STATE OF ALABAMA, DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE
	§	ADMINISTRATIVE LAW DIVISION
vs.		
	§	DOCKET NO. S. 92-169
HILLCREST PLAZA PACKAGE STORE, a partnership composed of Thomas D. Lunceford and Jennifer C. Lunceford 6165 Airport Blvd. Mobile, AL 36609,	§	
Taxpayers.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed sales tax against Hillcrest Plaza Package Store, a partnership composed of Thomas D. Lunceford and Jennifer C. Lunceford, for the period May, 1982 through March, 1991. Thomas D. Lunceford (Taxpayer) appealed to the Administrative Law Division and a hearing was conducted on August 17, 1992 in Mobile, Alabama. The Taxpayer represented himself. Assistant counsel Dan Schmaeling represented the Department. The relevant facts are set out below.

The Taxpayer operated several retail liquor package stores in Mobile County during the period in issue. As required by law, the Taxpayer purchased his liquor at wholesale from the Alabama ABC Board.

During the period in issue, the ABC Board charged the same price on both wholesale and retail bottle sales. However, the Board charged sales tax on the retail sales only and not on the wholesale sales. The higher price charged on the wholesale sales constituted an increased profit to offset the Board's higher costs associated with wholesale bottle sales. The Board remitted sales tax to the Department on its retail sales only. See generally,

memorandums from ABC Administrator Broadwater and Deputy Administrator Lazenby, Department Exhibits 1 and 2.

Nevertheless, after discussing the problem with ABC officials several times in 1982, the Taxpayer concluded that he was paying sales tax to the Board, and consequently, sometime in 1983 began taking a corresponding deduction on his monthly sales tax returns filed with the Department.[1] The Taxpayer continued deducting sales tax on his monthly returns and paying the tax as reported through April, 1988.

The Taxpayer complained to the Department that he was paying sales tax to both the ABC Board and to the Department, and finally, after receiving no relief or satisfactory response, he stopped filing returns and paying sales tax altogether after April, 1988. See, transcript at pages 28-45. The Taxpayer calculated at the time that he had overpaid sales tax by approximately $184,000 since 1982. The Taxpayer kept a running total of the alleged overpayment after April, 1988 by subtracting each subsequent month's liability from the overpayment and then adding a 1% per month interest charge to the balance. The Taxpayer now claims that he is owed approximately $214,000 by the State in overpaid sales tax plus interest.

The Department started a sales tax audit of the Taxpayer in 1986. However, the civil audit was suspended prior to completion

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[1] The Taxpayer apparently subtracted 6% (4% state sales tax and 2% local sales tax) from his gross receipts and reported and paid tax on the balance. As will be discussed, the Taxpayer continued claiming the sales tax deduction until he stopped filing returns in May, 1988.

and the case was turned over to the Department's Special Investigations Unit (SIU) for possible criminal action. The SIU eventually discontinued its criminal investigation without taking action against the Taxpayer, and the file was returned to the Sales Tax Division in January, 1991.

The Department reinstituted the civil audit in 1991 for the expanded period May, 1982 through March, 1991. The Taxpayer subsequently filed delinquent returns for May, 1988 through March, 1991 and also for the delinquent months of November, 1986 and March and August, 1987. The Taxpayer reported his gross receipts on the delinquent returns, but also claimed a corresponding deduction which resulted in no taxable receipts and no tax due.

The Department examiner used a markup audit for May through December, 1982. Using vendor records, the examiner determined that the Taxpayer had purchased $215,654 in merchandise during the period. An average markup of 24.45% based on a price survey of similar businesses in the area was applied to arrive at gross sales of $268,382. The Department then deducted $63,862 in consumer excise taxes that were included in the wholesale price of the liquor, beer and wine purchased by the Taxpayer during the subject period, to arrive at taxable sales of $204,515. The Taxpayer had reported taxable sales of $152,987 during the same period.

