

BEFORE THE STATE OF ALASKA OFFICE OF ADMINISTRATIVE HEARINGS¹

IN THE MATTER OF)
UNITED PARCEL SERVICE) OAH No. 05-0187-TAX
)
Corporate Income Tax for Tax Year 2002)

ORDER GRANTING SUMMARY JUDGMENT

I. Introduction

A. Summary

This is a tax penalty case. United Parcel Service is appealing an assessment by the Taxation Division of the Alaska Department of Revenue (Division) of a Failure-to-Pay penalty of \$52,717 for the late payment of United Parcel Service's 2002 Alaska corporate income tax liability. The Division also assessed a \$5,719 Underpayment of Estimated Tax penalty. United Parcel Service does not request abatement of the Underpayment of Estimated Tax penalty.²

The relevant facts in this case are not in dispute. United Parcel Service and the Division agree that United Parcel Service was late in paying part of United Parcel Service's 2002 tax liability. They also agree that the Division correctly calculated the penalty due. They agree about the facts surrounding the late payment. The only disagreement is whether given these undisputed facts United Parcel Service is entitled to a waiver of the penalty.³ Because United Parcel Service did not take in good faith all steps and precautions reasonably necessary to ensure the timeliness of the payment, the Administrative Law Judge grants the Division's motion.

B. History

On July 8, 2005, the Division filed a Motion for Summary Adjudication in this appeal,

¹ The Alaska Office of Administrative Hearings is the successor agency to the Office of Tax Appeals, effective July 1, 2005.

² United Parcel Service's letter dated July 8, 2005, page 1.

³ United Parcel Service's letter dated July 8, 2005, Division's Motion for Summary Judgment, and Division's Response Re: Motion for Summary Judgment.

alleging that no material facts are in issue and that it is entitled to judgment as a matter of law.

On July 8, 2005, United Parcel Service filed a request for abatement of the tax penalty assessed in the amount of \$52,717.⁴ This request was filed during the time period set, by agreement of the parties, to file dispositive motions.

On July 20, 2005, the Division filed a response brief.

II. Facts

A. Explanation of Underpayment

In order to calculate its 2002 Alaska tax, United Parcel Service first calculated its total federal taxable income for 2002. United Parcel Service then used a short-cut method to estimate the Alaska apportionment of its estimated 2002 tax liability. United Parcel Service multiplied its federal taxable income for 2002 by this short-cut effective rate to estimate its Alaska tax.

For the first three-quarters of 2002, United Parcel Service calculated what it called the "2000 Effective Rate." United Parcel Service derived this "2000 Effective Rate" by dividing its 2000 Alaska tax by its estimated 2000 federal taxable income.⁵ For the first three-quarters of 2002, United Parcel Service multiplied its estimated 2002 total federal taxable income by its "2000 Effective Rate" to estimate its Alaska tax.

This short-cut method would not have underestimated United Parcel Service's 2002 liability if United Parcel Service had stuck with the same data it used for the first three quarters of 2002 through to the end of the year. Instead, for the last quarter of 2002, United Parcel Service used its 2001 tax information to derive a "2001 Effective Rate" by dividing its 2001 Alaska tax by its estimated 2001 federal taxable income.⁶

When United Parcel Service calculated this new "2001 Effective Rate" it failed to add back the portion of 2001 income that had not been included as taxable because of a large nonrecurring 2001 net operating loss deduction. As a result, this new short-cut calculation of 2002 Alaska tax produced such a large under-estimate of United Parcel Service's actual liability

⁴ United Parcel Service does not mention the \$5,719 Underpayment of Estimated Tax penalty in its July 8, 2005 letter. I have therefore concluded that United Parcel Service no longer requests abatement of the Underpayment of Estimated Tax penalty. As the Division notes in its Motion for Summary Judgment, there is no provision in statute or regulation that allows abatement of the Underpayment of Estimated Tax penalty.

⁵ United Parcel Service's letter dated July 8, 2005, pages 1&2 and Division's Motion for Summary Judgment, pages 1-6.

that United Parcel Service concluded that it had already overpaid its 2002 Alaska net income. United Parcel Service, therefore, made no fourth quarter payment.⁷

If United Parcel Service had used an apportionment approach to estimate its Alaska effective rate it also would not have underestimated its Alaska tax. An apportionment approach would have derived the effective rate by multiplying United Parcel Service's 2001 Alaska apportionment factor by the Alaska tax rate.⁸

