STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. S. 91-201
SUSAN'S RESTAURANT, a partnership composed of Fred & Ethlene Marler 2541 29th Place Ensley, AL 35208, Taxpayer.	§	

FINAL ORDER

The Revenue Department assessed sales tax against Susan's Restaurant, a partnership composed of Fred Marler and Ethlene Marler (Taxpayers) for the period. January, 1984 through June, 1988. The Taxpayers appealed to the Administrative Law Division and a hearing was conducted on January 28, 1992. The Taxpayers were represented by attorney Grover S. McLeod. Assistant counsel Dan Schmaeling appeared for the Department.

FINDINGS OF FACT

The Taxpayers owned and operated a small restaurant/bar in Wylam, a suburb of Birmingham, from 1984 through mid-1988.

The Department's Special Investigations Unit investigated the Taxpayers in 1988 for possible criminal sales tax evasion. The Department also audited the Taxpayers for sales tax in conjunction with the criminal investigation.

The sales tax examiner obtained the Taxpayers' cash register tapes and purchase invoices from their accountant in Tuscaloosa and concluded that the records were insufficient to do a direct audit. The examiner thus conducted an indirect audit using vendor records

and other third-party information. The audit showed that the Taxpayers: owed $16,552.97 in sales tax over the 54 months of the audit period. The Taxpayers had reported and paid $8,328.00 over the same period.

The examiner completed the audit and turned it over to the Special Investigations Unit in November, 1988. The Taxpayers were not given a copy of the audit or billed for any additional tax due at that time, and did not hear from the Department until November 8, 1989, when Mrs. Marler was arrested and charged with criminal failure to pay sales tax under §40-29-110. Mr. Marler was also arrested and charged with the same offense in October, 1990.

The cases were heard together in Tuscaloosa County Circuit Court in December, 1990. Without a trial, the charges against Mrs. Marler were dropped and Mr. Marler agreed to plead guilty to two counts of "attempted violation of Title (sic) 40-29-110, a misdemeanor". Mr. Marler received no prison time and was not fined.

The Department subsequently entered the preliminary assessment in issue on February 14, 1991. The Taxpayers were not notified of any civil liability prior to that date.

The assessment includes a 25% fraud penalty pursuant to §40-23-16. The Department contends that the Taxpayers kept two daily cash register tapes but reported only one tape on their monthly return.. The Taxpayers deny the charge and explain that their cash

register was defective and sometimes did not automatically change dates from one day to the next.

The Taxpayers point out that they were previously audited for 1981 through 1983 and that no additional tax was found to be due. The Taxpayers also claim that they kept good records and that the Department's audit is excessive because (1) some of the items included as taxable in the audit were purchased for individuals or other businesses and not for resale; (2) they were not allowed credit for inventory taken or destroyed during at least five burglaries during the audit period; (3) they were not allowed credit for a number of credit sales during the audit period; and (4) they were not allowed credit for meals given away during the audit period. However, although the Taxpayers (Mrs. Marler) testified concerning the above, they failed to provide any records to support the claims.

CONCLUSIONS OF LAW

All taxpayers subject to sales tax are required to keep adequate records from which their liability can be accurately computed. See, Code of Ala. 1975, §40-23-9. In the absence of adequate records, the Department can use any reasonable information available to compute liability. Bradford v. C.I.R., 796 F.2d 303 (1986); Webb v. C.I.R., 394 F.2d 366 (1968). Thus, accepting as correct the Department examiner's conclusion that the Taxpayers' records were incomplete, the examiner properly performed

the audit using the best information available. The Department cannot be required to rely on a taxpayer's verbal assertions in lieu of records. State v. Ludlam, 384 So.2d 1089 (1980).

However, the determinative issue is not whether the audit is correct, but whether the tax was timely assessed by the Department.

Generally, a taxpayer must be notified of additional sales tax due within three years from the due date of the tax. See, §40-23-18(b). However, tax can be assessed at any time if the taxpayer files a false or fraudulent return with the intent to evade tax. See again, §40-23-18(b).

The preliminary assessment in issue is for the period January, 1984 through June, 1988. The Department first notified the Taxpayers of additional tax due when the preliminary assessment was entered on February 14, 1991. Thus, unless the Department can prove fraud, the period prior to February 14,1988 is barred by the three year statute of limitations.

The Department must prove fraud by clear and convincing evidence. Korecky v. C.I.R., 781 F.2d 1566 (1986); Douge v. C.I.R., 899 F.2d 164 (1990). Fraud can be established by cumulative circumstantial evidence showing a willful intent to evade. Biggs v. Commissioner, 440 F.2d 1 (1971.). Common badges of sales tax fraud are (1) an understatement of taxable gross receipts (income); (2) inadequate or altered records.; (3) failure to file returns;

(4) implausible or unbelievable explanations of behavior; and (5) failure to cooperate. Bradford v. C.I.R., supra.

The Department has not proved fraud in this case. The Taxpayers' failure to keep good records does not by itself prove fraud. Biggs v. C.I.R., supra. Also, if the Taxpayers had intended to evade tax, they would not have turned over both daily tapes to their accountant where the fraud could be discovered in a routine audit. There is also no evidence that the accountant conspired with the Taxpayers to defraud the State or even that only one of the two daily tapes was reported on the monthly returns.

The Taxpayers at all time cooperated with the examiner and also plausibly explained why the Department audit showed additional tax due. While the Department is not required to rely on the Taxpayers' unsupported testimony in computing the amount of tax due, their explanations as to burglaries, give-aways, etc. are believable and can be considered in deciding if they intentionally filed false returns.

The fact that Mr. Marler pled guilty in the criminal case also does not conclusively prove fraud. Mrs. Marler ran the business and her case was dismissed. Mr. Marler had little to do with running the business or paying the tax, even thought he sales tax account was in his name, and clearly his guilty plea was perfunctory. He received no fine or prison time. The fraud issue was never litigated and Mr. Marler has at all times denied the

fraud charge. Under those circumstances, the guilty plea does not constitute conclusive proof of civil fraud. Contrast Gray v. C.I.R., 708 F.2d 243, in which the offending taxpayer admitted fraud in open court.

In any case, the case action summary shows that Mr. Marler pled guilty to "attempted violation of Title (sic) 40-29-110, a misdemeanor". Section 40-29-110 is a felony violation, not a misdemeanor. Thus, technically Mr. Marler did not plead guilty to the criminal fraud felony specified in §40-29-110.

In summary, while the audit was properly conducted, the Department has failed to prove fraud by clear and convincing evidence and therefore all tax prior to February 14, 1988 is barred by the three year statute of limitations. The assessment. should be reduced and made final to include only tax due for the period February 14, 1988 through June 30, 1988, plus applicable interest.

Entered on July 1, 1992.

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BILL THOMPSON
Chief Administrative Law Judge