

# Nevada Supreme Court Rebukes Tax Commission in Masco: Equitable Tolling Suspends Statute of Limitations for Refunds



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## Procedure

The Nevada Supreme Court recently affirmed a trial court decision that the Nevada Tax Commission had improperly substituted its own judgment for that of an administrative law judge who had ruled in favor of a contractor seeking a refund for overpayment of sales taxes. In this article, authors Alfred Paladino, Dave Rennie, and Trevor Kwan, of Deloitte Tax LLP, review the case and its implications for construction contractors that use tangible personal property in the performance of construction contracts.

# Nevada Supreme Court Rebukes Tax Commission in *Masco*: Equitable Tolling Suspends Statute of Limitations for Refunds

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## INTRODUCTION

In *Nevada Dept. of Taxn. v. Masco Builder Cabinet Group*, the Nevada Supreme Court upheld a district court decision that reinstated a taxpayer-favorable administrative law judge (ALJ) determination.<sup>1</sup> The taxpayer, Masco Builder Cabinet Group (Masco), is a cabinet manufacturer that sells its cabinets in retail showrooms and as part of lump-sum construction contracts. The Nevada sales and use taxation of the lump-sum contracts was at issue in the case. Regarding those contracts, the Nevada Supreme Court held that the Nevada Tax Commission had improperly substituted its own judgment for that of the ALJ in reversing the ALJ's determination that Masco was:

- subject to use tax (on Masco's cost to acquire the cabinet components) as opposed to sales tax (on the retail sales price of the cabinets) and, accordingly,

<sup>1</sup> *Nevada Dept. of Taxn. v. Masco Builder Cabinet Group D/B/A Quality Cabinets of Nevada*, 2011 Nev. LEXIS 83; 127 Nev. Adv. Rep. Op. No. 67 (Oct. 20, 2011).

■ entitled to a refund of overpaid sales tax (due to the higher base upon which the sales tax had been calculated and remitted).

The supreme court also found that the statute of limitations for filing a refund claim for the overpaid sales tax should be tolled where the Nevada Department of Taxation had led the taxpayer to believe that a formal filing was not necessary.

In this article we summarize the supreme court's decision and discuss its ramifications.

## FACTUAL, PROCEDURAL BACKGROUND

For the audit periods at issue (May 2003 through April 2006), Masco had remitted sales tax with respect to its lump-sum construction contracts as the result of a "computer-generated accounting oversight" whereby Masco's invoices contained a line item for "sales tax."<sup>2</sup> During the audit, the department auditor and Masco agreed that the taxpayer's payment of sales tax as opposed to use tax with respect to these contracts arguably resulted in an overpayment of sales tax due to the higher base upon which the sales tax had been calculated.<sup>3</sup> The auditor and Masco also agreed that the auditor would consider the potential sales tax refund within the overall context of the audit.

As part of the audit, Masco signed, at the auditor's request, a series of waivers of the statute of limitations for assessment, thereby extending the time during which the department could assess a deficiency for periods going back as far as May 2003. Masco signed the waivers with the understanding that they would also maintain the timeliness of its refund request for any sales tax overpayment for the same periods. Relying on this understanding and the agreement with the auditor that the refund would be addressed in the context of the audit, Masco did not file a formal refund claim while the audit was ongoing.

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### **Masco signed the waivers with the understanding that they would also maintain the timeliness of its refund request.**

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By August 2007 the audit was completed. During this time, the auditor had ceased to be employed by the department, but had not notified Masco of his departure nor of the completion of the audit. Realizing that the most recent waiver was about to expire, Masco tried to contact the department, but Masco's calls were not returned. Finally in October 2007, following expiration of the most recent waiver, Masco made contact with a new auditor, who informed Masco that the refund request had been denied. In December 2007, the department issued a deficiency assessment, which made no mention of the refund request. As part of its petition for redeter-

<sup>2</sup> Masco, 2011 Nev. LEXIS 83, at 12.

<sup>3</sup> As noted previously, sales tax is calculated on the retail sale price of the cabinets (see Nev. Rev. Stat. §372.105) whereas use tax is calculated on a lower amount based on Masco's cost to acquire the cabinet components (see Nev. Rev. Stat. §372.185, Nev. Admin. Code §372.200.1).

mination filed in January 2008, Masco filed a formal refund claim.

At the hearing before the ALJ on Masco's petition for redetermination, the department argued that Masco was not entitled to a refund because Masco had been acting as a retail seller under the construction contracts and was therefore subject to sales tax. The department argued further that even if Masco were entitled to a refund, any overpayments made more than three years prior to January 2008 were time-barred by the statute of limitations.

