

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF ALABAMA

In re: )  
 )  
7 GENERAL CONTRACTING, INC., ) Case No. 20-10172  
 )  
Debtor. )

ORDER SUSTAINING OBJECTION (DOC. 192) IN PART

This case is before the court for estimation of the claim of the State of Alabama Department of Revenue (“DOR”), claim no. 20, pursuant to Bankruptcy Code § 502(c). Having carefully considered the parties’ briefs and exhibits, and the oral argument of counsel at the hearing held on January 8, 2021, the court estimates the DOR’s claim in the amount of \$256,629.29: \$209,863.01 priority and \$46,766.28 unsecured. The court thus sustains the objection filed by the debtor 7 General Contracting, Inc. in part and allows the claim in the amount of \$256,629.29, with \$209,863.01 priority and the remaining \$46,766.28 unsecured.

Background<sup>1</sup>

The debtor filed this chapter 11 bankruptcy in January 2020. According to its case management summary (doc. 47), the debtor “previously handled various areas of residential construction from general contracting to various subcontracting jobs such as plumbing, electrical and granite.” It now focuses primarily on its granite business. (*See id.*). The court has ordered the debtor to file a chapter 11 plan by January 29, 2021.

Claim no. 20 of the DOR relates to a final assessment for sales tax liability, including penalties and interest, in the total amount of \$351,734.87. The final assessment is based on an audit

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<sup>1</sup> This background is based on the court’s review of the briefs and exhibits and the parties’ oral argument. The hearing in this matter was for argument only, not testimony. These are not independent findings of fact and are not preclusive in any way.

of The Plumbing X Spurts, Inc. for the period of July 1, 2010 through December 31, 2015.<sup>2</sup> (*See* docs. 218-1, 218-2). Plumbing X Spurts was one of several entities that merged into the debtor prior to this bankruptcy filing.

The debtor appealed the assessment to the Alabama Tax Tribunal, but that administrative action was stayed by this bankruptcy. In December 2020, this court granted relief from the automatic stay for the purpose of allowing the appeal to the Tax Tribunal to proceed. However, the attorney for the DOR estimated that the appeal could take up to two years to conclude and noted that the debtor could appeal the Tax Tribunal's decision to state court.

#### Legal Standard

Section 502(c) provides that the court shall estimate “any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case . . . .” The court’s claim estimation does not “have any preclusive effect on the merits of [the] claim” if the parties choose to proceed with that claim in the Tax Tribunal and in state court, if applicable. *See, e.g., In re A & B Assocs., L.P.*, No. 17-40185-EJC, 2019 WL 1470892, at \*36 (Bankr. S.D. Ga. Mar. 29, 2019).

“Neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure provides any procedures or guidelines for estimation.” *Id.* at \*37 (citation, quotation marks, and brackets omitted). “Consequently, bankruptcy courts have wide discretion in estimating claims.” *Id.* “Generally, the [c]ourt may estimate claims by whatever method is best suited to the particular contingencies at issue, so long as the underlying purposes of the Code are not contravened.” *Id.* (citation and quotation marks omitted). An evidentiary hearing may be held, but is not required. *See id.*

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<sup>2</sup> The original audit period was longer, but was later shortened.

Bankruptcy courts have utilized various methods to estimate claims. *See id.* “Some courts have proceeded on an ‘all or nothing’ basis, awarding the full value of the claim if the claimant proves its case by preponderance, and awarding a zero value if the claimant fails to prove its claim.” *Id.* (citation and quotation marks omitted). “Other courts, however, adopt a method that estimates the probability a claim will succeed and apply the probability to the damages, reasoning that they should take into account the likelihood that each party’s version might or might not be accepted by a trier of fact.” *Id.* (citation and quotation marks omitted). The court finds this latter ‘probalistic’ method appropriate here. *See, e.g., In re Wall*, No. 19-14210 (Bankr. S.D. Ala. Aug. 28, 2020).