III. Discussion

A. Legal Standard for Relief from Penalty

United Parcel Service would be entitled to a waiver of the failure to pay penalty if the late payment was due to reasonable cause and not willful neglect.⁹ In the context of this case, reasonable cause would mean that United Parcel Service in good faith took all steps and precautions reasonably necessary to ensure the timeliness of the payment.¹⁰

B. Division's Justification for Denying Waiver

The Division pointed to several steps United Parcel Service could have taken that would have resulted in timely payment of the full tax liability.¹¹ The Division focused on two steps United Parcel Service failed to take that were reasonably necessary to ensure timeliness of full payment. The first step the Division identified would have been for United Parcel Service to have used a more straightforward and reliable approach to estimating its Alaska tax liability. The second step was avoiding the obvious error of failing to remove a nonrecurring deduction from the 2001 tax information United Parcel Service chose to use to estimate its 2002 Alaska tax liability.

⁶ United Parcel Service's letter dated July 8, 2005, page 2 and Division's Motion for Summary Judgment, pages 4 & 5.

⁷ Division's Motion for Summary Judgment pages 3 & 4.

⁸ Division's Motion for Summary Judgment pages 2-6

⁹ Alaska Statute 43.05.220(a).

¹⁰ See the examples of reasonable cause found in Alaska Regulation 15 AAC 05.200(c). United Parcel Service is not asserting that the late payment was due to an act of war or a third party.

¹¹ Division's Motion for Summary Judgment pages 2-6.

C. Reliance on United Parcel Service's Methodology to Justify Underpayment

1. Division's Position on United Parcel Service's Use of Short-cut Methodology

Although the Division admits that United Parcel Service's short-cut method of apportionment would not have resulted in an underestimate of the 2002 tax liability if United Parcel Service had stuck with the 2000 short-cut formula it used for the first three quarters of 2002, the Division does not admit that this demonstrates that the short-cut formula is a reasonably reliable method of estimating current tax liability.¹²

The Division also admits that United Parcel Service's 2001 short-cut formula would not have resulted in an underestimate of its 2002 tax liability if United Parcel Service had removed the nonrecurring 2001 net operating loss deduction from its 2002 fourth quarter 2001 short-cut calculation. The Division argues, however, that even if this obvious adjustment had been made, it would still not show that United Parcel Service's short-cut methodology reliably produces an accurate estimate of United Parcel Service's Alaska tax liability.¹³

The Division characterizes United Parcel Service's short-cut methodology as "flawed."¹⁴ The Division maintains that this short-cut method relies too heavily on information from prior tax years to calculate tax liability for the current tax year. The Division argues that the because estimates that result from United Parcel Service's short-cut method are not as likely to be accurate as estimates based on more current information using the apportionment approach, United Parcel Service bears the risk of tax penalties if underpayments result from United Parcel Service's reliance on its short-cut method.¹⁵

3. United Parcel Service's Justification for Using Short-cut Methodology

United Parcel Service justified its decision to use this short-cut methodology as follows:

An additional layer of complex calculations is required to determine the Alaska apportionment factors. The combined group has property in all 50 states as well as many other locations around the world. Sales and payroll factors are also present in each of the

¹² The Division suggests other methodologies for estimating United Parcel Service's tax, which would not have resulted in the underpayment. *See* Division's Motion for Summary Judgment pages 2-6.

¹³ Division's Motion for Summary Judgment page 8.

¹⁴ Division's Response Re: Motion for Summary Judgment, page 2.

¹⁵ Division's Motion for Summary Judgment, page 6 & 7.

50 states and many foreign locations.

This information is gathered from more than 130 companies that together operate in more than 200 countries and territories around the world. **Recalculating each of these components every three months would significantly impair the Company's ability to reasonably and accurately estimate its tax liabilities in a timely manner for the more than 600 returns it files.** (Emphasis added).¹⁶

United Parcel Service also points to its history of timely Alaska tax payments and the fact that it added an additional 10% to its estimated tax in attempt to avoid underpayments. United Parcel Service argues that because it set up an efficient system for estimating its Alaska tax and avoiding underpayments, it should not have to pay a penalty for an underpayment that resulted from a reasonable estimate using that system.¹⁷

4. Reliance on Short-cut Methodology Does Not Justify Waiver of Penalty

United Parcel Service's use of a short-cut method that underestimated its taxes was not reasonable cause for late payment. United Parcel Service's reason for using its short-cut method instead of calculating its Alaska apportionment using updated information is that it does not wish to dedicate the resources that would be required to produce the more accurate estimate. Late tax payments that result from the manner in which a taxpayer elects to allocate its resources are not the result of reasonable cause and will not excuse a penalty.

