BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of	)	
	)	
SODEXO INC. & SUBSIDIARIES	)	OAH No. 18-0397-TAX
	)	

DECISION

I. Introduction

In tax years 2014-16, Sodexo, Inc., & Subsidiaries, paid its corporate income taxes to Alaska by check. Under the law, however, it was required to pay by electronic transfer. Because Sodexo had failed to pay its taxes in the proper form, the Alaska Department of Revenue assessed a penalty against Sodexo. The penalty was called a "failure-to-deposit penalty."

Sodexo appealed the penalty. It argued that the Department could not assess the penalty because the Department had not notified taxpayers that failure to follow the law would result in a failure-to-deposit penalty.

The facts in this record prove that the failure-to-deposit penalty was obscure—so obscure that the Department itself did not assess the penalty in previous years, even though it could have done so. When the Department changes its approach, and decides to assess an obscure penalty that it has not assessed in the past, it must give notice to taxpayers that their failure to follow the law will subject them to a penalty. Because the Department did not provide this notice to Sodexo, it abused its discretion by assessing the penalty. Therefore, the penalty is abated.

II. Facts

Sodexo is a food service company.[1] It has over 6,000 food service operations in the United States and Canada.[2] Its business model includes operating cafeterias in schools, colleges, and businesses, and providing meals for hospital patients and senior living centers.[3]

Sodexo operates food service venues in Alaska. This means that it must pay corporate income tax to the State under the Alaska Net Income Tax Act, AS 43.20. Corporations generally must make estimated payments of tax to the State throughout the year.[4] This case concerns the rules that govern how a taxpayer makes its payments—whether by check or by electronic transfer. For the tax years involved in this case, 2014-16, Sodexo did not follow the rules for making payments.

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1 Sodexo Petition for Modification of Assessment, R. 188.
2 *Id.*
3 *Id.*
4 AS 43.20.030.

In setting out the relevant facts that provide a framework for analyzing the issues raised by the parties, this decision will first describe the 2014 changes to the Department's regulation governing tax payments. It will then turn to Sodexo's decision to not follow the requirements of that regulation, and the Department's assessment of the penalty. After this brief presentation of the facts, the decision will discuss whether the penalty assessed by the Department can be upheld.

A. The Department changes the regulations governing electronic payment of tax in 2014

The Department's regulation 15 AAC 05.310 sets out the rules for payments of tax to the State of Alaska. Under 15 AAC 05.310, taxpayers whose quarterly payments are less than $100,000 may pay either by check mailed to the Department or by an approved electronic payment methodology.[5] Before 2014, the only available method for making an electronic payment was by wire transfer.[6]

Taxpayers whose quarterly payments are larger than $100,000 do not have the option to pay by check. These taxpayers must make their payments electronically. Before 2014, the Department required that quarterly payments of $100,000 or more had to be by wire transfer.[7]

In 2014, however, the Department amended its regulation to broaden the options for electronic payments. Under the new regulation, in addition to wire transfers, taxpayers were allowed to make electronic payments using the Automated Clearing House network, typically referred to as "ACH," or by another method as approved by the commissioner.[8]

B. Sodexo is aware of the requirement to pay electronically but elects to ignore it

For the tax years at issue here, 2014-16, Sodexo made eight tax payments of $100,000 or more. Sodexo was required to make these payment electronically, either by a wire transfer or by an ACH transaction.[9] The electronic payment had to be made on the day that the payment was due.[10] Sodexo, however, did not make these payments electronically. Instead, it mailed checks to the Department.[11]

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5 15 AAC 05.310(a).

6 15 AAC 05.310(a) & (c). The provision for payment by check for amounts below $100,000 is in both the 2013 and earlier versions of the regulation, and the 2014-2018 version.

7 15 AAC 05.310(a) (2013).

8 15 AAC 05.310(a) (2014) (amendment effective on February 21, 2014). For taxpayers who had the option to pay by check, and chose to use that option, the payment would be considered timely if it was postmarked on or before the payment was due. 15 AAC 05.310(c) (for all versions). For an electronic payment, however, the electronic transfer of funds has to be initiated (wire transfer) or completed (ACH) by the due date for the payment to be timely. 15 AAC 05.310(d) (2013); 15 AAC 05.310(e)(4) (2014) (wire transfer); 15 AAC 05.310(i) (2014) (ACH).

9 15 AAC 05.310(b) (2014).

10 *Id.*

11 Record at Sodexo 183.

In its opening brief in this appeal, Sodexo offers the following explanation for its failure to make its payment electronically. First, Sodexo admits that when preparing its 2014 Alaska tax return, its Alaska tax analyst (the employee with initial responsibility for preparing the Alaska tax payment) "recognized the new electronic payment issue."[12] Sodexo then explains that the tax analyst met with the company treasurer "to discuss changing Sodexo's income tax payment control procedures to pay Alaska by ACH debit."[13] According to the brief, Sodexo's treasury department was concerned about the risk to Sodexo created by the "ACH debit" process.[14] The brief explains that other states allow electronic payment by a different process, called "ACH credit."[15] Sodexo explains the difference between the two processes as follows: In ACH debit transactions, "third parties are removing large amounts of money from Sodexo's bank account, in excess of $100,000."[16] In contrast, in an ACH credit transaction, according to Sodexo, "Sodexo [is] releasing the payments to third parties."[17]

According to Sodexo's brief, its "treasury department declined to accept this increased risk."[18] The brief asserts that the treasury department made this determination because it did not have "clear civil penalty information to evaluate the potential costs," and because of the "uncertainty created by the other similar late penalties."[19]

In its Petition for Modification, Sodexo recounts the facts somewhat differently. There, Sodexo omits mention of the consultation with its treasury department, and places all responsibility for the decision to disregard 15 AAC 05.310 on the tax analyst: "the tax analyst came to an incorrect conclusion that Sodexo could not comply with Alaska's additional technological request that the EFT be remitted by ACH debit."[20]

C. The Department does not include notice of the failure-to-deposit penalty in its instructions or clarify that the penalty applies to income taxes.

