NICOLE SAWYER d/b/a FRY CITY 2893 PEAKE ROAD RAMER, AL 36069, Taxpayer, v. STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § § § §	STATE OF ALABAMA ALABAMA TAX TRIBUNAL DOCKET NO. S. 14-164

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Nicole Sawyer ("Taxpayer"), d/b/a Fry City, for State sales tax for January 2008 through March 2013. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on July 17, 2014. The Taxpayer represented herself at the hearing. Assistant Counsel Billy Young represented the Department.

In mid-March 2013, the Montgomery County Sheriff's Office notified the Alabama Alcohol Beverage Control ("ABC Board") that a location on Peake Road in rural South Montgomery County was operating an unlicensed nightclub/bar known as Fry City. The Sheriff's Office indicated that the business had distributed advertising flyers at various convenience stores in the area stating that a birthday party was scheduled at the location for Friday night, March 22, 2013, and that a Hawaiian party was scheduled for the next night, Saturday, March 23, 2013. The flyer indicated that there would be a $5 cover charge or admission fee for ladies until 10:00 p.m., and that there would be various drink specials.

The Sheriff's Department, the ABC Board, and the Alabama Department of Public Safety subsequently planned to raid the location on March 23rd, the night of the Hawaiian party. The ABC Board also notified the Revenue Department of the intended raid, and

asked if the Department would like to participate. The Department agreed and assigned an examiner to the case.

There was a pre-raid meeting on the night of the 23rd involving agents of the ABC Board, the Montgomery County Sheriff's office, the Alabama State Troopers' office, and the Revenue Department examiner. A deputy sheriff informed the group at the meeting that another deputy sheriff had made contact with the establishment the weekend before because of a fight in the area, and that sheriff's deputies had been watching the place for an unspecified period of time. Sheriff's deputies had also observed the business open on the previous Friday night, March 22, and also on Friday or Saturday night of the prior weekend.

Shortly before the raid, an undercover ABC Board agent entered the facility, which he described as a "shed type building," see Dept. Ex. 2. Upon entering, the agent was told that the admission fee or cover charge was $5. He paid the $5, which an unidentified female at the door put into a metal box. The agent had his hand stamped to show that he had paid, and proceeded to the bar. He asked the bartender the price for a double shot of Crown Royal. The bartender told him $6. The agent gave the bartender a $10 bill, and also asked for a Bud Light, which was an additional $2. After a few minutes, the agent left the building and informed the task force waiting outside that the buy had been made. Members of the task force immediately entered the building at approximately 10:00 p.m.

The Department examiner entered the building shortly after the raid. She observed a large bar area that included a regular-sized and a smaller refrigerator. There were cases of beer, liquor bottles, and mixers behind and on the bar, and a buffet-type table with food at the rear of the bar. The examiner also observed various posters on the wall showing

that entertainment had been offered at the facility on specific dates going back to 2009, and also that the facility had hosted pool tournaments in 2009 and 2010. Most of the posters indicated that an admission fee would be charged for the event being advertised. One of the posters stated "Est. 2008," and another advertised the "5th Annual Fry City Camp Meeting." A sign on the door into the bar area stated that "if you are not a part of my staff DO NOT ENTER beyond this point."

The examiner talked with the Taxpayer on the night of the raid. The Taxpayer admitted that she owned the facility, but argued that she was not operating a business open to the public. Rather, she claimed that it was her family's facility where they had their private family gatherings, i.e. barbeques, birthday parties, Christmas parties, family entertainment, etc. She also told the examiner she had never sold alcohol or charged an admission fee, and that the prior Friday night, March 22, was the first night she had operated the facility.