### Analysis

Claim no. 20 is for a total of \$351,734.87. This amount consists of \$201,008.58 in tax and \$50,221.85 in interest, for a priority total of \$251,230.43. It also includes an unsecured fraud penalty balance of \$100,504.44.

A contractor such as the debtor must pay sales tax at the time it purchases materials from a vendor or, alternatively, must pay a use tax. The debtor does not dispute that it owes at least some of the taxes reflected in the audit but contends that the audit numbers are inflated on four grounds.

First, it argues that the DOR has “estimated taxes as owed for the period July 1, 2010 to July 30, 2011 when the [d]ebtor did not yet have a Sales Tax License Number and would have been incapable of buying inventory from vendors without paying sales tax on such inventory.” (*See* debtor brief, doc. 219, at p.5; *see also* doc. 219-4). These estimated taxes total \$2,433.49. (*See* doc. 219-2).

Second, the debtor takes issue with the DOR’s overall audit process because the DOR used mainly estimates for the covered tax period. Specifically, the debtor contends that the DOR should not have used the higher numbers from later years to estimate the numbers for earlier years.

Third, the debtor contends that some of the sales were of grinder pumps, which it states are exempt from sales tax as “pollution control facilities” under Alabama Code § 40-23-4. According to the debtor, these estimated taxes amount to \$29,458.09, plus the corresponding interest and penalties. (See debtor brief, doc. 219, at p.7).

Finally, the debtor argues that the DOR should have applied the 5% negligence penalty of Alabama Code § 40-2A-11(c), not the 50% fraud penalty of Alabama Code § 40-2A-11(d). The debtor states that it “reasonably relied upon the advice of its outside, independent accountant until it hired [its current] Chief Financial Officer at which time all sales tax issues immediately ceased.” (See debtor brief, doc. 219, at p.8). The debtor also contends that the interest should be lower based on the arguments above.

The court reiterates that it is not the ultimate trier of fact; rather, it is only estimating the DOR’s claim using the “probabilistic” method discussed above. See *In re Thomson McKinnon Securities, Inc.*, 191 B.R. 976, 989 (Bankr. S.D.N.Y. 1996) (“The court need not don the garb of the clairvoyant; rather, all that is required is a ‘rough estimate.’”) (citation omitted). In doing so, the court has broken the claim into several elements based on the debtor’s arguments above, each with its own estimated probability of liability.

The first category consists of the estimated taxes for the disputed period from July 1, 2010 to July 30, 2011, which is before the debtor obtained its sales tax license number in August 2011. The DOR has not explained how the debtor would have been able to avoid paying sales tax during that time and does not have any specific evidence of it doing so. The court finds that the DOR’s probability of success on that aspect of the claim is only 10%.

The second category is the taxes due for the period August 2011 through December 2015 (excluding taxes on grinder pumps, which will be discussed separately). The debtor admits that it did not pay taxes during this period. Even though it attempts to poke holes in the DOR’s estimates, the debtor had the burden of maintaining sufficient records, which it failed to do. See, e.g., *State v.*

*Mack*, 411 So. 2d 799, 802 (Ala. Civ. App. 1982); *State v. T.R. Miller Mill Co.*, 130 So. 2d 185, 190 (Ala. 1961). Its argument that the numbers for earlier years should be lower is a problem of the debtor's own making through its poor recordkeeping. The court finds that the DOR has a high probability of success on these years, which it estimates at 90%.

