

NEXTEL SOUTH CORPORATION	§	STATE OF ALABAMA
6500 SPRINT PKWY, KSOPHL0S512-5ATTX		DEPARTMENT OF REVENUE
OVERLAND PARK, KS 66251-0001,	§	ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. BIT. 13-136
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Nextel South Corporation (“Taxpayer”) for 2006 and 2007 business income tax. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. The case was submitted on a joint stipulation of facts and briefs. Chris Grissom and Will Thistle represented the Taxpayer. Assistant Counsel Kelley Gillikin represented the Department.

ISSUE

The Taxpayer concedes that it underpaid its Alabama income tax in the subject years. The sole issue is whether the Department correctly computed the statutory interest due on the amounts underpaid in those years.

The parties agree that interest is due on any tax not paid by the due date, and also that any interest due shall be computed at the federal underpayment rate at 26 U.S.C. §6621, see Code of Ala. 1975, §40-1-44(a). The parties further agree that §6621(c)(1) provides for an additional two percent “hot interest” rate applicable to large corporate underpayments of over \$100,000, and that the additional two percent rate applies to the Taxpayer’s 2006 and 2007 Alabama liabilities.

The specific dispute is whether the additional two percent rate applies from the due date of the tax, as argued by the Department, or from the “applicable date,” as that term is

used and defined in §6621(c)(1), as argued by the Taxpayer. Section 6621(c)(1) provides that the “applicable date” that triggers the additional two percent rate for federal purposes is the 30th day after either (i) “the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, or (ii) the date on which the deficiency notice under Section 6212 [IRC Sec. 6212] is sent,” whichever is earlier.

SUMMARY OF ARGUMENTS

The Taxpayer argues that the additional two percent rate begins to accrue only on the “applicable date,” and not on the due date of the tax. It contends that the Alabama equivalent to the federal “1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review” is the entry of a preliminary assessment by the Department, from which the taxpayer can seek an administrative review by filing a petition for review pursuant to Code of Ala. 1975, §40-2A-7(b)(4)a. It contends that the Alabama equivalent to the federal “deficiency notice under section 6212” is a final assessment entered by the Department. Because the Department entered preliminary assessments against the Taxpayer for the years in issue before it entered the final assessments in issue, the Taxpayer asserts that pursuant to §6621(c), the additional two percent hot interest rate began accruing 30 days after the Department entered the 2006 and 2007 preliminary assessments against the Taxpayer.

The Department contends that the first sentence in §40-1-44(a) requires that interest shall be added at the applicable rate from the due date of the tax. It argues that the Legislature adopted federal §6621 only for purposes of setting the rate of interest, and

that §6621 does not control when the applicable rate, in this case the additional two percent rate, shall begin accruing. That is, because the Taxpayer's underpayments for 2006 and 2007 were large corporate underpayments, §40-1-44(a) requires that the additional two percent hot interest rate required by §6621(c) must be computed from the due date of the tax for those years.

FACTS

The Taxpayer was doing business in and subject to Alabama income tax from 2005 through 2009. The Department audited the Taxpayer for corporate income tax for those years.

The Department entered a preliminary assessment of 2006 income tax against the Taxpayer on August 12, 2010. The Taxpayer petitioned for a review of the 2006 preliminary assessment on September 7, 2010.

The Department entered a preliminary assessment for 2007 and 2008 income tax against the Taxpayer on September 1, 2011. The amount assessed for 2007 included an underpayment of tax in the amount of \$979,184, plus interest computed at the large corporate underpayment rate from the due date of the tax. The amount assessed for 2008 was less than \$100,000, and included interest computed at the normal interest rate. The Taxpayer petitioned for a review of the 2007 and 2008 preliminary assessment on September 28, 2011.

The Department also notified the Taxpayer in September 2011 of audit adjustments concerning the 2006 and 2009 tax years. The revised 2006 audit reduced the underpayment for that year to \$481,618, plus interest computed at the additional two

percent hot interest rate from the due date of the tax. The revised 2009 audit resulted in an overpayment of tax in the amount of \$310,226, plus interest calculated at the additional two percent hot interest rate.¹

The parties negotiated and subsequently settled the substantive issues involved in the audit. The Taxpayer paid the agreed net tax due for the audit years in March 2012. It also paid interest on the net tax due at the normal interest rate.

The Department entered the 2006 and 2007 final assessments in issue against the Taxpayer in November 2012. The final assessments are comprised solely of interest computed at the additional two percent hot interest rate from the due date of the tax for those years. This appeal followed.

ANALYSIS

26 U.S.C. §6601 governs the payment of interest on any underpayment of federal income tax. Section 6601(a) specifies the general rule that if any tax is not paid “on or before the last date prescribed for payment,” i.e., the due date, interest at the underpayment rate established at §6621 shall be paid from the due date to the date paid.