The methodology that United Parcel Service used to estimate its tax liability simply was not reliable enough to justify a waiver of the penalty in the event that reliance on that methodology resulted in an underpayment. Compared to the apportionment approach, United Parcel Service's short-cut method tends to increase inaccuracies that are the result of differences in the Alaska tax due for the current tax year and the tax year that is used to calculate the effective rate.¹⁸ Furthermore, United Parcel Service was using 2000 Alaska tax to calculate its 2002 effective rate. While this fortuitously would have resulted in an overpayment rather than an underpayment if United Parcel Service had continued to use the 2000 Alaska tax, a taxpayer using Alaska tax from two years prior to the current tax year to calculate its Alaska effective rate has not taken all reasonable steps to avoid underpayment. To avoid tax penalties, a taxpayer

¹⁶ United Parcel Service's letter dated July 8, 2005, page 2.

¹⁷ United Parcel Service's letter dated July 8, 2005, page 2.

¹⁸ Division's Motion for Summary Judgment page 5.

must anticipate the magnitude and complexity of its tax obligations, and to plan accordingly. Explanations that a taxpayer's records or information could not be assimilated fast enough, that accounting staff was overworked, or that the computer system was inefficient, are not reasonable cause.¹⁹ A taxpayer is free to allocate its business resources as it sees fit. However, if the taxpayer's decision to use a less reliable short-cut method to estimate its Alaska tax liability results in an underpayment, the taxpayer must pay the penalty for the under payment. Using this short methodology was a step that United Parcel Service should reasonably have avoided taking.

D. Failure to Correct for Obvious Inconsistency Also Disqualifies United Parcel Service for Waiver

Even if United Parcel Service had shown that in theory its short-cut methodology was as reliable as the methods suggested by the Division, United Parcel Service's failure to remove nonrecurring deductions from the earlier tax year it used in its short-cut methodology was a reasonable step United Parcel Service should have taken to ensure timely payment of the tax. Taking this obvious step would have avoided late payment.²⁰

United Parcel Service's use of the Alaska tax due for prior years in its short-cut methodology to estimate its current Alaska tax liability is based on the assumption that the prior year tax will be similar to the tax due for the current year. United Parcel Service, therefore, should have corrected for any obvious differences between the prior tax year and the current one. Failing to review the prior year return to determine if there were large nonrecurring deductions claimed for the prior year, before using that prior year Alaska tax to estimate current tax, is not reasonable cause for underpayment. United Parcel Service did not provide a specific explanation for its failure to make this simple and obvious correction.²¹ United Parcel Service should have taken the reasonable step of reviewing the 2001 tax return for nonrecurring deductions to avoid underpayment of tax.²²

¹⁹ *State, Dep't of Revenue v. Dyncorp*, 14 P.3d 981, 987 (Alaska 2000).

²⁰ Division's Motion for Summary Judgment page 5.

²¹ United Parcel Service's letter dated July 8, 2005.

²² The fact that changing the tax year United Parcel Service used to calculate tax for the first three quarters of 2002 and the last quarter of 2002 from 2000 to 2001 led to such a dramatic difference in the estimated tax for 2002 makes it even less reasonable that United Parcel Service failed to look closely at the 2001 return to check for obvious reasons why the 2001 taxable income might be different from that of 2002.

IV. Conclusion

Based on the undisputed facts of this case, United Parcel Service's late payment was not due to reasonable cause, and the Division correctly assessed a Failure-to-Pay penalty of \$52,717.

V. Order

1. The Division's a Motion for Summary Adjudication is GRANTED.
2. United Parcel Service's request for abatement of the tax penalty assessed in the amount of \$52,717 is DENIED.
3. This case will not be scheduled for formal hearing.
4. The Division's assessment of a Failure-to-Pay penalty of \$52,717 for United Parcel Service's 2002 Alaska corporate income tax is affirmed.
5. The Division's assessment of a \$5,719 Underpayment of Estimated Tax penalty for United Parcel Service's 2002 Alaska corporate income tax is also affirmed.

VI. NOTICE

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.²³

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.

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.²⁴ 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.²⁵

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

²³ Alaska Statute 43.05.465(f)(1).

²⁴ Alaska Statute 43.05.470.

²⁵ Alaska Statute 43.05.470(b).

decision becomes final.²⁶

DATED this 9th day of November 2005.

By: _____

Mark T. Handley

Administrative Law Judge

The undersigned certifies that this date an exact copy of the foregoing was provided to the following individuals:

Scott Potts

Michael Barnhill

Signature ~ 1

Date

11.2.05

²⁶

Alaska Statute 43.05.465 sets out the timelines for when this decision will become final.