

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of)
)
 VECO CORPORATION)
) OAH No. 10-0137-TAX
 Tax Period April 1-September 7, 2007)

DECISION ON SUMMARY ADJUDICATION

I. Introduction

CH2M Hill Companies, Ltd., on behalf of VECO Corporation, appealed the Department of Revenue’s assessment of a 25 percent penalty for late payment of taxes for the period preceding CH2M Hill’s purchase of VECO’s stock. The sole issue on appeal is whether VECO had reasonable cause for the late payment because it did not know the amount due until the tax return was prepared months after the payment deadline. VECO did not show that it was unable to make a timely payment, but rather only that if it had done so the amount might have resulted in an overpayment or underpayment.

Case precedents establish that lack of certainty about the amount of tax due does not constitute reasonable cause to postpone making a payment when due. VECO failed to meet its burden to prove that penalty abatement is justified. The department’s assessment of a 25 percent penalty, therefore, is affirmed.

II. Facts

On September 7, 2007, CH2M Hill acquired 100 percent of the VECO Corporation stock.¹ The acquisition followed a four-month due diligence marked by extraordinary challenges, including the need for a detailed forensic review for corruption, the withdrawal by VECO’s auditors of pre-acquisition financial statements, and immediate termination of most VECO executives.²

The Sales Purchase Agreement provided for CH2M Hill to hold back twice the percentage (\$70 million; about 20%) of the unadjusted purchase price, for three times as long (36 months instead of 12), as is typical for CH2M Hill’s acquisitions.³ The holdback was “intended to cover all unknown liabilities,” including unknown tax liabilities.⁴

¹ July 20, 2010 Stipulation for Summary Adjudication at ¶ 1.

² *Id.* at ¶¶ 2-3.

³ *Id.* at ¶ 5 (explaining that the \$70 million holdback authorized for a period of up to three years, represented approximately 20 percent of the unadjusted purchase price, whereas CH2M Hill’s typical holdback is 10 percent for a period of 12 months).

⁴ *Id.*

After the acquisition, CH2M Hill engaged with the Internal Revenue Service (IRS) to examine VECO's pre-acquisition tax filings.⁵ Nearly three years after the acquisition, the IRS still had not completed its examination for three pre-acquisition periods, including the short period (April 1-September 7, 2007) at issue here.⁶ The examinations were challenging for CH2M Hill, in part because former VECO executives were no longer with the company.⁷

Getting the pre-acquisition tax returns prepared after the acquisition was challenging as well: "The VECO Director of Tax wanted to resign at the date of acquisition[.]"⁸ CH2M Hill did not know the actual liabilities until the returns were completed.⁹ Immediately after the seller's representative completed them, CH2M Hill "filed the returns and paid the assessment as well as a self-assessed interest payment of \$100,000."¹⁰

In the ordinary course, the federal return for the short period ending September 7, 2007, would have been due March 15, 2008, with the Alaska return due a month later.¹¹ An extension to October 15, 2008, was obtained for the filing of the Alaska return.¹² The return was filed 30 days before that extended deadline, with the payment having been made on September 12, 2008, a few days before the return was filed.¹³

A little over a year later, the department assessed VECO penalties totaling \$502,561 (25 percent of the tax) allocated as follows: \$402,049 (20 percent) for failure to timely file and \$100,512 (five percent) for failure to timely pay.¹⁴ VECO challenged the assessment, requesting an informal conference.

At informal conference, the department determined that the failure-to-timely-file penalty had been assessed in error because the assessment had not taken into account the extension of the filing deadline to October 15.¹⁵ The department reversed that assessment but increased the

⁵ *Id.* at ¶ 4.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at ¶ 6.

⁹ *Id.*

¹⁰ *Id.*

¹¹ March 2, 2010 Informal Conference Decision at 2.

¹² *Id.* (explaining that VECO filed a federal extension to September 15, which had the effect of extending the Alaska filing deadline until October 15, 2008). Under AS 43.20.030, VECO had to file its Alaska return "within 30 days after the federal return [was] required to be filed[.]"

¹³ *Id.* at 2.

¹⁴ *Id.* at 1 (describing penalty assessment that occurred October 8, 2009).

¹⁵ *Id.* at 2.

failure-to-timely-pay penalty from five percent to the maximum 25 percent.¹⁶ This left the assessment remaining at \$502,561.¹⁷ The department reasoned that the complexity of determining VECO's tax did not constitute reasonable cause for the late payment.

VECO (though CH2M Hill) appealed the department's determination, asserting that reasonable cause exists for abatement of the failure-to-timely-pay penalty.¹⁸ The parties agreed to submit the matter on cross motions for summary adjudication.