For 1983 through 1990, the examiner used the gross receipts amounts reported by the Taxpayer on Schedule C of his federal income tax returns. Consumer taxes were deducted (until October,

1987)[2] to arrive at taxable receipts. Below is a table showing the Schedule C information used by the examiner (columns 1 and 2), the consumer tax deduction allowed (column 3), taxable sales per the audit (column 4), and actual sales reported (column 5).

	(1) Cost of goods sold (per income tax returns)	(2) Gross sales (per income tax returns)	(3) Consumer tax credit (per vendor records)	(4) Taxable sales per audit	(5) Actual sales reported by Taxpayer
1983	$477,684	$592,505	($112,137)	$480,367	$231,561
1984	$524,056	$710,075	($121,461)	$588,613	$164,397
1985	$505,672	$670,809	($127,550)	$543,258	$114,121
1986	$478,084	$685,578	($81,044)	$604,534	$119,832
1987	$381,236	$535,061	($14,601)	$520,459	$78,043
1988	$236,876	$312,362	$0.00	$312,362	$96,820
1989	$197,969	$262,501	$0.00	$262,501	$121,288
1990	$227,911	$300,765	$0.00	$300,765	$174,520

The Department again used a markup audit for January through March, 1991. A markup of 31.64% was applied to wholesale purchases

[2] The Department stopped allowing a consumer tax deduction after passage of Act 87-662 effective October 1, 1987. This issue is discussed later in the Order.

of $133,438 to arrive at taxable sales of $175,653. The Taxpayer had reported taxable sales of $98,677 for the same period.

The Taxpayer first argues that he overpaid sales tax during the audit period because he paid sales tax twice on his liquor, once to the ABC Board and a second time to the Department. However, the evidence is clear that the ABC stores collected and remitted sales tax to the Department on its retail sales only. Sales tax was not included in the wholesale price paid by the Taxpayer. Consequently, the Taxpayer should not have deducted sales tax on his returns from May, 1982 through April, 1988, and clearly is not due a refund and should not have stopped filing returns in May, 1988. If the Taxpayer believes he was overcharged by the ABC Board, the matter should be addressed with the ABC Board and not the Revenue Department.

The Taxpayer next argues that the Department examiner should have used his sales records to do the audit. The Taxpayer provided the Department with his daily sales records when the audit first started in 1986. Those records were transferred to the Department's SIU and eventually returned to the Taxpayer. No records were ever submitted for the period 1986 through 1991.

The examiner had copies of some of the Taxpayer's records for 1982 through 1986 which he conceded were probably adequate for audit purposes. See, transcript at page 71. However, the examiner instead used the Taxpayer's Schedule C and vendor information because the sales records, although voluminous, were not complete. The examiner also suspected the accuracy of the records because

some were dated on a Sunday, when the Taxpayer's stores were supposedly closed.

The Department should consider a taxpayer's records, but if the records are incomplete or inaccurate, the taxpayer's liability can be computed using the best information available. Webb v. C.I.R., 394 F.2d 366; Denison v. C.I.R., 689 F.2d 701. The Department's calculations are presumed correct and will be upheld as long as they are based on reasonable evidence. The burden then shifts to the taxpayer to prove that the Department's calculations are incorrect. Denison v. C.I.R., supra; Bradford v. C.I.R., 796 F.2d 303; Jones v. C.I.R., 903 F.2d 1301.

The Taxpayer's income tax returns and vendor records are reliable sources of information and provide a rational basis for the audit. The Taxpayer has failed to present any tangible evidence that the audit calculations are incorrect. Under the circumstances, the audit must be upheld.

The Taxpayer argues that his Schedule Cs included gross receipts from land transactions, stock sales and other nontaxable items that greatly exaggerate his true liability. The Department offered to reduce the audit if the Taxpayer provided some evidence in support of that claim. See March 5, 1992 letter from Hearing Officer Joe Cowen. However, the Taxpayer failed to present any tangible evidence supporting his claim either at the informal conference or at the administrative hearing. The Department is not required to rely on a taxpayer's verbal assertions, State v. Mack,

411 So.2d 799, and in lieu of records to the contrary, the Department's prima facie correct audit must be upheld.

A comparison of taxable sales per the audit (column 4 of table) versus reported sales (column 5) also verifies that the Taxpayer substantially unreported sales during the audit period. For example, the Taxpayer reported sales of $78,043 in 1987 but the audit established sales of $520,459. If the Taxpayer's returns are incorrect, then it follows that his records on which the returns were based are also incorrect.