The Department provides taxpayers with instructions on how to file, and how to pay, their income taxes. The instructions inform taxpayers that they would be subject to a "failure-to-pay"

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12 Sodexo Opening Brief at 8. Sodexo does not cite to the record or provide an affidavit from the tax analyst to support this claim.
13 *Id.*
14 *Id.*
15 *Id.*
16 *Id.*
17 *Id.*
18 Sodexo Opening Brief at 8.
19 *Id.*
20 Record at Sodexo 189.

penalty for a late payment of tax.[21] The instructions also advise taxpayers that if they do not *file* electronically, they would subject the taxpayer to a "failure to file" penalty.[22] Nothing in the instructions, however, advise taxpayers that paying by check, when required by 15 AAC 05.310 to pay electronically, would result in a penalty based solely on the use of the wrong payment methodology.

Although the Alaska Net Income Tax Act does not include a specific penalty that applies when a taxpayer uses the wrong method for paying its taxes, the Internal Revenue Code does. Section 6656 of the Internal Revenue Code (IRC § 6656) establishes a "failure to deposit" penalty.[23] IRC § 6656 is included in Alaska state law because the Alaska Net Income Tax Act incorporates many sections of the Internal Revenue Code, including IRC § 6656.[24]

The failure-to-deposit penalty may be assessed anytime a payment is made by an unauthorized method.[25] The size of the failure-to-deposit penalty depends on how late the wrongly-deposited payment is.[26] If the check (or other wrongfully deposited payment) is received timely, or not more than five days late, the penalty is two percent of the tax due.[27] If the payment is received between five and fifteen days late, the penalty is five percent.[28] For payments over 15 days late, the penalty is 10 percent.[29]

As with many aspects of the Internal Revenue Code, the scope of the failure-to-deposit penalty is somewhat confusing. A reader looking at IRC § 6656 might conclude that it only applies to employment taxes—the income taxes withheld from employees' paychecks, and the amount due under the Federal Insurance Contributions Act (better known as "FICA" or "social security"). Although the subsection that imposes the penalty, IRC § 6656(a), does not limit the scope of the penalty, the possible ambiguity arises because subsection (c) creates an exception for "first-time depositors of employment taxes" and includes a definition of "employment taxes." Moreover, the Treasury Regulation that specifically implements IRC § 6656, Treasury Regulation § 31.6302-1, includes many pages of instructions that are specific to employment taxes. As will

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21 Sodexo Exhibit H, *2016 Instructions for Form 6000, 2016 Alaska Corporation Net Income Tax Return* at 8.
22 *Id.*
23 26 U.S.C. § 6656.
24 AS 43.20.021(a).
25 26 U.S.C. § 6656(a); 26 C.F.R. § 31.6302-1(h). If, however, the taxpayer had reasonable cause for its failure to deposit, and the failure was not due to willful neglect, the penalty would not be imposed. 26 U.S.C. § 6656(a).
26 26 U.S.C. § 6656(b)(1)(A).
27 *Id.*
28 *Id.*
29 *Id.*

be explained later in detail, however, the federal failure-to-deposit penalty does apply to federal income taxes. The important takeaway here is that, as the Department acknowledged to Sodexo, "at first blush," the scope of the penalty is not clear.[30]

D. The Department audits Sodexo and assesses a failure-to-deposit penalty

In 2017, the Department began an audit project to address the issue of taxpayers who were not following the requirement to pay electronically.[31] The project was designed to address all payments of over $100,000 that were made by check since March 1, 2014.[32] The March 2014 date appears to have been selected because it was the first month after the Department adopted new regulations governing electronic payment.[33] (These were the new regulations that allowed taxpayers to use either ACH transactions or wire transfers when they were required to, or chose to, make tax payments electronically.[34])

Sodexo was one of the companies audited under the project. During the tax years at issue here, 2014-16, Sodexo made a total of eight payments by check that, under 15 AAC 05.310, should have been made electronically.[35] The audit determined that Sodexo had four payments that were five or fewer days late (two percent penalty) and four that were more than five but less than 15 days late (five percent penalty).[36]

Following the audit, the tax division of the Department assessed a failure to deposit penalty against Sodexo for its failure to pay electronically during the three years.[37] The total penalty assessed was $50,150.

