

**BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS**

IN THE MATTER OF )  
Granite Construction, Inc. ) OAH Case No. 12-0004-TAX  
)  
Corporate Income Tax – Tax years 2008-2009 )

**DECISION**

**I. Introduction**

This case is the tax appeal of Granite Construction, Inc. Granite Construction is appealing the look-back interest of \$60,906 for 2008 and \$98,323 for 2009, and an additional tax of \$2,187 for 2008 and \$2,570 for 2009 by the Alaska Department of Revenue (DOR) in an informal conference decision issued on December 5, 2011.

The parties filed briefing and participated in oral arguments. Based on the undisputed facts, DOR correctly assessed the additional taxes and interest, but while an argument could be made that DOR should have applied the federal overpayment interest rate to the additional taxes due, the state rate applies as what was perhaps an unforeseen consequence of the state adopting a different overpayment interest rate than that found under the IRS code.

**II. Undisputed Facts**

Granite Construction does not contest DOR’s calculations of the tax due or look-back interest in the Informal Conference Decision being appealed. Those calculations resulted in look-back interest of \$60,906 for 2008 and \$98,323 for 2009, and an additional tax of \$2,187 for 2008 and \$2,570 for 2009. The dispute in this case is whether DOR had the statutory authority to assess any look-back interest and whether the Alaska or the federal overpayment interest rate applies.

**III. Discussion**

a. *Look-back Interest*

Under the Federal Internal Revenue Code (IRC), “look-back interest” is interest that needs to be paid by a taxpayer or refunded to a taxpayer as the result of income from a long-term contract that has been reported on prior-year tax returns using the percentage of completion method. Section twenty-six of the Internal Revenue Code sets out the rules for accounting for contract revenue for long-term contracts using this method. The “look-back” provisions account for the difference between the gross profit that was reflected in tax returns for prior years that the

contract was in effect and the actual gross profit after the job is completed.<sup>1</sup> The calculation determines whether or not the gross profit for that particular job was over or under reported in prior years based on job cost estimates at the time of the tax reporting. Under the percentage of completion method, long-term contract revenue is reported based on estimates. The incentive for a taxpayer to defer reporting taxable income in the earlier years that the long-term contract is in effect by understating a contract's percentage of completion is removed through look-back interest. If the taxpayer's profit for those early tax years was understated due to conservative estimates and, as a result, taxes were underpaid, the taxpayer is required to pay look-back interest on the difference. This removes the incentive to defer tax liability by reporting a majority of income in the final years of the contract.

b. *Taxpayer's Position*

Granite Construction argues that DOR did not have the statutory authority to assess any look-back interest, and that even if look-back interest was due, DOR should have charged interest at the federal rather than the state overpayment rate. Granite Construction also argues that equitable considerations preclude the assessment of interest in this case.

c. *Standard of Review*

AS 43.05.435(2) & (3) establish the applicable standards of review requiring the administrative law judge to resolve a question of law through the exercise of the independent judgment of the administrative law judge, and only to defer to DOR in a matter where DOR has exercised legally vested discretion and DOR's exercise of that discretion had a reasonable basis. DOR has not requested deference on the basis of an exercise of discretionary authority.

d. *Alaska Overpayment Interest Rate Applies*

Alaska has adopted portions of the IRC that include the portions that provide for look-back interest.<sup>2</sup> Alaska has an exception for the rate of interest charged in the IRC for overpayments and underpayments of tax.<sup>3</sup> As applied to Granite Construction's look-back tax liability, there is no dispute that if the Alaska interest rate applies, it would be 11%. This is the rate that DOR would apply whether there was an underpayment or an overpayment.<sup>4</sup> Under the IRC, the overpayment rate and the underpayment rate are both different from the Alaska Rate: the overpayment interest rate is lower than the underpayment rate. The IRC cites the federal

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<sup>1</sup> 26 U.S.C. §460

<sup>2</sup> AS 43.20.021(a), AS 43.20.300(a) & (b).

<sup>3</sup> AS 43.20.225(1).

overpayment rate as the rate that must be applied to either an overpayment or an underpayment under the look-back provisions.

An argument could be made that the federal overpayment rate should be applied. The argument would be that the look-back interest provisions apply to a separate situation from a normal overpayment or underpayment of taxes that result in interest being due from the taxpayer or the taxing authority, and that this creates an exception to the application of the Alaska interest provisions. This argument, however, only explains why such an approach would make Alaska law more consistent with the way IRC gives taxpayers a reduced interest rate, that is, the overpayment rate, for look-back interest on underpayments. Alaska law is applicable to a look-back underpayment, and Alaska law uses the same rate for both underpayments and overpayments. Alaska law has its own interest rate for overpayments.

