for a refund based on the push-down accounting issue had expired for the taxpayer in *Rheem*).

Rheem, BIT 08-1021 at 8 – 9.

The Taxpayer in this case is entitled to a full refund of the tax it erroneously paid on the human tissue. For the reasons explained above, the refund cannot be offset by any contingent tax liability the Taxpayer may owe concerning the food items. Rather, as discussed, the Department must assess the Taxpayer for any additional tax due on the food, assuming that the statute of limitations for doing so has not expired.

The Department is directed to refund to the Taxpayer the full amount of the tax it overpaid on the human tissue during the period in issue, plus applicable interest.[5] Judgment is enter accordingly.

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

[5] Although not in issue in this appeal, the pending refund petition submitted by Gadsden Regional Medical Center concerning the tax it paid on the human tissue is also due to be granted.

Entered July 8, 2010.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: J. Wade Hope, Esq.
James H. Privett
Joe Cowen
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