Sodexo requested an informal conference with the Department of Revenue to challenge the assessment of the penalty.[38] The Informal Conference Decision (ICD) upheld the legality penalty.[39] The ICD found, however, that the audit had erred in determining the size of the penalty, and reduced it to $42,350.[40] Sodexo then appealed the ICD to the Office of Administrative Hearings (OAH). After a period of discovery, the parties agreed to submit the appeal on the record. Both parties filed briefs requesting entry of a decision. Neither party

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30 Record at Sodexo 120 (email from Michael R. Williams to Chip B. Hines).
31 Sodexo Exhibit C (Record at Sodexo 252-56.
32 *Id.*
33 *Id.*
34 *Compare* 15 AAC 05.310(a) (2014) *with* 15 AAC 05.310(a) (2013).
35 Record at Sodexo 183.
36 Record at Sodexo 179-81.
37 Record at Sodexo 8.
38 *Id.* at 8, 103.
39 *Id.* at 8-12.
40 Record at Sodexo 10 (ICD).

moved for summary adjudication, and neither argued that the standards for summary adjudication should apply to this decision.[41]

III. Discussion

Sodexo makes two arguments to support its request that the penalty be abated. First, Sodexo argues that the Department never told taxpayers that it would assess a failure-to-deposit penalty for violations of 15 AAC 05.310(b). In Sodexo's view, the absence of notice means that the penalty would be an illegal deprivation of property in violation of the requirements of the due process clauses of the United States and Alaska Constitutions.[42] Second, based on its view that it had sound business reasons for not using the ACH payment methodology, Sodexo argues that it had reasonable cause for not using an electronic payment method. Under the statute, the penalty cannot be applied when the taxpayer had reasonable cause for its failure to properly deposit the payment.[43] Therefore, Sodexo concludes, even if the penalty could be applied without violating due process, the penalty should be abated under the statutory exception for reasonable cause.

In response, the Department asserts that Sodexo's constitutional argument is not properly before OAH.[44] Even if jurisdiction is proper, however, the Department then argues that Sodexo had sufficient notice, and that Sodexo did not have reasonable cause for its violation of 15 AAC 05.310(b).

This decision will first address the Department's jurisdictional argument. As explained below, that argument, while incorrect, does raise a valid point that adjudications should not be decided on constitutional grounds if there are other grounds for deciding the case. Therefore, after discussing the jurisdictional argument, this decision will turn to whether this case can be decided based on an abuse of discretion.

A. Does OAH have authority to determine whether the Department's notice of the failure-to-deposit penalty was inadequate?

In its responsive brief, the Department asserts that OAH does not have jurisdiction to consider Sodexo's constitutional argument.[45] In the Department's view, Sodexo's argument is a challenge to the constitutionality of a statute, and only a court has jurisdiction to decide that issue.

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41 Unlike summary adjudication, when an appeal is submitted for a decision on the record, the decisionmaker is not required to hold an evidentiary hearing if material facts are in dispute. Under this process, the decisionmaker will make findings of fact on the record without having to interpret facts in the light most favorable to the nonmoving party.

42 Sodexo Opening Brief at 1 (citing U.S. Const. amends. V, XIV; Alaska Const. art 1, § 7).

43 26 U.S.C. § 6656.

44 Department's Responsive Brief at 2-3.

45 Department's Responsive Brief at 2-3.

The Department is correct that an administrative adjudicative agency, like OAH, cannot declare a statute unconstitutional. With some limited exceptions, the authority to resolve a facial challenge to a statute resides exclusively in the judicial branch of government.[46] The Department does not deny, however, that the OAH can decide an "as-applied" constitutional issue that is based on the facts and circumstances of the case. Thus, when the question is whether the agency has conformed its conduct to the requirements of the constitution, rather than whether a law conforms to the constitution, OAH may hear and decide the constitutional issue.[47]

Here, the Department argues that the constitutional issue raised by Sodexo is "a facial challenge to the constitutionality of enacting such a penalty."[48] The Department, however, misconstrues Sodexo's argument. Sodexo does not deny that the Department can assess the failure-to-deposit penalty. Sodexo is arguing that the Department must first conform its conduct to the requirements of the due process clauses of the United States and Alaska Constitutions by giving taxpayers notice that failure to pay electronically will subject the taxpayer to the penalty. That issue is squarely within OAH's authority to hear and decide.

Although the Department is not correct regarding OAH's jurisdiction over this appeal, its argument does raise a valid point. In general, an adjudicating body should avoid reaching a constitutional issue if other grounds are present for making a decision.[49]

Sodexo's notice argument directly addresses the question of the Department's discretion to undertake an enforcement action. OAH, sitting as the administrative tax court, has authority to review the Department's decision to begin enforcing the failure-to-deposit penalty without first giving notice that it would apply the penalty. The Department's decision to begin enforcing the penalty does not require formal procedures—it has discretion to begin an audit when it has the resources to do so or otherwise concludes that an enforcement action is appropriate. The Alaska Supreme Court has advised that "[w]e review discretionary actions that do not require formal

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[46] *Wade v. Nolan,* 414 P.2d 689 (Alaska 1966). The exception to this rule is not applicable here and would not authorize OAH to declare a statute unconstitutional. *Id*.

[47] For a thorough discussion of the difference between a facial challenge to the constitutionality of a statute and an "as applied" challenge regarding the constitutionality of an agency's application of a statute, see *In re Holiday Alaska, Inc.,* OAH Nos. 08-0245-TOB, 08-0313-TOB, 08-0314-TOB, 08-0420-TOB, 08-0621-TOB (Dep't of Commerce, Community, and Econ. Dev 2009) at 5-9, *available at* https://aws.state.ak.us/OAH/Decision/Display?rec=6204, *aff'd Holiday Alaska, Inc. v. State, Div. of Corp, Bus., and Prof. Lic.,* 280 P.3d 537 (Alaska 2012).