The Taxpayer subsequently failed to provide the examiner with any purchase or sales records concerning the business. The examiner consequently estimated the Taxpayer's sales and door receipts, and the resulting sales tax due, based on information obtained in the raid. The examiner's audit report, Dept. Ex. 11, explains how the liquor sales were calculated, as follows:

> In estimating an audit liability, the retail value of the alcohol sold was based on the amount of liquor confiscated during the raid. The retail value was assigned by the ABC Board as follows.
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> The alcohol seized was:
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> 130 bottles of differing types of beer
> The beers were being sold for $2.00 a bottle
> $260.00 being the retail value assigned by the ABC Board

> 16 varying sizes and types of alcohol – liquor
> The average size bottle was 1.75 liters
> The "shots" were being sold for $3.00 a shot
> $1,623.00 being the retail value assigned by the ABC Board
>
> Based on the above provided retail values of the seized liquor, the estimated liquor sales of $1,883.00 were used for each night of operation.
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> In determining the nights in operation, it can safely be said that the club was open on Friday and Saturday night (March 22nd and 23rd 2013) of the raid week. The Montgomery County Sheriff's office made contact with the bar the previous week (March 15th or 16th, 2013) because of a fight, and as a follow up, the deputy stated that he rode by the establishment on Friday night (March 22nd).
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> Additionally, it was my observation that the club had been in operation for quite some time, as the pictures on the wall suggested such. Based on this information, the nights of operation used were Friday and Saturday of each week for the last five years, going back to January 1, 2008.

An ABC agent that participated in the raid testified that he estimated that from 70 to 100 people were in the building at the time of the raid. Using that information, the examiner estimated the sales tax due on the cover charges by estimating that 75 individuals attended the establishment on a given night. She multiplied that number by an average cover charge of $6 per person to arrive at estimated nightly door receipts of $450 (75 x $6 = $450). The Department subsequently assessed the Taxpayer for sales tax on her estimated liquor sales and estimated door receipts for every Friday and Saturday night going back to January 2008.

There is an obvious disagreement concerning the facts in this case. The Taxpayer testified that only her family used the facility maybe once every two months for various private parties or events, that she never sold alcohol or charged admission at the location, that only 20 family members were in the building on the night of the raid, and that Friday, March 22, 2013, was the first time that the facility was open. She also asserted that the

posters on the walls advertising various entertainment events at the facility were "just decoration on the wall." (T. 9).

The evidence shows, however, that entertainment events at the location were advertised to the public by flyers at convenience stores in the area. The public, and not just the Taxpayer's family members, were thus being invited to the events. And there is also no evidence that any of the individuals in the facility on the night of the raid were members of the Taxpayer's family. The Taxpayer also had "staff" at the facility, as evidenced by the sign on the bar door, which further indicates that it was a business open to the public. The ABC undercover agent was also required to pay a $5 cover charge when he entered the building on the night of the raid, which was deposited into a metal box at the door. The advertising posters in the building most all indicated that there would be a cover charge for the advertised event. The agent subsequently ordered a double Crown Royal and a beer and paid $6 and $2, respectively, for those items. Finally, an ABC agent that participated in the raid stated twice at the July 17 hearing that at least 70, and perhaps up to 100, individuals were in the building at the time of the raid, not the 20 claimed by the Taxpayer.

Given the above evidence, I must conclude that the Taxpayer was operating a business open to the public, and was also selling alcohol and charging an admission fee on the nights that an entertainment event was conducted at the location.[1] The Taxpayer is thus liable for sales tax on her gross receipts from the business. The harder issue is whether the Department correctly computed those receipts.

[1] The Taxpayer also pled guilty in Montgomery County Circuit Court to selling alcohol without a license.

The Administrative Law Division, now the Tax Tribunal, has held in numerous cases that if a taxpayer fails to provide the Department with adequate records, as in this case, the Department can estimate the taxpayer's liability using the best available information.

> "If a taxpayer fails to provide adequate records, the Department is authorized to compute the taxpayer's liability using the best available information. §40-2A-7(b)(1)a. A final assessment based on the best available information is *prima facie* correct, and the burden is on the taxpayer to prove that the final assessment is incorrect. §40-2A-7(b)(5)c. The Administrative Law Division has repeatedly affirmed the Department's authority to estimate a taxpayer's liability using the best available information. *William T. Gipson v. Department of Revenue*, Docket P. 95-210 (Admin. Law Div. 4/07/95); *State v. Red Brahma Club, Inc.*, Docket S. 92-171 (Admin. Law Div. 4/07/95).