Section 6621(a)(2) provides that the underpayment rate shall be the federal short term rate plus three percentage points. Section 6621(c)(1) provides that “for purposes of determining the amount of interest payable under section 6601 [IRC Sec. 6601] on any large corporate underpayment (\$100,000 or more) for periods after the applicable date,”

¹ The parties stipulated only that while the Department computed interest on the 2009 overpayment at the additional two percent hot interest rate, “it did not calculate the interest due on the overpayment from the original due date of the tax.” Joint Stipulation of Facts at 4, ¶15. The stipulation does not identify the date from which Department computed the hot interest on the 2009 overpayment.

two additional percentage points, or a total of five points, shall be added to the federal short term rate.

As indicated, Section 6621(c)(2) defines the “applicable date” as “the 30th day after the earlier of – (i) the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeal is sent, or (ii) the date on which the deficiency notice under section 6212 [IRC Sec. 6212] is sent.”

Reading the above statutes together, interest computed at the normal rate is due on an underpayment of federal income tax from the due date of the tax until the date paid. If, however, the underpayment constitutes a large corporate underpayment, i.e., an underpayment of \$100,000 or more, then two rates of interest will apply. Interest accrues at the normal rate from the due date of the tax and continues to accrue at that rate until the “applicable date,” at which time the additional two percent hot interest rate begins to accrue.

The Alabama counterpart to IRC §6601 is §40-1-44(a). That section is modeled after §6601 because it also provides that interest shall be added to any tax that is not paid by the due date. And like §6601, the last sentence of §40-1-44(a) provides that such interest shall be computed based on the federal underpayment rate established at §6621.

As indicated, the Department argues that for Alabama purposes, the large corporate underpayment rate begins to run on the due date of the tax, and not on the “applicable date,” as specified in §6621(c)(1). The Department asserts that “[n]othing in the language employed by the legislature in drafting (§40-1-44) suggests an intent to adopt or

incorporate by reference this federal applicable period for purposes of determining the rate at which interest will accrue on large corporate underpayments. . . .” Department’s Reply Brief at 6.

I agree that the Legislature did not “suggest” that the applicable federal period for applying the hot interest rate should apply. Rather, it specifically adopted the federal rule for when hot interest begins to accrue because it adopted §6621 in its entirety, including the hot interest provision at §6621(c). By adopting §6621, the Legislature clearly expressed its intent to follow the federal scheme for computing interest on underpayments. That scheme includes an additional two percent rate on large corporate underpayments, and that rate applies or begins to accrue only after the “applicable date,” not on the due date of the tax.

Section 40-1-44(a) clearly requires that interest begins to accrue on any underpayment from the due date. But §40-1-44(a) does not control when the additional two percent hot interest rate shall apply. Rather, that date is specifically addressed and is controlled by §6621(c) for both federal and Alabama purposes. The Department’s position in substance is that the language in §6621(c)(1) that provides that the additional two percent rate shall apply “for periods after the applicable date” should be ignored. I find no support for that position. The Legislature adopted §6621 in its entirety, including the above language that the hot interest rate on large corporate underpayments shall apply “for periods after the applicable date,” not from the due date of the tax.

The only question presented by Alabama’s adoption of the additional two percent rate applicable to large corporate underpayments concerns when the higher rate is

triggered for Alabama purposes.

The hot interest rate for federal purposes is triggered by the 1st letter of proposed deficiency or the §6212 deficiency notice, whichever is issued first. The Revenue Department does not issue documents known as a “1st letter of proposed deficiency” or “a §6212 deficiency notice.” I agree with the Taxpayer, however, that the Alabama equivalent to the federal 1st letter of proposed deficiency is the preliminary assessment issued pursuant to Code of Ala. 1975, §40-2A-7(b)(2). That is the first action by the Department that allows a taxpayer an opportunity for a formal administrative review by filing a petition for review pursuant to §40-2A-7(b)(4)a. The Alabama equivalent to the §6212 deficiency notice is the final assessment entered by the Department. Because the Department is required to enter a preliminary assessment before entering a final assessment, except in limited circumstances, the entry of a preliminary assessment will in most cases trigger the running of hot interest on large corporate underpayments.²

The Department argues that other states that have adopted the federal rates in §6621 have identified the specific actions by the state that would trigger the “applicable date,” i.e., the running of the additional two percent rate, citing Cal. Rev. and Tax. §19521. Department’s Reply Brief at 7.

The above California statute, at §19521(c), does “modify” §6621(c) so as to identify the specific actions by the California Franchise Tax Board that will trigger the additional two

² The limited circumstances are where the tax as reported on a return is undisputed by the Department, or where the taxpayer consents to a proposed deficiency in writing, or when the Department enters a final jeopardy assessment against a taxpayer, see Code of Ala. 1975, §40-2A-7(b)(1)b. The Department is authorized to enter a final assessment in the above circumstances without first entering a preliminary assessment.

percent rate in California.³ Alabama would have been well-served if the Alabama Legislature had also specified the procedural actions by the Department that would trigger the higher rate. But the fact that it did not does not alter the fact that the Legislature, by adopting §6621 in its entirety, clearly intended for the additional two percent rate to apply at some point after the due date, i.e., after the “applicable date.” And the clear Alabama equivalent to the federal 1st letter of proposed deficiency that triggers the higher rate for federal purposes is the entry of a preliminary assessment by the Department.