[48] Department Responsive Brief at 3.

[49] *See, e.g., State, Dep't of Health & Soc. Servs. v. Valley Hosp. Ass'n, Inc.,* 116 P.3d 580, 584 (Alaska 2005) (deciding case on abuse of discretion instead of due process grounds because "[t]his is consistent with our practice of reaching constitutional issues only when the case cannot be fairly decided on statutory or other grounds.").

procedures under the arbitrary and capricious or abuse of discretion standard."[50] Therefore, the first question to be reviewed here is whether the Department abused its discretion by beginning an enforcement action without first giving notice. As will be seen, answering this question will obviate the need to address the constitutional issue or whether Sodexo had reasonable cause to violate 15 AAC 05.310.

B. Does the lack of notice of the failure-to-deposit penalty mean that the Department cannot impose the penalty on Sodexo?

Sodexo has proved that the Department did not provide specific notice that the Department would assess a failure-to-deposit penalty under IRC § 6656 (as incorporated by AS 43.20.021) when a taxpayer failed to make a payment by the required methodology. Sodexo notes that not only did the Department not include a penalty statement in 15 AAC 05.310, the instructions provided to taxpayers on how to make payments also did not say that failure to pay electronically (when required to do so) would result in assessment of a failure-to-deposit penalty.

Sodexo contrasts the omission of any notice regarding the failure-to-deposit penalty with the explicit statement in the instructions that taxpayer would be subject to a failure-to-pay penalty for a late payment of tax (the failure-to-pay penalty is different from the failure-to-deposit penalty).[51] In addition, Sodexo notes that the instructions also alert the taxpayer that a failure to file electronically would subject the taxpayer to a "failure to file" penalty (the failure-to-file penalty is also different from the failure-to-deposit penalty).[52] Sodexo concludes that a taxpayer reading the instructions would not think that the taxpayer would be subject to a failure-to-deposit penalty.[53]

Sodexo then raises a related argument regarding the need for notice. Sodexo correctly notes that the failure-to-deposit penalty is obscure.[54] First, the penalty is only picked up by Alaska law through the incorporation of the Internal Revenue Code. This incorporation is not always easy to navigate, because federal law does not always easily transfer to state law.[55] Moreover, the particular provision here is doubly difficult to construe because it appears that it

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50 *Olson v. State, Dep't of Nat. Res.,* 799 P.2d 289, 293 (Alaska 1990). This standard of review requires deference to the agency. "The deferential abuse of discretion standard of review is proper in appeals of discretionary acts not requiring formal procedures because it allows agencies latitude to act that is commensurate with their discretion." *Id.*

51 *Id.* at 2, 7 (citing Sodexo Exhibit H, *2016 Instructions for Form 6000, 2016 Alaska Corporation Net Income Tax Return* at 8.).

52 *Id.*

53 *Id.*

54 *Id.* at 9-10.

55 *Id.* at 10.

might apply only to employment taxes.[56] Although Sodexo agrees that IRC § 6656 can be applied to income taxes, it notes that this conclusion can be affirmed only through a painstaking review of treasury regulations.[57] In Sodexo's view, this obscurity makes the need for notice more pressing.

Turning to the legal consequences of the Department's failure to provide specific notice, Sodexo argues that it must have notice before it can be deprived of its property.[58] Sodexo notes how easy it would have been for the Department to publish the failure-to-deposit penalty in its instructions.[59] Under the flexible analysis for due process that balances the ability of an agency to provide procedural protections against the risk of erroneous harm to a private interest, Sodexo concludes that applying the penalty here would be a violation of due process of law.[60]

In response, the Department argues that Sodexo's notice argument does not apply to penalties.[61] In the Department's view, the only notice that the government must provide is notice of the law that governs conduct. The Department concludes that as long as the taxpayer knows what it must do to obey the law, if the taxpayer chooses to disobey the law, the lack of notice of the penalty is not relevant unless the penalty is grossly excessive.[62]

1. If a taxpayer has notice of the law, and then disobeys the law, can the taxpayer complain that it did not have notice of the penalty?

The underlying thread to the Department's argument that it does not have to publish specific notice that violating the law would result in a penalty is simply a notion that having a law on the books is notice enough. "As a general rule, people are presumed to know the law."[63] Although many cases disallow enforcement of a law when the law is vague and does not provide sufficient notice of what a person must do in order to conform his or her conduct to the law, these cases generally focus on the difficulty of *obedience.*[64] For example, the Alaska Supreme Court,

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56 *Id.* (citing subsection (c) of section 6656).

57 *Id.* (citing Treas. Reg. Section 1.6302-1(b)).

58 *Id.* at 3 (citing *Mullan v. Central Hanover Bank & Trust Co.,* 330 U.S. 306 (1950).

59 *Id.* at 3-5 (citing *Matthews v Eldridge,* 424 U.S. 319 (1976) and *Wilkerson v. State, Dep't of Health and Soc. Servs.,* 993 P.2d 1018 (Alaska 1999)).