Dial Bank v. State of Alabama, Docket Nos. Inc. 95-289 and F. 95-308 (Admin. Law Div. OPO 8/10/1998), at 20.

The Division has also held, however, that the Department's calculations must be based on some minimum evidentiary foundation, and must be reasonable under the circumstances.

> Where the record reflects no reasonable basis for the Commissioner's assessment, where the assessment cannot be deemed reasonable on its face, and where no finding is made in that regard, we cannot afford a presumption of correctness to attach automatically to the assessment.
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> *Denison*, 689 F.2d, at 773.
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> Taxpayers do bear the burden of maintaining accounting records which enable them to file a correct tax return, *e.g., Webb*, 394 F.2d at 371, and in the absence of such records the IRS may compute the taxpayer's income by any reasonable method that clearly reflects income, 26 U.S.C.§446(b)(1997); however, a tax determination without rational foundation is 'not properly subject to the usual rule with respect to the burden of proof in tax cases.' *Janis*, 428 U.S. at 441, 96 S. Ct. At 3026 (citing *Helvering v. Taylor*, 293 U.S. 507, 514-15, 55 S. Ct. 287, 290-291, 79 L.Ed. 623 (1935)). As this Court eloquently noted in *Carson*: 'The tax collector's presumption of correctness has a herculean muscularity of Goliathlike reach, but we strike an Achilles' heel when we find no muscles, no tendons, no ligaments of fact.' 560 F.2d

at 696; *see also Portillo*, 932 F.2d at 1133.

Yoon, 135 F.3d, at 1013, 1014.

> Suffice it to say, however, that...having by these two witnesses convinced us that the determination was arbitrary, the Government is elevated on its own powder charge and we are required to decide nothing beyond our present finding that the determination was arbitrary.

Jackson, 73 T.C., at 403.

Dial Bank, supra, at 20.

The Department estimated the tax due in this case based on the retail value of the alcohol confiscated in the raid and the estimated number of individuals in the facility on the night of the raid. As noted, the calculations based on that evidence must be reasonable under the circumstances.

Concerning the estimated alcohol sales, there is no rational correlation between the retail value of the alcohol confiscated in the raid and the amount of alcohol sold on that night or any other night the facility may have been open. The Taxpayer testified that many of the "guests" in the building were family members that had brought their own alcoholic beverages. The Taxpayer's veracity is questionable, given that her testimony that she was not selling alcohol or charging a cover charge is directly refuted by the evidence. It is at least plausible, however, that some of the individuals in attendance may have brought their own alcohol. In any case, even if it is assumed that all of the alcohol confiscated in the raid belonged to the Taxpayer, the fact that she had alcohol on hand to sell does not prove that she sold that amount on the night of the raid, and certainly not on every night that the facility was open. If anything, it only proves that that amount of alcohol was not sold on the night of the raid.

I understand that the examiner used the retail value of the confiscated alcohol to estimate the Taxpayer's liquor sales because she had no other evidence to rely on. But relying on evidence that in no way reflects the Taxpayer's actual liquor sales is insufficient. I must find that the Department's estimated liquor sales computation is arbitrary and without a reasonable evidentiary foundation.

The examiner estimated the door receipts by multiplying the estimated number of individuals in the building at the time of the raid, i.e., 75, by the average door charge of $6. That estimate is not unreasonable under the circumstances. Some of the individuals in the building may have been family members that were not required to pay the cover charge, but again, there is no evidence supporting that claim. The reasonableness of the estimate is also bolstered by the fact that the ABC agent estimated that from 70 to 100 individuals were present on the night of the raid, and the examiner used a figure on the lower end of that estimate.

The primary problem with the Department's computations is that it assumes that the facility was open for business every Friday and Saturday night without exception from March 2013 going back to January 2008.