III. Discussion

In administrative adjudications, the right to be heard does not require development of facts through an evidentiary hearing when no factual dispute exists, and the disputed issue can be decided as a matter of law.¹⁹ Instead, the matter can be resolved through summary adjudication. Summary adjudication in an administrative proceeding uses the same standard as summary judgment in court: if the material facts are undisputed, they are applied to the relevant law and the resulting legal conclusions determine the outcome. Only if the parties genuinely dispute a material fact (not legal conclusion) is it necessary to hold an evidentiary hearing.²⁰

VECO and the department have stipulated to facts they consider material to resolution of the legal issue in this appeal and the record supplies the remaining material facts through the Informal Conference Decision. Summary adjudication, therefore, is appropriate here.

A. *Standard of Review for Legal Issue*

The standards for decision set out in AS 43.05.435 apply to this appeal.²¹ Under those standards, the administrative law judge exercises independent judgment to resolve questions of law and affords deference to the department's determination only "as to a matter for which

¹⁶ Consistent with 15 AAC 05.210(c), the original failure-to-timely-pay penalty has been assessed at just five percent because the subsequently reversed failure-to-timely-file penalty had accounted for 20 percent of the 25 percent maximum.

¹⁷ *Id.* at 3-4. Partway through the briefing in this appeal, the parties inexplicably began using a different penalty assessment amount—\$554,337. That figure first appears in the Department's summary adjudication motion and then is repeated in VECO's response. If the parties are in agreement that the 25 percent penalty amount was, or should have been, assessed at \$554,337, not at the \$502,561 figure recited in the Informal Conference Decision, they may so stipulate and may jointly request that this decision be modified to reflect the agreed upon amount.

¹⁸ March 24, 2010 Notice of Appeal at 2.

¹⁹ See *Smith v. Dep't of Revenue*, 790 P.2d 1352, 1353 (Alaska 1990).

²⁰ A fact is not "material" unless it would make a difference to the outcome. *Whaley v. State*, 438 P.2d 718, 720 (Alaska 1968).

²¹ This appeal is within the original jurisdiction of the Office of Administrative Hearings under AS 43.05.405.

discretion is legally vested in the Department of Revenue[.]”²² No deference is due to the department’s determination that reasonable cause for a delayed payment does not exist.²³

B. Failure-to-Timely-Pay Penalty

The civil penalty provision of AS 43.05.220 imposes an escalating percentage-of-tax penalty on failure to pay a tax on time. The penalties imposed can be abated “if the taxpayer shows reasonable cause for delay in ... paying the tax.”²⁴ Under the department’s regulations, many different circumstances might constitute “reasonable cause” for a late payment.²⁵ If the taxpayer “took in good faith all steps and precautions reasonably necessary to ensure the timeliness of the ... payment” but the payment was still late, reasonable cause may be found for the delay.²⁶ If “acts or omissions by a third party which were beyond the control of the [taxpayer] made delay unavoidable” reasonable cause may be found for the late payment.²⁷

VECO’s “reasonable cause” argument essentially is that it could not make the payment on time because it did not know the exact amount of tax due until it prepared the return. VECO also argued that acts of third parties, such as the accounting firm’s withdrawal of the audited financial statements, contributed to the need to postpone preparing the return.

VECO did not succeed in extending the tax payment date by obtaining an extension of the return filing deadline.²⁸ That VECO felt unable to prepare the return by the original due date and obtained a six-month extension does not of itself establish reasonable cause for VECO’s failure to timely pay the tax. The focus is not on the cause for postponing filing the return. That ceased to be an issue when the department reversed the failure-to-timely-file penalty, after learning at the informal conference level that VECO had obtained an extension of the federal filing deadline, which had the effect of automatically extending the state filing deadline.

Instead, the focus is on the cause for VECO’s failure to make the payment when due. The issue is whether lack of knowledge of the tax amount due on the date due constitutes “reasonable cause” to delay payment for several months. Prior precedents answer this question.

²² AS 43.05.435(2)&(3).

²³ *Department of Revenue v. Dyncorp*, 14 P.3d 981, 984-985 (Alaska 2000) (explaining that no special deference was owed to the department’s decision at the administrative appeal stage because the reasonable cause determination rested on the application of established law to undisputed facts).

²⁴ 15 AAC 05.200(a).

²⁵ See 15 AAC 05.200(c) (identifying three groups of circumstances that may constitute reasonable cause and making clear that the groups are not all inclusive).

²⁶ 15 AAC 05.200(c)(3).