60 *Id.*

61 *Id.* at 4.

62 *Id.* (citing *BMW of North America v. Gore,* 517 U.S. 559, 568 (1996)).

63 *Hutton v. Realty Execs., Inc.,* 14 P.3d 977, 980 (Alaska 2000).

64 For example, the cases cited by Sodexo in support of its argument that lack of notice of a law raises due process concerns go to the issue of a respondent's ability to conform his or her conduct to the law. They do not address the issue of whether lack of notice that a violation of a law will give rise to a penalty raises due process concerns. *See* Sodexo Opening Brief at 6 (citing *Christopher v. Smithkline Beecham Corp,* 567 U.S. 142 (2012); *Diamond Roofing Co., Inc. v. Occupational Safety and Health Rev. Comm'n,* 528 F.2d 645 (5th Cir. 1976); *Rollins Environmental Servs. (NJ), Inc. v. U.S. Envir. Prot. Agency,* 937 F.2d 649 (D.C. Cir. 1991)).

in finding a law too ambiguous to support imposition of penalty, explained that "[l]aws should give the ordinary citizen fair notice of what is and what is not prohibited."[65] Requiring an agency to give clear notice of what a taxpayer must do to follow the law is different from requiring notice of the penalty.

Here, Sodexo admits it had notice of what course of conduct it had to follow in order to conform to the law.[66] It knew that it was required to pay by an electronic transfer of funds, using either the wire transfer or ACH debit methodology.[67]

Further, it knew, or should have known, that AS 43.20.021, on its face, purports to incorporate a statute, IRC § 6656, that imposes a penalty when a taxpayer does not follow the payment methodology required by law. Although it was not clear from the text of IRC § 6656 whether the penalty applied to income tax, nothing in the text of the statute states that it does not.[68] Given that a taxpayer is presumed to know about the incorporation of IRC § 6656, we would generally expect a taxpayer to either follow the rules on the methodology for payment, or at least inquire about whether the penalty might apply.[69]

Moreover, the Department is correct that uncertainty about the size of the penalty does not necessarily give rise to a need for more precise notice to comply with due process.[70] Although in a criminal case the Alaska Supreme Court has found that misleading a defendant about the penalty can give rise to a violation of due process of law, that case has little application here—this is not a criminal case, and no evidence suggests that Sodexo requested or received misleading oral advice about the failure-to-deposit penalty.[71]

In sum, looking only at the text of the statute, the Department's argument that the incorporation of IRC § 6656 under AS 43.20.021 is "notice enough" might be persuasive. Indeed,

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65 *Alaska Pub. Offices Comm'n v. Stevens,* 205 P.3d 321, 325 (Alaska 2009) (quoting *VECO Int'l, Inc. v. Alaska Pub. Offices Comm'n,* 753 P.2d 703, 714 (Alaska 1988) (footnotes omitted)).

66 Sodexo Opening Brief at 8.

67 *Id.*

68 Nothing in this decision implies that the slight ambiguity in IRC § 6656 would excuse the taxpayer's failure to follow the law.

69 *Cf., e.g., In re New West Fisheries, Inc.,* OTA No. 5-OTA- 97 (Office of Tax Appeals 1998) *available at* https://aws.state.ak.us/OAH/Decision/Display?rec=4820 (holding that taxpayer inquiry into applicability of penalty for failure to follow 15 AAC 05.310 in fish tax case, and reliance on oral advice, was grounds for abating penalty).

70 Department Responsive Brief at 4-5 (citing *United States v. Batchelder,* 442 U.S. 114 (1979)).

71 *Olson v. State*, 260 P.3d 1056 (Alaska 2011) (holding that police officer's incorrect advice that defendant's action would be misdemeanor not felony makes prosecution for felony violative of due process notwithstanding defendant's obligation to know the law). *But see also Stoner v. State,* 421 P.3d 108 (Alaska App. 2018) (holding that defendant's obligation to know law justified imposition of felony penalties for crime of absconding from halfway house notwithstanding agency's publication of misleading statement that absconding from halfway house was misdemeanor).

if this case rested on balance between the Department's failure to publish specific notice of a penalty, and the taxpayer's decision to neither follow a law that clearly required electronic payment, nor inquire about the statute that clearly set out a penalty (acknowledging that whether the penalty applied was unclear), that balance might well favor imposition of the penalty.[72] As explained below, however, here, other factors come into play that affect this balance.

2. Was the assessment of the failure-to-deposit penalty in 2017 a change in course for the Department?

In this case, three additional factors come into play. First, as Sodexo notes, the Department did publish instructions, and those instructions do contain notice of some penalties, but not the failure-to-deposit penalty. Standing alone, the lack of a reference to the failure-to-deposit penalty in the instructions does provide some support for an inference that there was no penalty for violations of 15 AAC 05.310(b).

Second, the problem for the Department here is compounded by the fact that it is relying on an *incorporated* statute rather than a specifically adopted statute. The statute incorporating the Internal Revenue Code, AS 43.20.021, specifically names those sections of the Internal Revenue Code that are incorporated. It then creates an exception to incorporation if the federal law is "excepted to or modified by other provisions of this chapter."[73] The exception to the code might be implicit rather than explicit.[74] An implicit exception might not always be self-evident.[75] Thus, without notice in the instructions, a taxpayer might well be confused or uncertain about the applicability of an incorporated penalty.