The Taxpayer may argue that a comparison of audit sales and reported sales is misleading because the audit includes nontaxable receipts. However, other areas of the audit also prove that the Taxpayer underreported sales during the audit period.

The consumer tax deduction shown in column 3 is based on actual ABC Board and vendor records. The consumer tax on liquor is approximately 50% of the wholesale price, but is only a few cents per beer and there is no consumer tax on groceries, soft drinks and the other miscellaneous items sold by the Taxpayer. At most, consumer taxes paid by the Taxpayer should not exceed 25% to 35% of his total purchases, and even a smaller percentage of his sales (purchases plus markup). However, as illustrated by the table, consumer taxes equalled approximately 73% of the Taxpayer's reported sales in 1984, 69% of reported sales in 1986, and the consumer tax actually exceeded reported sales by over $13,000 in 1985 (consumer tax paid of $127,550 versus reported sales of

$114,121). The consumer tax figures are based on actual records and the only reasonable conclusion is that the Taxpayer underreported sales during the audit period. The Taxpayer also provided the Department with sales summaries for 1988, 1989 and 1990. The summaries indicate sales of $233,134, $203,497 and $243,444, respectively, for a three-year total of $680,075. The figures include all sales by the Taxpayer -groceries, soft drinks and other miscellaneous items in addition to liquor, beer and wine. Compare the above sales figures to vendor information indicating that the Taxpayer purchased $250,332, $154,357 and $281,091 respectively in liquor, beer and wine alone during the same three-year period, for total purchases of $685,780. As illustrated, total purchases of liquor, beer and wine actually exceeded the Taxpayer's reported retail sales for both 1988 and 1990 and also overall for the three year period. Obviously, a taxpayer's retail sales should exceed his wholesale purchases, especially when the purchase figures do not include a reasonable mark-up or the cost of groceries and other miscellaneous items sold by the Taxpayer. Again, the only reasonable conclusion is that the Taxpayer substantially underreported sales during the audit period.

Concerning the consumer excise taxes, Act 87-662 (§40-23-26(d)) requires that all sales tax collected by a retailer must be remitted to the Department, even if the tax was erroneously collected. The Department disallowed a consumer tax deduction after the effective date of the Act (October, 1987) because it claims that the Taxpayer charged and collected sales tax on the

consumer tax from his customers. If correct, then the deduction was properly disallowed.

The Taxpayer argues that the deduction should be allowed because the Department cannot prove that he included the consumer taxes in the measure of the sale tax charged to his customers. The Taxpayer claims that the consumer tax was removed before sales tax was computed.

The Taxpayer charged a lumpsum, tax included price for his liquor, beer, and wine and he has provided no records showing that the consumer taxes were removed before sales tax was computed. A taxpayer must keep good records supporting all claimed deductions, and in the absence of adequate records the deduction must be denied. State v. Ludlam, 384 So.2d 1089. Consequently, the Department properly disallowed consumer tax paid by the Taxpayer as a deduction after October 1, 1987.

Also, although §40-23-26(d) became effective October 1987, in my opinion the same result was required by prior case law, specifically Ross Jewelers, Inc. v. State, 72 So.2d 402. That case holds that as between the retailer and the State, any tax overcollected by the retailer should go to the State. Consequently, because the Taxpayer cannot prove that sales tax was not collected on the consumer taxes, consumer tax should not have been deducted even prior to October 1, 1987.