The third category relates to the alleged exemption for grinder pumps. In this respect, “[e]xemptions from taxation are to be strictly construed against the exemption unless the intention to exempt clearly appears from the statute . . . .” *See State v. Mack*, 411 So. 2d at 803; *see also, e.g., Jefferson County v. Acker*, 885 So. 2d 739, 743 (Ala. 2003) (“Exemptions from taxation are to be strictly construed against the person or party claiming the exemption in favor of the right to tax.”) (citation, quotation marks, and brackets omitted). The DOR “contends that the [grinder pumps] are not pollution control devices as contemplated by the exemption statute but instead building materials affixed to real property.” (*See* DOR brief, doc. 218, at p.5). Regardless, the DOR argues that the debtor cannot claim the exemption under Rule 810-6-3-.46(8) of the Alabama Administrative Code, which states in pertinent part: “Property which is acquired primarily for the production of goods or services and is integral to a profit-motivated business purpose or activity does not qualify for the pollution control exemption [of Alabama Code § 40-23-4] even when the property controls, reduces, or eliminates air or water pollution.” This court finds the cases cited by the DOR, while not completely on point, are persuasive and finds that the DOR’s chances of success on this claim are 60% because it appears more likely than not that the grinder pumps were “part and parcel of the taxpayer’s business purpose.” *See, e.g., HLH Constructors v. State Dep’t of Rev.*, 902 So. 2d 680, 689 (Ala. Civ. App. 2004).

The fourth category is the penalty – 50% for fraud or 5% for negligence. The DOR acknowledges that it will bear the burden of proof on this issue on appeal. *See* Ala. Code § 40-2B-2(k)(7). Even so, the court finds that the DOR has a reasonably strong case for the fraud penalty given the fact that the debtor obtained a sales tax license number but then failed to remit any use

taxes when the purchased items were installed. At a minimum, the debtor will be liable for the 5% negligence penalty. The court finds that the DOR has a 50% chance of obtaining the penalty for fraud and 50% for negligence. Combining the two (.50 x .50 added to .05 x .50) yields an estimated penalty percentage of 27.5%, which the court will apply to the estimated tax liability.

These numbers are not precise because the court cannot calculate the interest exactly, but the court determines the estimated claim as follows:

7/1/10 – 7/31/11	\$2,433.49	x .10 =	\$243.35
8/2011 – 12/2015 claimed taxes excluding those for grinder pumps	\$169,045.56 <sup>3</sup>	x .90 =	\$152,141.00
Claimed taxes for grinder pumps	\$29,458.09	x .60 =	\$17,674.85
Estimated tax claim exclusive of interest or penalty =			\$170,059.20
Estimated interest	7/1/10 – 7/31/11	\$438.36 x .10 =	\$43.84
	Remainder excluding pumps <sup>4</sup> (85.16%)	\$39,579.63 x .90 =	\$35,621.67
	Grinder pumps (14.84%)	\$6,897.16 x .60 =	\$4,138.30
Total interest	\$39,803.81		
Estimated penalty	\$170,059.20 x .275 =		\$46,766.28

The court thus estimates the state's priority claim (taxes plus interest) as \$209,863.01 and its unsecured claim (penalty) as \$46,766.28.

<sup>3</sup> The court arrived at this number using the DOR's latest tax figure of \$198,503.65 (*see* doc. 224) minus \$29,458.09 attributable to pumps.

<sup>4</sup> DOR attributes \$46,476.79 in interest to the period of August 2011 through December 2015. (*See* doc. 224). The court has prorated that amount between the pump and nonpump aspects.

### Conclusion

Using the analysis above, the court estimates claim no. 20 of the Alabama Department of Revenue under § 502(c) in the total amount of \$256,629.29 and orders as follows:

1. The court sustains the debtor's objection to claim no. 20 in part: the court allows the claim for the time being in the total amount of \$256,629.29, with \$209,863.01 priority and the remaining \$46,766.28 unsecured, pending a final determination of the claim. This includes the appeal to the Alabama Tax Tribunal and any further appeal, if applicable.

2. Either party may move for reconsideration under Bankruptcy Code § 502(j) once the Alabama Tax Tribunal has made a final decision. Regardless, the debtor should immediately notify this court of the final decision of the Alabama Tax Tribunal and whether any further appeal(s) is anticipated.

3. This claim estimation is not binding in any way outside the bankruptcy case.

Dated: January 13, 2021

  
HENRY A. CALLAWAY  
CHIEF U.S. BANKRUPTCY JUDGE