Third, the facts in this record show that before 2017, the Department had not applied the failure-to-deposit penalty to violations of 15 AAC 05.310(b).[76] For a taxpayer, this means that

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[72] Sodexo argues that the Department's failure to warn taxpayers about the penalty was bad policy, citing the Internal Revenue Manual on penalties, and pointing out that the purpose of a penalty is to encourage voluntary compliance. *See, e.g.,* Sodexo Response Brief at 3 and Exhibit A to Sodexo Response Brief. Although Sodexo makes a good point, the Department's decisions on the *policy* of a particular approach are not reviewable by this office. The Department's *actions*, however, are reviewable under the deferential abuse of discretion standard.

[73] AS 43.20.021(a).

[74] *See, e.g., State, Dep't of Rev. v. OSG Bulk Ships, Inc.,* 961 P.2d 399, 403, (Alaska 1998).

[75] *Id.*

[76] The conclusion that the Department had not enforced the penalty before 2017 is based on the assertion by Sodexo in its opening brief that the 2017 audit project was the first time that the Department enforced IRC § 6656. The Department does not deny this assertion. *See* Department Responsive Brief. Many other aspects of this record also support this conclusion. As noted above, the lack of notice of the penalty in the instructions, and the need to undertake a special project to begin enforcing the penalty in 2017, all show that the Department had not been enforcing the penalty earlier. Moreover, the ICD explains that the Department's decision to enforce the failure-to-deposit penalty in 2017 was predicated on the adoption of Treasury Regulation § 1.6302-1(b) in 2011. Record at Sodexo 9. In the Department's view, because the federal law changed in 2011, now making the penalty applicable to federal income tax payments (instead of being limited to employment taxes), the Department was justified in changing its practice, and applying the penalty to Alaska income tax payments. This statement makes clear that the

when the Department has a longstanding history of not applying an incorporated statute, the taxpayer could infer that the Department has concluded that the statute is "excepted to."

Here, the inference that the Department did not consider IRC § 6656 applicable to violations of 15 AAC 05.310(b) is even stronger because of the doubt about whether IRC § 6656 applied to income tax. The Department acknowledged this doubt when it explained to Sodexo that "[a]t first blush, IRC Sec 6656 and supporting regs at 31.6302-1 appear to only apply to FICA and withholding taxes."[77] Thus, the Department agrees that the applicability of IRC § 6656 was obscure, and that only through a careful analysis of federal regulations is its applicability made clear.

Although the Department has discretion to decide when to undertake an enforcement action, as will be explained below, a failure to enforce an obscure penalty creates an obligation to provide notice before beginning enforcement. Before discussing that obligation, however, this decision must review whether a 2011 change in federal regulations clears up any obscurity and in itself provides sufficient notice of the applicability of the penalty.

3. Does the 2011 change in federal regulation provide notice to taxpayers that the penalty would now apply to violations of 15 AAC 05.310(b)?

A significant issue in this case is the obscurity of whether IRC § 6656 was incorporated into Alaska law under AS 43.05.021(a) or was "excepted to." As noted above, the Department had a history of not enforcing IRC § 6656, which appears to signal to taxpayers that it considered IRC § 6656 excepted to. In the ICD, however, the Department justified its decision to change course and begin enforcing IRC § 6656 based on a 2011 change in Treasury Regulations.[78] According to the Department, "[e]ffective January 1, 2011, Treas. Reg. § 1.6302(b) required deposits of corporation income tax and estimated income taxes by electronic funds transfer."[79] If this change in the Treasury Regulations was a clear change in meaning, it could be considered

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Department had not previously applied the failure-to-deposit penalty to violations of 15 AAC 05.310(b). Further support for the conclusion that the Department had never applied the failure-to-deposit penalty for violations of 15 AAC 05.310(b) before 2017 is found in the Department's audit plan for auditing deposits and assessing the failure-to-deposit penalty only for payments after March 1, 2014. Sodexo Exhibit C (record at Sodexo 253). If the Department had a history of applying the penalty, the audit could have related back to payments before March 1, 2014. Although electronic payments before March 1, 2014 were limited to wire transfers, the failure-to-deposit penalty was every bit as applicable before 2014 as it was after 2014. Nothing in the change that allowed payment by ACH transfers had any effect on the applicability of the failure-to-deposit penalty.

77 Record at Sodexo 120 (email from Michael R. Williams to Chip B. Hines).

78 Record at Sodexo 9 (ICD); Record at Sodexo 120 (email from Michael R. Williams to Chip B. Hines).

79 Record at Sodexo 9 (ICD).

notice to a taxpayer that the failure-to-deposit penalty was excepted to before 2011, but incorporated after 2011.[80]

The particular change that the Department relies upon, however, is a change in 2011 to paragraph (b) in Treasury Regulation § 1.6302-1.[81] This regulation is entitled "Deposit rules for corporation income and estimated income taxes."[82]

I have tried to follow the Department's logic regarding why this change was important for purposes of interpreting the incorporation of IRC § 6656, but have not been successful. My research has found that the change to paragraph (b) in 2011 was "redesignating paragraph (b)(2) as paragraph (b), and revising the heading for paragraph (b)."[83] The new heading for paragraph (b) was "(b) *Deposits by electronic funds transfer.*"[84]