The Department also assessed a 25% fraud penalty as provided by Code of Ala. 1975, §40-23-16. The fraud issue is important beyond the 25% penalty because unless the Department can prove

fraud, most of the audit period is barred by the three-year statute of limitations at Code of Ala. 1975, §40-23-18.[3] The months of May, 1988 through March, 1991 and also November, 1986 and March and August, 1987 are not barred and can be assessed in any case because the returns for those months were not filed until 1991. See again, §40-23-18.

The Department must prove fraud by clear and convincing evidence. Bradford v. C.I.R., supra. The Taxpayer's consistent understatement of taxable sales is evidence of fraud but is not conclusive proof of fraud, Romm v. C.I.R., 245 F.2d 730, especially since the understatement was established by indirect audit. Consequently, the fact that the Taxpayer failed to disprove the Department audit is not proof of fraud. As stated in Biggs v. C.I.R., 440 F.2d 1, at page 5: "The mere fact that a taxpayer is

[3] While §§40-23-16 and 40-23-18 are both applicable in this case because they were in effect during the period in question, both were repealed by the Uniform Revenue Procedures Act effective October 1, 1992. Fraud is now governed generally by Code of Ala. 1975, §40-2A-11(d), and the statute of limitations for assessing tax is governed generally by Code of Ala. 1975, §40-2A-7(b)(2).

unable to prove that the commissioner's deficiency assessments are erroneous, even if a number of taxable years are involved, is not sufficient to sustain the burden of proving fraud". Note - The above cases are federal income tax cases, but the same principles would also apply to sales tax.

The ABC charged the same price on wholesale and retail sales during the subject period and the Taxpayer could have in good faith believed that he was paying sales tax when he purchased his liquor from the ABC stores. The Taxpayer also voluntarily informed the Department when the audit started in 1986 that he was deducting sales tax on his returns. Consequently, although the Taxpayer should not have deducted sales tax on his returns from 1983 until April, 1988, his doing so did not constitute fraud.

Also, by refusing to file returns after April, 1988, the Taxpayer certainly was not attempting to hide or secretly underreport his liability for those months. The Taxpayer had complained to the Department that he was paying sales tax twice, and the Department also knew or should have known that the Taxpayer stopped filing returns in May, 1988 and could have acted against him at any time. An audit involving a fraud investigation normally requires more time to complete, which is one reason why there is no statute of limitations in fraud cases, see generally Badaracco v. C.I.R., 104 S.Ct. 756. However, I do not understand why the Department held the audit and took no action against the Taxpayer from 1986 until 1991, a period of 5 years.

The Department concedes that the Taxpayer kept voluminous records during the audit period[4], and the Taxpayer also cooperated fully during the audit. I also think it relevant that the Department dropped its criminal investigation without bringing fraud or other charges against the Taxpayer. In summary, while the Taxpayer failed to carry his burden of disproving the Department's audit, the Department also failed to prove fraud. The above considered, the audit results are upheld but the months prior to May, 1988 (except November, 1986 and March and August, 1987) are barred by the three-year statute of limitations for assessing tax and should be deleted from the assessment. The assessment should be recomputed to include only the months of November, 1986, March and August, 1987 and May, 1988 through March, 1991.[5] The Department should then add to the tax due a 10% failure to timely file penalty (Code of Ala. 1975, §40-2A-11(a)) and a 10% failure to timely pay penalty (Code of Ala. 1975, §40-2A-11(b)), plus applicable interest. The Department should inform the Administrative Law Division of the Taxpayer's adjusted liability,

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[4] As stated, the Department examiner conceded at the administrative hearing that the Taxpayer's records may be sufficient to do an audit. However, as stated, the Department's use of the Taxpayer's income tax returns and vendor records was reasonable under the circumstances.

[5] The Taxpayer's returns for the period show no tax due and are obviously wrong. Also, the Taxpayer never provided any sales records for the period except the clearly erroneous sales summaries for 1988, 1989 and 1990 discussed above. Consequently, there should be no question that the audit for the assessable months is correct and should be upheld. The Taxpayer has offered no records or other evidence to the contrary.

and a Final Order will be entered from which either party may appeal.

Entered on February 26, 1993.

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BILL THOMPSON
Chief Administrative Law Division