²⁷ 15 AAC 05.200(c)(2).

²⁸ 15 AAC 05.210(d) (explaining that “[a]n approved extension to file is not an extension to pay”).

Many “reasonable cause” precedents exist. Some are Alaska-specific precedents, including those found in the decisions of the Office of Administrative Hearings and its predecessor.²⁹ The body of available precedents also includes administrative and judicial interpretations of the analogous federal “reasonable cause” exception to imposition of penalties.³⁰ The department has committed to apply federal interpretations when determining whether “reasonable cause,” as used in AS 43.05.220, exists.³¹ When the administrative law judge considers whether a penalty should be abated, the federal “reasonable cause” interpretations apply as well.³²

Federal precedents interpreting the Internal Revenue Code’s “reasonable cause” exception, therefore, supplement existing state precedents. The federal “reasonable cause” exception states, in pertinent part:

A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship ... if he paid on the due date.^[33]

VECO’s position is that it was unable to pay the tax when due because it had not yet determined the amount due. Implicit in that position is the assertion that ordinary business care and prudence entails letting a tax payment deadline pass simply because the amount due is not yet known. State and federal “reasonable cause” precedents do not support this assertion.

In one Alaska corporate income tax case, the corporation obtained an extension of the return filing deadline but did not pay the tax when due, and then sought abatement of the failure-

²⁹ The Office of Administrative Hearings succeeded the Office of Tax Appeal effective July 1, 2005. Prior to that date, the Office of Tax Appeals had original jurisdiction to hear tax appeals such as this. The decisions of the Office of Tax Appeals and the Office of Administrative Hearings on questions of law in tax appeals such as this have “the force of legal precedent” unless reversed or overruled. AS 43.05.475(a).

³⁰ See 15 AAC 05.200(b). This section provides, in part, as follows: “In determining whether the delinquency was due to reasonable cause and not to willful neglect, the department will apply the administrative and judicial interpretations of Internal Revenue Code § 6651 and the Treasury Regulation § 301.6651-1(c).” The cited federal tax statute provides for assessment of penalties for late filings and late payments but relieves the taxpayer of liability for such penalties when the taxpayer’s tardiness is “due to reasonable cause and not due to willful neglect” 26 U.S.C. § 6651(a)(1)-(3). The cited Treasury Regulation sets out the procedure a federal taxpayer must follow to make the showing of “reasonable cause” necessary to get relief from the penalties. See 26 C.F.R. § 301.6651-1(c).

³¹ 15 AAC 05.200(b).

³² See *Dyncorp*, 14 P.3d at 984-985 (explaining that “the body of federal law interpreting the Internal Revenue Code’s reasonable-cause exception” has been incorporated in the department’s regulation and concluding that the outcome of that particular “reasonable cause” case rested on “the application of established federal law to undisputed facts”).

³³ 26 C.F.R. § 301.6651-1(c)(1) (emphasis added).

to-timely-pay penalty, arguing that unusual circumstances made it impossible to calculate the correct payment amount until the company filed its return.³⁴ The corporation needed the extension because its long-time bookkeeper had left work suddenly due to a serious illness, and died ten days later, leaving the books in disarray. The bookkeeper had fallen months behind, apparently in part because the complexity of the corporation's activities had outgrown her bookkeeping abilities during a period of years when management was not paying as much attention to financial matters as it admittedly should have been.³⁵ It took months, and the help of an outside accounting firm, to get the corporation's financial records sorted out. Reasonable cause for late payment was not found.³⁶

VECO's situation is similar. Like the corporation, VECO suffered the loss (or threatened loss) of key personnel and critical accounting support at a time when the tax return and payment for the short period were coming due. VECO, too, sought an extension of the return filing deadline but did not pay the tax when due. VECO, too, decided to delay payment of the tax until it had calculated the exact amount due while preparing the postponed return.

The only potentially material difference between the corporation's situation and that of VECO concerns the steps that could have been taken to avoid late payment. The corporation was found to have "failed to exercise ordinary business care and prudence to prevent the late payment" because it did not provide more bookkeeping oversight or otherwise dedicate more resources to ensure timely payment.³⁷ Management was not paying close attention to financial matters in the lead up to the bookkeeper's death. The "books were in such a bad state that [the corporation] did not believe it could make a payment of its estimated tax liability" when requesting the extension to file the return.³⁸ The corporation, however, failed to show that it could not have made "a timely payment based on a rough estimate of its tax liability ..." using prior tax years' information.³⁹ VECO's situation is not materially different.