The important language of paragraph (b), however, was already in the income-tax regulation, Treasury Regulation § 1.6302-1(b). This language was added in 1997, and states as follows:

> For the requirement to deposit corporation income and estimated income taxes and certain taxes of tax-exempt organizations by electronic funds transfer, see § 31.6302-1(h) of this chapter.[85]

The other Treasury Regulation relied upon by the Department is the cross reference from the deposit instructions for employment taxes, found at Treasury Regulation § 31.6302-1(h)(3), to income tax regulations.[86] This regulation, which lists corporate income tax as one of the "taxes required to be deposited by electronic funds transfer," was also adopted in 1997.[87] Finally, the cross-reference in the income tax regulations to the failure-to-deposit penalty, now found at Treasury Regulation § 1.6302-1(c), was added to the regulation in 2001.[88]

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80 Although the Department waited until 2017 to begin an enforcement action, the delay from 2011 to 2017 might not be significant for purposes of review under the abuse of discretion standard. If the change in federal regulation in 2011 gave taxpayers notice that a previously inapplicable statute was now applicable, a delay of six years to gather the resources to begin an enforcement action might be within the Department's discretion. The important point here is that the change in federal regulation in 2011 did not provide notice that the Department's longstanding practice of not enforcing the failure-to-deposit penalty would be subject to change.

81 Record at Sodexo 9 (ICD *citing* Treas. Reg. § 1.6302-1(b)).

82 Treas. Reg. § 1.6302-1.

83 75 Fed. Reg. at 75899 (2010). The 2011 amendment also deleted paragraph (b)(1) of § 1.6302-1.

84 *Id.*

85 62 Fed. Reg. at 37492 (1977). In 1977 the quoted language was located in subparagraph (b)(2).

86 Record at Sodexo 9 (ICD).

87 62 Fed. Reg. at 37493 (1977).

88 66 Fed. Reg. at 32542 (2001). This paragraph states, "(c) *Failure to deposit.* For provisions relating to the penalty for failure to make a deposit within the prescribed time, see section 6656." The 2001 and 1997 amendments to the income tax regulations resolve any doubt that IRC § 6656 was limited to employment tax. Thus, even though IRC § 6656 and its implementing regulations could have been read as limited to employment taxes, by 2001, a careful reading of the Treasury Regulations would have shown that IRC § 6656 applied to income tax.

Based on this history, I see no reason that the Department could not have been enforcing the failure-to-deposit penalty beginning in 2001 at the latest. From that date on, it would have been clear to a person familiar with these Treasury Regulations that the penalty applied to income taxes. For the vigilant and alert reader of the regulations, it would follow that the penalty was incorporated into Alaska law and not excepted to.[89]

Yet, in spite of the history of the Treasury Regulations, the Department did not apply the failure-to-deposit penalty to violations of 15 AAC 05.310(b). A reasonable taxpayer could conclude that the Department had made a determination that the crab-walk required to apply IRC § 6656 to income taxes meant that IRC § 6656 was not incorporated into Alaska law, notwithstanding Treasure Regulations §§ 1.6302(b), 1.6302-1(d), and 31.6302-1(h)(3). That decision would have been incorrect, and subject to later correction by the Department. Given the obscurity of the penalty, however, the decision to not apply the penalty would have signaled that the Department considered the penalty "excepted to," rather than incorporated.

The Department could assert that its inaction signaled nothing because tax returns, including penalties, are confidential. In this situation, however, this line of argument would not be persuasive. As this record shows, a general tax enforcement project would not be confidential except as applied to an individual taxpayer. The absence of an audit project enforcing IRC § 6656 before 2017, the need to undertake an audit project in 2017, the limitation of the project to 2014 and later, the lack of notice in the instructions, and the doubt about whether IRC § 6656 was incorporated or excepted to, all signal that the Department did not consider IRC § 6656 applicable to violations of 15 AAC 05.310(b). Moreover, Sodexo's Exhibit D establishes that several taxpayers violated 15 AAC 05.310 in 2014-17. Although we do not know how many taxpayers violated 15 AAC 05.310 with impunity before 2014, Sodexo asserts in its brief that it had a history of paying by check.[90] Further, even if the Department's policy with regard to IRC § 6656 before 2017 were entirely secret, nothing prevents taxpayers from talking among themselves.

In sum, here the Department had not previously applied the failure-to-deposit penalty, the penalty was based on a federal statute that might not have been incorporated into Alaska law, and

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[89] Here, both parties agree that IRC § 6656 is incorporated into Alaska law and not excepted to. This decision does not preempt a taxpayer from arguing in the future that IRC § 6656 is excepted to, although, like the parties, I do not see a basis for that argument.

[90] Sodexo Opening Brief at 8. Although whether it had a history of violating 15 AAC 05.310 without incurring a penalty (in other words, whether its checks were for more than $100,000 but it failed to pay by wire transfer before 2014) is not documented in this record, its behavior here provides support for an inference that Sodexo knew that the Department did not apply the penalty before 2014.

the Department omitted mention of the penalty in its instructions, while informing taxpayers about other penalties. Therefore, a reasonable taxpayer in 2014-16 could conclude that there was no penalty for violations of 15 AAC 05.310(b).