When the IRC applies the overpayment rate to look-back tax deficiencies, either the Alaska overpayment or underpayment rate applies to Alaska look-back tax liabilities. Both rates are the same. This result may be inconsistent with the policy behind these IRC provisions that provide a reduced interest rate for look-back tax liabilities under the IRC, but that does not mean that the Alaska overpayment interest rate does not apply in this case. The failure of Alaska tax law to provide consistency with this IRC policy may be an unintended consequence of the interplay of the state and federal laws, but this does not mean that this consequence can be ignored.

Granite Construction argues that the Alaska interest rate for delinquent taxes is inapplicable to look-back interest because look-back tax liability is not for delinquent taxes. Granite Construction cites the Alaska statute that provides the interest rate charged on tax paid late and underpaid taxes and notes that the statute explicitly refers to its applicability to “delinquent” taxes.<sup>5</sup> Whether the look-back tax liability can fairly be characterized as delinquent or not, the interest charged for look-back shortfalls or look-back underpayments under the IRC is the overpayment rate, not the underpayment rate. Under Alaska law, the overpayment rate of course does not include language explicitly implying that its application be limited to delinquent taxes. It is simply a rate; that is, the same rate paid on delinquent taxes.<sup>6</sup>

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<sup>4</sup> AS 43.05.280.

<sup>5</sup> AS 43.05.225(1).

<sup>6</sup> AS 43.05.280(a) simply provides: Interest shall be allowed and paid on an overpayment of a tax under this title at the rate and in the manner provided in AS 43.05.225(1).

Granite Construction points out that a recent Supreme Court case held that it would not be appropriate to apply the Alaska tax overpayment rate to the overpayment of commercial fisheries fees, and refers to the overpayment rate under AS 43.05.225 as a punitive interest rate.<sup>7</sup> Granite Construction also points out that the Alaska rate of interest is seven times the rate that would have been charged under the IRC. Again, however, the issue of what interest rate Alaska should charge or pay on a look-back under or over payment is not the question. The issue is what interest rate is charged under Alaska law. The overpayment that the Supreme Court declined to charge the Alaska overpayment rate on was an overpayment for fees that were not charged under AS 43. The taxes due in this case are for taxes under AS 43. The AS 43 rate therefore applies.

e. *Failure to More Guidance on Look-Back Interest Does Not Require Abatement*

Granite Construction argues that DOR's failure to provide taxpayers with more guidance on its position about the applicability of the look-back provisions and interest through regulations, instructions, and forms should preclude the assessment of interest in this case. Alaska law provides for both interest and penalties for the underpayment of taxes, but the abatement of penalties only when the taxpayer shows that there was reasonable cause for the failure to timely pay and file.<sup>8</sup> There is no corresponding requirement that interest be abated upon a showing of good cause.

f. *Equitable Considerations Do Not Require Abatement*

Granite Construction explains that it has been an Alaska taxpayer since 2004 and was not asked to pay look-back interest until the audit of the 2008 and 2009 tax years, even though it had federal look-back interest reported for 2005. DOR is not required to abate interest on a showing that there are equitable considerations that mediate toward abatement.

**IV. Conclusion**

DOR's Informal Conference Decision issued on December 5, 2011 is affirmed.

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<sup>7</sup> *State, Commercial Fisheries Entry Comm'n v. Carlson*, 270 P.3d 755, 764 (Alaska 2012), reh'g denied (Feb. 21, 2012), as modified on reh'g (Apr. 13, 2012).

## NOTICE

1. This is the hearing decision of the Administrative Law Judge under Alaska Statute 43.05.465(a). Unless reconsideration is ordered, this decision will become the final administrative decision 60 days from the date of service of this decision.<sup>9</sup>
2. A party may request reconsideration in accordance with Alaska Statute 43.05.465(b) within 30 days of the date of service of this decision.
3. When the decision becomes final, the decision and the record in this appeal become public records unless the Administrative Law Judge has issued a protective order requiring that specified parts of the record be kept confidential.<sup>10</sup>
4. A party may file a motion for a protective order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.<sup>11</sup>
5. Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date of this decision becomes final.<sup>12</sup>

DATED this 7th day of May, 2014.

By: Signed  
Mark T. Handley  
Administrative Law Judge

[This document has been modified to conform to the technical standards for publication.]

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<sup>8</sup> AS 43.05.220(a).  
<sup>9</sup> AS 43.05.465(f)(1).  
<sup>10</sup> AS 43.05.470.  
<sup>11</sup> AS 43.05.470(b).  
<sup>12</sup> AS 43.05.465 sets out the timelines for when this decision will become final.