VECO's management was distracted by the corruption investigation from attending to financial matters. Withdrawal of the audited financial statements and other factors complicating the sale transaction no doubt left VECO (both the seller and the purchaser, CH2M Hill) in less

³⁴ *In re Altrol, Inc.*, OAH No. 10-0049-TAX at 3 (Alaska Office of Admin. Hearings 2010).

³⁵ *Id.* at 2 (discussing admissions of company president in context with company's history of late tax payments and failure to address the bookkeeper's inability to keep up).

³⁶ *Id.* at 7-8.

³⁷ *Id.* at 6-7.

³⁸ *Id.* at 7.

³⁹ *Id.*

than ideal circumstances to focus on calculating tax liability. Like the corporation, however, VECO has not shown that it was unable to make a timely payment based on an estimate.

Instead, VECO attempted to distinguish its situation from that of the corporation by asserting the following:

[T]he tax implications related to the assets that were spun out immediately prior to the acquisition and the fact that VECO's business had been severely impacted by the Department of Justice investigation into its management, deemed using prior year information to be an unreasonable approach. There was very little correlation between the prior year performance and taxable income of VECO for the September 7, 2007 year end.^[40]

This bare advocacy in VECO's briefing is not supported by the record. The parties' stipulation and the Informal Conference Decision do not address tax implications of spun out assets or provide any information on how VECO's taxable income for the short period in question compared to that of prior years. VECO's briefing spoke about some such matters but without record support.⁴¹

Like the corporation, VECO has not established reasonable cause for penalty abatement. VECO has not shown that it was unable to make a payment when due but only that it had not by the due date figured out the exact amount to pay. VECO made no showing that funds were not available to pay the tax when due. The parties' stipulation establishes that \$70 million was set aside (held back by CH2M Hill) in the sale transaction to cover, among other things, unknown tax liabilities. The stipulation is silent on how much was paid to the sellers in total, but VECO has not shown that the \$70 million and funds from the portion of the purchase price not held back were unavailable to satisfy what would have been an unpaid tax liability of between \$2.0 and \$2.3 million.⁴²

The sale took place more than six months before the tax payment was due. VECO could have made an estimated payment by the due date but chose not to make any payment at all until it knew the exact amount it owed according to the completed return. When a taxpayer makes that

⁴⁰ October 20, 2010 CH2M Hill Response to Department of Revenue's Motion for Summary Adjudication at 2 (attempting to distinguish VECO's situation from that of the *In re Altrol, Inc.* taxpayer).

⁴¹ *Id.*; September 23, 2010 VECO Corporation's Motion for Summary Adjudication at 5-6 (making numerous assertions of fact about corporate restructuring and CH2M Hill's efforts toward being in position to file the tax returns not backed up by the parties' stipulated facts or other record evidence).

⁴² The parties did not include in their stipulation or otherwise include in the record the amount of tax unpaid on the due date. A 25 percent penalty amount of either \$502,561 or \$554,337 suggests that the unpaid tax was either \$2,010,244 or \$2,217,348, hence the \$2.0-2.3 range.

choice, abatement of the failure-to-timely-pay penalty is not appropriate. The corporate tax case discussed above illustrates this.

No abatement similarly was the result applying the same AS 43.05.220 penalty provision in a fisheries tax case. The taxpayer chose not to make a final tax payment until after the deadline because it could not compute the exact tax due until it received a price report two months later.⁴³ Timing of the price report was beyond the taxpayer's control, just as withdrawal of the audited financial statements by VECO's accounting firm was beyond VECO's control. Those factors did not preclude the taxpayer or VECO from making an estimated payment by their respective due dates. The taxpayer failed to demonstrate that it had "exercised ordinary business care and prudence or took in good faith all steps and precautions to comply with the payment requirement, or was prevented from complying by the acts or omissions of a third party beyond its control."⁴⁴

Like VECO, the taxpayer asserted that its inability to calculate the exact tax due before the deadline was reasonable cause for the late payment. The taxpayer, however, did not show that it had tried to figure out what amount to pay using its records from prior years but was thwarted in this effort by the absence of the price report.

Similarly, VECO has not shown that it tried to figure out what payment might be necessary, and make such a payment to reduce the risk or extent of a penalty assessment. Instead, VECO argued that

because it would have been impossible to estimate with reasonable accuracy the amount of tax that would be due before all [the return] was completed, no reasonable business person would make an estimated payment, any excess of which might be credited to the sellers' account for prior years' tax.^[45]

It may well be true that a reasonable business person purchasing 100 percent of a company's stock would not want to hand the seller a windfall by overpaying past tax liability with the purchaser's funds. Taking precautions to avoid such a windfall can be accomplished by contracting that allocates the risks and responsibilities between the seller and purchaser.