4. What must an agency do when it undertakes a discretionary action that is a change from its well-established approach to a matter that significantly affects the public?

When an administrative agency has consistently taken action (or consistently taken no action) that significantly affects members of the public, and the public could reasonably conclude that the agency will continue with past practice, courts have ruled that the agency cannot change course without giving notice that it is changing course. A federal district has explained that "[a]s a general matter, when an adjudicating agency retroactively applies a new legal standard that departs radically from the agency's previous interpretation of the law, the agency must give entities regulated by the agency proper notice and a meaningful opportunity to adjust."[91] The Ninth Circuit also has addressed the issue, explaining that although agencies have broad leeway to adopt new approaches through adjudication, an agency abuses its discretion when "the new standard, adopted by adjudication, departs radically from the agency's previous interpretation of the law, where the public has relied substantially and in good faith on the previous interpretation, where fines or damages are involved, and where the new standard is very broad and general in scope and prospective in application."[92]

With regard to penalties, the Alaska Supreme Court has stated that "[p]eople should not be required to guess whether a certain course of conduct is one which is apt to subject them to criminal or serious civil penalties."[93] Here, given the lack of notice or prior enforcement of the penalty, and the obscurity of the penalty (evidenced by the Department's own view that until 2011 the failure-to-deposit penalty did not apply to violations of 15 AAC 05.310(b)), without notice from the Department, a taxpayer making a payment could only guess whether paying by check would result in a penalty (and almost certainly would guess wrong). As Sodexo notes, a

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91 *Alabama v. Shalala,* 124 F.Supp.2d 1250, 1264 (M.D. Ala. 2000). This statement of the law from *Shalala* was quoted in the Alaska Supreme Court decision in *Valley Hosp.,* 116 P.3d at 584. The quote, however, was merely included in the Supreme Court's setting out of the superior court's order in full. This line of reasoning was not part of the Supreme Court's decision because the Supreme Court did not find it necessary to reach the issue of the agency's change of course to dispose of the case. 116 P.3d at 584. Nevertheless, the statement in *Shalala*, and the reasoning of the superior court in *Valley Hospital,* are both persuasive and applicable here.

92 *Pfaff v. U.S. Dep't of Housing & Urban Dev*., 88 F.3d 739, 748 (9th Cir. 1996). The court further explained that "[r]adically inconsistent interpretations of a statute by an agency, relied upon in good faith by the public, do not command the usual measure of deference to agency action." *Id.*

93 *Stevens,* 205 P.3d at 325-26 (quoting *VECO*, 753 P.2d at 714).

reasonable taxpayer who believed that paying by check would incur no penalty, could reasonably elect to pay by check if the cost of compliance with 15 AAC 05.310 exceeded the cost of noncompliance.[94] In the circumstances of this case, the Department must give notice of the penalty before it assesses the penalty. Until the Department gives notice, enforcement of the penalty is an abuse of the Department's discretion.[95]

IV. Conclusion

The Department of Revenue abused its discretion when it retroactively assessed a failure-to-deposit penalty against Sodexo without giving notice to Sodexo that the penalty would apply to violations of 15 AAC 05.310(b). This finding of an abuse of discretion is based on the totality of the circumstances of this case, which includes the facts that the Department had not previously applied the penalty, the applicability of the penalty was obscure, and the Department had published notice of the applicability of other penalties, but not this penalty. Therefore, the failure-to-deposit penalty assessed against Sodexo is abated.

DATED: March 4, 2019.

By: *SIGNED*
Stephen Slotnick
Administrative Law Judge

[94] This decision is limited to the circumstances of this case. This decision does not hold that an agency's failure to enforce a penalty in the past automatically gives rise to an inference that the penalty does not apply to the taxpayer's failure to follow the law. Here, the Department's lack of notice is an abuse of discretion only because the penalty was shrouded in doubt and had not been enforced in the past. In other circumstances, the lack of, or delay in undertaking, an enforcement action would not necessarily signal that the Department would not, or could not, retroactively enforce a penalty. Indeed, the analysis here should be a cautionary tale to taxpayers that they should inquire into the applicability of penalties before they decide to not follow the law, and to the Department that wherever possible it should give notice of a penalty in advance of undertaking an enforcement action to apply the penalty.

[95] The outcome here makes it unnecessary to discuss Sodexo's constitutional argument or its argument that it had reasonable cause to violate 15 AAC 05.310. Nothing in this decision, however, implies that Sodexo had reasonable cause. This decision analyzes the obligation of the Department to provide notice without inquiry into the obligation of Sodexo to obey the law.

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.[96]

A party may request reconsideration in accordance with AS 43.05.465(b) within 30 days of the date of service of this decision.

Here, because no evidentiary hearing was held, neither the facts nor the arguments were as fully-developed as needed for a decision. Therefore, this decision has relied on facts and law that were gleaned from the record and the party's briefs, but not necessarily explicitly discussed by the parties. In these circumstances, if a party moves for reconsideration to provide additional information or argument regarding those facts and law, I will be receptive to such a motion.

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.[97] 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.[98]

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.[99]

[This document has been modified to conform to the technical standards for publication. Names may have been changed to protect privacy.]

96 AS 43.05.465(f)(1).
97 AS 43.05.470.
98 AS 43.05.470(b).
99 AS 43.05.465 sets out the timelines for the decision becoming final.