

State and Local Tax Bulletin

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Alabama Edition



Amended Class Action Suit Alleges that Private Auditing Firm Committed Multiple Violations of Alabama Taxpayers' Bill of Rights

By Bruce P. Ely and J. Sims Rhyne III

Upcoming Seminars Involving Members Of Our SALT Practice Group

October 18-21, 2011

The Council On State Taxation (COST) 42nd Annual Meeting will be held in New Orleans, Louisiana, at The Ritz-Carlton. On Thursday, October 20, Bruce Ely and Jamie Yesnowitz of Grant Thornton LLP will be speaking on "Sales of Other Than Tangible Personal Property: What Does a Shift to Market-Based Sourcing Mean to Taxpayers?" "State Tax Audit and Appeal Strategies When Dealing With Difficult Audit Issues" will be presented by Chris Grissom on Friday, October 21. His co-presenter will be Erica Horn of Stites & Harbison PLLC. For more information, visit www.cost.org.

October 23-28, 2011

New York University's 70th Institute on Federal Taxation will be held in New York City at the Grand Hyatt Hotel on October 23-28, 2011, and will also be held in San Francisco at The Fairmont Hotel from November 13-18, 2011. Bruce Ely will be speaking at the New York venue and Chris Grissom will be speaking at the San Francisco venue on "The Strained Relationship Between the Federal and State Taxation of Pass-Through Entities." For more information, please visit the NYU Continuing Education Department's website at www.scps.nyu.edu/ift.

November 4, 2011

Lorman Education Services' annual seminar on "Sales and Use Tax in Alabama" will be held at The Harbert Center in downtown Birmingham, Alabama. Bruce Ely, Chris Grissom, Jimmy Long, and Will Thistle will be leading this comprehensive eight hour course. For more information, visit www.lorman.com.

The two Alabama taxpayers who filed an eye-opening class action suit against the best-known private contract auditing firm in Alabama recently filed a second amended and restated class action complaint in the Circuit Court of Jefferson County. *Washer & Refrigeration Supply Co., Inc. and David L. Smith et al. v. PRA Government Services, LLC, et al.*, CV 2010-903417 (Aug. 11, 2011). A hearing was held before Circuit Judge Robert Vance last week. One of the defendants, PRA Government Services, doing business as "Revenue Discovery Systems" or "AlaTax" and its affiliates ("AlaTax"), is by far the largest private auditing firm in Alabama, collecting and administering various taxes for over 250 local jurisdictions within the state. Co-plaintiff David Smith is a shareholder and President of Washer & Refrigeration Supply Company who had liens filed by the defendants on his real and personal property for taxes allegedly owed by the company, apparently without ever having received a personal assessment for those taxes.

The amended complaint adds two new taxpayer-plaintiffs, Funsorce, Inc. and Hollywood Pool & Spa, Inc., and also adds the City of Warrior, Alabama as a co-defendant. In adding the City of Warrior, the plaintiffs seek certification of a defendant class consisting of that municipality and all other taxing authorities in Alabama that have participated in AlaTax's multi-jurisdictional audits of any of the class plaintiffs. The plaintiffs are represented by McCallum, Hoaglund, Cook & Irby, LLP and Johnston, Barton, Proctor & Rose LLP, both of Birmingham.

The amended complaint alleges that AlaTax and its auditors have committed multiple violations of the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act ("TBOR"), many of which were listed in the original complaint. The plaintiffs seek certification as a class that would include all Alabama citizens and businesses that have remitted local taxes to AlaTax, were audited by AlaTax, or participated in an administrative review conducted by AlaTax. If certain taxpayer claims are validated by the court, AlaTax may be forced to suspend operations for a minimum of six months.

Alabama is the only state that allows every local governing body (counties and municipalities) to both levy and collect their own sales, use, rental and lodgings taxes, either through self-administration, by using the

Alabama Department of Revenue as agent, or by employing a private auditing firm or even another local jurisdiction as agent. Private auditing firms such as AlaTax, as well as counties and municipalities, are subject to TBOR and additional restrictions by virtue of the Local Tax Simplification Act of 1998. See *GMAC v. City of Red Bay*, 894 So. 2d 650 (Ala. 2004).

The plaintiffs allege that AlaTax has violated several key aspects of TBOR, including: failing to notify taxpayers who have overpaid taxes of the procedures for filing a refund claim; failing to notify taxpayers of the right to an administrative appeal (in lieu of filing an appeal in circuit court); failing to comply with auditor surety bonding requirements; entering into contingency fee auditing contracts; and compensating its employees and independent contractors through incentive bonuses based on tax collections or assessments.

For example, the plaintiffs allege that a so-called "Tax Revenue Enhancement Agreement" exists between AlaTax and numerous local jurisdictions, which allegedly provides compensation to AlaTax for its examination services "equal to 50% of the business license revenue collected" from targeted taxpayers. The plaintiffs allege that this compensation scheme, along with AlaTax's so-called "bounty hunter" contracts, violate taxpayers' due process rights and create a biased administrative appeals process. In support of that argument, the plaintiffs cite evidence that taxpayers obtain refunds in approximately 45% of their appeals before the Department of Revenue's Administrative Law Division, compared to only a 0.2% success rate before AlaTax hearing officers. The amended complaint further alleges that TBOR does not authorize AlaTax employees to execute preliminary or final assessments against taxpayers or to conduct administrative hearings on behalf of its local government clients citing a recent Alabama Supreme Court case involving the city of Huntsville. The plaintiffs assert that the power to enter assessments and conduct administrative procedures is reserved by TBOR and the Alabama Constitution to counties and municipalities.

The plaintiffs request several forms of relief in their Amended and Restated Complaint, including a declaratory judgment that AlaTax's contracts with its local government clients are void and unenforceable under TBOR; that AlaTax's practices are common, uniform, improper, and violative under TBOR; and that any and all tax assessments, liens, levies, and collection performed in relation to AlaTax's "Tax Revenue Enhancement Agreements" are invalid, void, and constitute unlawful takings. The plaintiffs also request an injunction against AlaTax from engaging in any conduct that is found to violate TBOR as well as a refund of all fees collected by AlaTax in violation of TBOR.

AlaTax is represented by the Birmingham law firm of Burr & Forman LLP, who filed a motion to dismiss on behalf of AlaTax earlier this month, arguing that the circuit court lacks subject matter jurisdiction and that a private right of action for the taxpayer-plaintiffs does not exist under TBOR. Specifically, AlaTax argues that the plaintiffs must proceed through the administrative assessment and appeals process prescribed in TBOR and that this appeals process is the plaintiffs' exclusive remedy. Thus, AlaTax argues that the plaintiffs have no right of action under TBOR to seek forfeiture of RDS' licenses, or cancellation or revocation of its auditing contracts, imposition of Class A misdemeanor penalties, or damages.

Co-defendant City of Warrior also filed a motion to dismiss and a motion for summary judgment. The City argues that the taxpayer-plaintiffs' alleged complaints were wrongful acts committed by AlaTax, not the City. As such, the City asks the court to dismiss it as a party to the suit.

The taxpayer-plaintiffs filed a motion responding to the motions filed by both AlaTax and the City of Warrior and the Court held a hearing on all the motions on September 15. Although the case has yet to be certified as a class action, it is being watched closely by both the business community and local governments alike. If you have any questions regarding this case or related issues, feel free to contact any of the Alabama members of our SALT Practice Group at the email address or telephone number listed on the next page.

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