The contracting parties appear to have done that insofar as the VECO sellers agreed to CH2M Hill retaining \$70 million for up to three years, and the retained funds could be used to

⁴³ *In re Western Queen Fisheries, LLC*, OAH No. 05-0775-TAX at 12-14 (Alaska Office of Admin. Hearings 2006).

⁴⁴ *Id.* at 14.

⁴⁵ September 23, 2010 VECO Corporation's Motion for Summary Adjudication at 7.

satisfy tax liabilities. Whether the Sales Purchase Agreement allocated the risks of late-payment penalties and overpayment refunds in a manner more favorable to the VECO sellers or the CH2M Hill purchaser has no bearing on VECO-the-taxpayer's requirement to timely pay its taxes or face assessment of a penalty. The state, as a taxing authority, is not responsible for protecting the purchaser of a taxpaying corporation, or the corporation itself, against liability for a penalty resulting from the taxpayer's decision to wait to pay the tax until the postponed return is ready.

As to federal case precedents, VECO's reliance on *Hudson Oil* is misplaced. The bankruptcy court found that it was "physically impossible" for the trustee to prepare the tax return in question in the three week period available and thus concluded that reasonable cause existed for the trustee's *late filing of the tax return*.⁴⁶ It did not address at all whether reasonable cause existed for late payment.⁴⁷ *Hudson Oil* simply was not a late payment case and thus does not provide any guidance as to whether the same circumstances that justified the trustee's late filing would have been grounds for abating a late payment penalty.

In some cases, failure to timely pay is due to exactly the same cause as failure to timely file the return. For instance, when a taxpayer sends the return and payment in advance of the deadline but the courier service misdelivers the package and cannot rectify the situation before the deadline, reasonable cause may be found.⁴⁸ This is not such a case.

The cause for late payment was VECO's decision to defer payment until the exact amount due could be determined from the postponed return, even though the law quite clearly informs taxpayers that an extension of the return filing deadline does not extend the tax payment due date. Having made the choice to postpone payment until the return was ready, VECO incurred the failure-to-timely-pay penalty. Whether that penalty falls to the VECO sellers or to CH2M Hill as purchaser under the contract between the two has no bearing on whether the penalty imposed by the taxing authority must be paid.

IV. Conclusion

VECO has not established reasonable cause for late payment of its tax liability for the short period ending September 7, 2007. VECO has not disputed that the length of the delay—

⁴⁶ *In re Hudson Oil Company, Inc.*, 91 B.R. 932, 950 (D. Kan. 1988).

⁴⁷ *Id.* at 949 (indicating that the tax return came due when the IRS canceled an extension of the filing deadline after the debtors advised the IRS that they could not pay the tax).

nearly five months—in making the payment warrants the maximum 25 percent penalty under AS 43.05.220(a). The Department of Revenue’s assessment of a 25 percent failure-to-timely-pay penalty, therefore, is affirmed.

This decision is not intended to preclude the parties from resolving the discrepancy of slightly more than \$50,000 between the penalty amount recited in the Informal Conference Decision and in the briefs, or to seek to be heard on the matter of the correct penalty amount.

DATED this 12th day of October, 2012.

By: Signed _____
Terry L. Thurbon
Chief Administrative Law Judge

NOTICE

This is the decision of the Administrative Law Judge under AS 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.⁴⁹

A party may request reconsideration in accordance with AS 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.⁵⁰ 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.⁵¹

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with AS 43.05.480 within 30 days after the date on which this decision becomes final.⁵²

Certificate of Service

The undersigned certifies that on October 15, 2012, this decision was distributed by **U.S. MAIL** to the following: John Bauer-Martinez, counsel for VECO Corp.; R. Scott Taylor, Assistant Attorney General. A courtesy copy was distributed by **U.S. MAIL** Holly Kovach, Department of Revenue, Tax Division.

Signed _____
Neil Roberts

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

⁴⁸ See *In re New West Fisheries, Inc.*, Case No. 5-OTA-97, Decision on Reconsideration at 6 (Alaska Office of Tax Appeals 1998) (concluding that “New West exercised ordinary business care in arranging to make timely payment of its 1995 fish taxes but failed to do so [in part] because of ... a UPS delivery error).

⁴⁹ AS 43.05.465(f)(1).

⁵⁰ AS 43.05.470.

⁵¹ AS 43.05.470(b).

⁵² AS 43.05.465 set out the timelines for the decision becoming final.