The ALJ rejected the department's arguments and determined that with respect to the lump-sum contracts, Masco had acted as a construction contractor subject to the use tax and not as a retail seller subject to sales tax. The ALJ thus determined that Masco was entitled to a refund of sales tax that had been overpaid due to the higher base (retail sales price as opposed to component cost) upon which tax had been calculated. The ALJ also determined that the refund should apply to all periods at issue in the audit (May 2003 through April 2006) despite Masco's failure to file a formal refund claim within the applicable statute of limitations, because that failure was attributable to the auditor's representation that he would consider Masco's refund request as part of the audit.

The department appealed the matter to the Nevada Tax Commission, an eight-member panel that both oversees the department and hears taxpayer appeals of administrative decisions. The commission reversed the ALJ's determination that Masco was entitled to a refund and concluded that Masco's failure to timely file a formal refund claim would have rendered a portion of its refund request time-barred by the statute of limitations.

On petition for judicial review filed by Masco, the Nevada District Court held that the commission had improperly substituted its own judgment for that of the ALJ. The district court reinstated the ALJ's determination that:

- Masco was due a refund, and
- the refund should cover the entire audit period.

The department then appealed the matter to the Nevada Supreme Court.

## SUPREME COURT'S DECISION

The following two issues were before the Nevada Supreme Court:

- whether the commission improperly substituted its own judgment for that of the ALJ in reversing the ALJ's decision that Masco was subject to use tax (and not sales tax) and was, thus, entitled to a refund of overpaid sales tax; and
- whether the statute of limitations for filing a refund claim should be tolled because the department had led the taxpayer to believe that a formal filing was not necessary.

### **Commission Improperly Substituted Its Judgment**

Regarding the first issue, namely, whether the commission had improperly substituted its own judgment for that of ALJ, the Nevada Supreme Court described as follows the standard to which the commission must adhere in its review of an ALJ decision:

with regard to factual issues, [the review is] limited to determining whether the agency's decision is supported by substantial evidence. Substantial evidence is evidence that a reasonable mind might accept as adequate to support a conclusion. . . . [Thus,] if the ALJ's findings were supported by substantial evidence, the Tax Commission was prohibited from substituting its own judgment for that of the ALJ.<sup>4</sup>

As explained by the court, upon review of the contracts in question and Masco's explanation of those contracts, the ALJ had concluded factually that Masco "had indeed acted as a construction contractor."<sup>5</sup> The ALJ based this determination on the "belief that each contract in question was, in essence, an agreement between Masco and its customer wherein Masco promised to install cabinets in the customer's house in exchange for a lump-sum price."<sup>6</sup> Regarding the line item for sales tax that appeared on Masco's lump-sum contract invoices, the court explained that:

Because the . . . invoices equaled the lump-sum amounts that Masco's customers had contractually agreed to pay, the ALJ discounted the fact that the invoices contained a specific line for sales tax, downplaying the Tax Department's contention that this line-item evinced a conscious decision on Masco's part to act as a retail seller.<sup>7</sup>

Based on these factual conclusions, the ALJ determined that the lump-sum contracts were subject to use tax and that, accordingly, Masco was entitled to a refund of overpaid sales tax.

The supreme court noted that the commission, in overturning this ALJ determination, "failed to address the ALJ's detailed findings and the evidence upon which these findings were based[,] [making] no mention whatsoever of Masco's contracts, much less why it found them unpersuasive or why it found the ALJ to have been clearly erroneous in relying on them."<sup>8</sup> The court went on to conclude that:

the Tax Commission improperly substituted its own judgment for that of the ALJ. The ALJ's decision was supported by substantial evidence, as the contracts in question clearly demonstrate agreements between Masco and its customers to provide and install cabinets in the customers' houses in exchange for a lump-sum price. These contracts, combined with Masco's explanation of how the invoices were generated, were more than adequate to support the ALJ's conclusion.<sup>9</sup>

On this basis, the court affirmed the district court's order to reinstate the ALJ's determination that Masco is entitled to a refund.<sup>10</sup>

## Equitable Tolling Operated to Suspend Running of Statute of Limitations

Regarding the second issue, namely, whether the statute of limitations for filing a refund claim should be

tolled because the department had led the taxpayer to believe that a formal filing was not necessary, the supreme court began its analysis by discussing the doctrine of equitable tolling. As explained by the court, "Equitable tolling operates to suspend the running of a statute of limitations when the only bar to a timely filed claim is a procedural technicality."<sup>11</sup> The court explained further that "the application of . . . [this] doctrine is appropriate only when 'the danger of prejudice to the defendant is absent' and 'the interests of justice so require.'"<sup>12</sup>

Applying this standard, the court found that the sole basis for the department's argument is a procedural technicality, namely, that Masco did not submit a formal letter to the department in request of a refund. However, as noted by the court, Masco had otherwise clearly communicated its intention to seek a refund by requesting of the auditor that a refund be considered as part of the audit and by stating its basis for that refund. Further, the court pointed out that the record shows that the auditor had communicated in writing to his supervisor that Masco intended to seek a refund.<sup>13</sup>