The business was obviously open on the night of the raid, and the Montgomery Sheriff's office indicated that the facility was also open on the prior Friday night, March 22, and also on one night of the previous weekend. The advertisement posters in the building also indicated that the club was open on August 9 and 8, 2009, see, Department Ex. 3, on "This Saturday Nite," see, Department Ex. 9, and on "Saturday Nite" and also on a Friday night, see Department Ex. 8. There were also at least two pool tournaments at the facility during the audit period. As indicated, one of the posters also stated "Est. 2008." Based on

the above, the examiner concluded that "the club had been in operation for quite some time, . . . (and that) [b]ased on this information, the nights of operation used were Friday and Saturday of each week for the last five years, going back to January 1, 2008," see, Department Ex. 11.

Evidence that the facility was open on 10 to 12 nights over the 63 month audit period does not prove that the facility was open on any other night, and certainly not every Friday and Saturday night during that 63 month period.

In substance, the Department projected the Taxpayer's estimated liability on the night of the raid onto every Friday and Saturday night of the audit period. The Department may use projections in computing a taxpayer's sales tax liability if the taxpayer fails to keep good records. For example, the Department can compute a taxpayer's liability for a period for which good records are available, and then project that liability to a period for which no or incomplete records are available. In such cases, the projection will be affirmed as reasonable, absent extraordinary circumstances. "Projecting a retailer's sales for periods in which no records are provided is reasonable and necessary in some instances." *Abdirahman A. Ali, d/b/a Delta Food Mart v. State of Alabama*, Docket S. 03-238 (Admin. Law Div. 8/2/2013) at 5.

But the Department can project a liability to a period only if there is evidence reasonably establishing that the retailer conducted business and made sales during the period. As indicated, there is no evidence in this case indicating that the Taxpayer's facility was open every Friday and Saturday night going back to January 2008.

The Montgomery County Sheriff's Office told the examiner that deputies had been watching the facility for some unspecified period. I do not doubt that deputy sheriffs had

observed the location for some period before the raid, and that they may have observed activity at the location. The building is, however, on property owned by the Taxpayer's family, and is adjacent to and between the Taxpayer's residence and her mother's residence. Consequently, some of the activity observed by the sheriff deputies may have involved only the Taxpayer's family members, as claimed by the Taxpayer. In any case, the fact that sheriff's deputies had been watching the facility for some unspecified period is also inconclusive.

Given the above facts, I must conclude that the evidence is insufficient to support the Department's assumption that the business had been open every Friday and Saturday night since January 2008.

The Taxpayer testified that the facility was open one night every two months. There is evidence, however, that the business was open three nights in March 2013. There is thus evidence supporting a finding that the facility was open three nights every other month. The audit period January 2008 through March 2013 encompasses 63 months. If the business was open three times every other month, it was open 94 nights during the audit period.[2] Given the evidence that the Taxpayer's door receipts totaled $450 each night the business was open, there is evidence supporting a finding that the Taxpayer had door receipts of $42,300 during the audit period, which results in sales tax due of $1,692 on the door receipts. The Department should compute the applicable penalties and interest due on that amount, and notify the Tax Tribunal of the adjusted amount due. An appropriate Final Order will then be entered.

[2] 63 months divided by 2 (for every other month) equals 31.5 multiplied by 3 equals 94.5, which rounds down to 94.

I understand that the Taxpayer is not being required to pay sales tax on her liquor sales. There is evidence that the Taxpayer sold liquor because most all of the posters in the facility advertised drink specials, and the business actually sold alcohol to the undercover agent on the night of the raid. But there is no evidence showing the amount of the Taxpayer's liquor sales. As discussed, the value of the liquor confiscated on the night of the raid in no way correlates to the amount of liquor sold on that or any other night. Without some reasonable evidentiary foundation, the final assessment loses its presumption of correctness. The sales tax assessed on the estimated liquor sales thus cannot be affirmed.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered October 17, 2014.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Warren W. Young, Esq.
Nicole Sawyer