It could be argued that because Alabama does not issue a “1st letter of proposed deficiency” or “a deficiency notice under section 6212,” then the additional two percent rate can never be triggered in Alabama, and thus can never apply. But again, the clear intent of the Legislature by adopting §6621 in toto was for the additional two percent rate to apply at some point. Accordingly, the only reasonable interpretation is that the higher rate applies 30 days after a preliminary assessment or a final assessment is entered, whichever occurs first.

The Department asserts that its position concerning when hot interest begins to accrue on underpayments is supported by its position on how such interest is computed on overpayments. The record is not clear, however, concerning how the Department computes interest on large corporate overpayments.

³ The triggering events under the California statute are the date on which the proposed deficiency is issued or the date the notice and demand is sent, whichever is earlier. Those actions are similar if not identical in substance to the entry of a preliminary assessment and a final assessment, respectively, by the Department.

Section 40-1-44(b)(1) requires the Department to pay interest on refunds “at the same rate as provided herein for interest on underpayments.” Under normal circumstances, it is fair and reasonable that the Department should pay the same interest on overpayments that it charges on underpayments. But the computation of interest on large corporate overpayments and underpayments presents certain policy issues.

Section 6621(c) requires corporations to pay an additional two percent rate on underpayments of over \$100,000. The obvious policy behind requiring a higher rate on large corporate underpayments is to discourage such underpayments. By adopting the §6621(c) hot interest rate on large corporate underpayments, Alabama likewise discourages corporations from substantially underpaying their liability to the Department.

Concerning overpayments, the U.S. Treasury is required to pay interest on refunds at three percentage points above the federal short term rate, but only two points above that rate on overpayments by corporations, see §6621(a)(1)(B). But that same section provides that on overpayments by corporations over \$10,000, the Treasury pays only 0.5 percent above the short term rate. The clear policy argument for paying a lower rate of interest on large corporate overpayments is to discourage a corporation from intentionally and substantially overpaying its liability, and thereby receiving an attractive return in interest income on its “investment.”

Alabama has not adopted the federal scheme for paying interest on refunds. Rather, as discussed, §40-1-44(b)(1) requires the Department to pay the same rate on refunds that it charges on underpayments. Consequently, Alabama law in effect rewards corporations that substantially overpay their Alabama liability because they can receive

interest on the overpaid amount at the higher hot interest rate. The rationale for the federal government paying a lower interest rate on large corporate overpayments is thus turned on its head under Alabama law. That result was perhaps not intended or envisioned by the Legislature, but §40-1-44(b)(1) clearly requires the Department to pay interest on overpayments at the same rate as underpayments.

An obvious problem with paying hot interest on large corporate overpayments is determining when the additional rate begins to accrue. Hot interest on underpayments begins to accrue 30 days after the taxpayer is formally notified of the amount due, i.e., the issuance of a 1st notice of proposed deficiency for federal purposes and the issuance of a preliminary assessment for Alabama purposes. The 30 day lag time allows a corporation to avoid the higher rate by paying the proposed amount due within the 30 days, and then seeking a refund of some or all of the amount paid.

Section 6621 does not address when hot interest begins to run on large corporate overpayments because, as discussed, the federal government pays a lower rate of interest, not a higher rate, on large corporate overpayments over \$10,000. Alabama law also does not address the issue.

The parties stipulated that the Department computed interest on the Taxpayer's 2009 overpayment at the hot interest rate, but not from the due date of the tax. The record does not indicate the date from which the Department computed the hot interest due on the 2009 overpayment. Department Reg. 810-14-1-.35, entitled "Interest on Refunds," only provides that the Department shall pay interest on any refund from the date of overpayment. It does not address or mention hot interest on large corporate

overpayments.

The Taxpayer indicates in its Brief at 12, n. 1, that “[t]he Department calculates hot interest as an additional two percent (not 0.5 percent) on overpayments in excess of \$100,000 (not \$10,000) computed from 90 days after the earlier of the initial due date of the return or the date of filing.” It is not known if the above statement is indeed the Department’s policy concerning hot interest on large corporate overpayments, or whether that is how the Department computed the hot interest due on the Taxpayer’s 2009 overpayment.

The above discussion illustrates the uncertainty as to how the Department should compute interest on large corporate overpayments. Ideally, the uncertainty will be resolved by clarifying legislation, or at the least by a Department regulation addressing the issue. But how the Department may compute interest on large corporate overpayments is not relevant in this case because the Taxpayer has not contested the Department’s computation of interest on its 2009 overpayment. The only issue in this case is the date on which hot interest began accruing on the Taxpayer’s large corporate underpayments in 2006 and 2007. Alabama has adopted §6621(c), and as discussed, a reasonable interpretation of that provision is that the Taxpayer owes hot interest beginning 30 days after the Department entered the 2006 and 2007 preliminary assessments against the Taxpayer.

The 2006 and 2007 preliminary assessments were entered on August 12, 2010 and September 1, 2011, respectively, before the final assessments in issue were entered. The Department should compute the hot interest due beginning 30 days from those dates and

notify the Administrative Law Division of the amount due for each year. An appropriate Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered August 15, 2013.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

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