The court went on to conclude that the danger of prejudice to the department as a result of tolling the statute of limitations "is absent" because the department "was fully apprised of Masco's basis for its refund request from the inception of the audit, and because it has already denied the request, we assume that it has already fully investigated the matter."<sup>14</sup>

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**The court found that the sole basis for the department's argument is a procedural technicality, namely, that Masco did not submit a formal letter to the department in request of a refund.**

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Finally, the court addressed the question of whether the interests of justice required a tolling of the statute of limitations. In its analysis, the court cited what it described as "nonexclusive factors to determine whether it would be just or fair to toll the statute."<sup>15</sup> Included among the relevant factors are "the claimant's diligence, the claimant's knowledge of the relevant facts, the claimant's reliance on authoritative statements made by the administrative agency, and whether these statements misled the claimant."<sup>16</sup> Each of these factors was satisfied in this case. As explained by the court,

given the auditor's assurances that . . . [the] refund request would be considered within the context of the audit, the Tax Department's conduct effectively lulled Masco into a false sense of security. Moreover, having understood that the viability of its refund request was contingent on the continuing validity of

<sup>4</sup> *Masco*, 2011 Nev. LEXIS 83, at 10-11.

<sup>5</sup> *Masco*, 2011 Nev. LEXIS 83, at 13.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Masco*, 2011 Nev. LEXIS 83, at 13-14.

<sup>9</sup> *Masco*, 2011 Nev. LEXIS 83, at 14.

<sup>10</sup> *Id.*

<sup>11</sup> *Masco*, 2011 Nev. LEXIS 83, at 17.

<sup>12</sup> *Id.*, citing *Seino v. Emplrs Ins. Co.*, 1 21 Nev. 146, 152 (2005) (quoting *Azer v. Connell*, 306 F.3d 930, 936 (9th Cir. 2002)).

<sup>13</sup> *Masco*, 2011 Nev. LEXIS 83, at 18.

<sup>14</sup> *Id.*

<sup>15</sup> *Masco*, 2011 Nev. LEXIS 83, at 19.

<sup>16</sup> *Id.*

the waivers, Masco diligently attempted to contact someone at the Tax Department to ensure that a new waiver would be signed in time. The fact that a new waiver was not timely signed was solely the result of the Tax Department's failure to return Masco's phone calls and its own disorganization with regard to who was in charge of the audit after the original auditor left the Tax Department. Even after Masco was eventually able to contact someone in the Tax Department, it had to wait another two months to receive an actual deficiency assessment, during which time Masco was essentially left in limbo as to the status of its refund request.<sup>17</sup>

Accordingly, the supreme court found that in light of the department's active participation in and contribution to Masco's delay in filing its formal refund claim, the interests of justice require that the statute of limitations to be equitably tolled "during the time in which the Department hindered Masco from filing its formal written claim."<sup>18</sup>

### **Nevada Supreme Court's Conclusion**

The Nevada Supreme Court concluded that substantial evidence supported the ALJ's determination that Masco was entitled to a sales tax refund, and that the statute of limitations was equitably tolled.<sup>19</sup> On that basis, the supreme court upheld the district court decision that reinstated the ALJ's determination in favor of the taxpayer.<sup>20</sup>

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<sup>17</sup> *Masco*, 2011 Nev. LEXIS 83, at 19-20.

<sup>18</sup> *Masco*, 2011 Nev. LEXIS 83, at 20-22.

<sup>19</sup> *Masco*, 2011 Nev. LEXIS 83, at 21-22.

<sup>20</sup> *Id.*

## **POTENTIAL IMPACT ON OTHER TAXPAYERS**

This decision reaffirms that construction contractors are consumers of the tangible personal property used in the performance of their construction contracts. In this case, the ALJ looked to the structure of the transaction, focusing on the fact that Masco had contractually agreed with its customers to install cabinets in the homes of such customers in exchange for a lump-sum price. Based on this interpretation, the ALJ concluded, and the state supreme court agreed, that the transactions were appropriately characterized as lump-sum construction contracts and that this characterization was not altered by the fact that sales tax was charged by Masco.

In addition, the supreme court's decision also delineates the permissible scope of the commission's review of an ALJ decision. Specifically, the commission's review is limited to determining whether the ALJ's decision is supported by substantial evidence. In performing that review, the commission may not substitute its judgment for that of the ALJ. For other taxpayers that receive favorable ALJ decisions, this case may strengthen the ability of such taxpayers to sustain those decisions when challenged on appeal before the commission.

Finally, the supreme court's decision regarding equitable tolling suggests that the court appears willing to hold the department responsible for its actions and representations, especially where those actions, when reasonably relied upon by an otherwise diligent taxpayer, may lead to taxpayer detriment under circumstances where the department fails to follow through.