MARLEN E. DUNNING D/B/A ONE LIGHTFOOT PACKAGE STORE 4402 SAINT STEPHENS ROAD EIGHT MILE, AL 36613-3507, Taxpayer, v. STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § § § § §	STATE OF ALABAMA ALABAMA TAX TRIBUNAL DOCKET NO. S. 14-962

FINAL ORDER

The Alabama Department of Revenue assessed Marlen E. Dunning ("Taxpayer"), d/b/a One Lightfoot Package Store, for State sales tax for May 2008 through July 2013. The Taxpayer appealed to the Alabama Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on March 18, 2015. The Taxpayer and his attorney, Michael McNair, attended the hearing. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer owned a convenience/liquor store, One Lightfoot Package Store, during the period in issue. The store is located within the police jurisdiction of the City of Prichard. The store primarily sold liquor, beer, wine, cigarettes, soft drinks, and snacks during the subject period.

The Department audited the store for sales tax for May 2008 through April 2011. The Department examiner requested the store's sales tax-related records. The Taxpayer provided the examiner with purchase and sales journals, and his purchase invoices. The Taxpayer was unable to provide the examiner with any cash register z-tapes because his cash register was destroyed during a break-in at the store in 2008 or 2009.

Because the examiner was not provided any sales records, she estimated the Taxpayer's liability using a purchase mark-up audit. The examiner obtained the Taxpayer's purchase information for the audit period from his primary vendors. She compared the purchases per the vendors' records with the Taxpayer's purchase invoices and determined that the records "matched up very closely." (T. 16). The examiner consequently used the Taxpayer's purchase invoices in computing his total purchases.

The examiner next applied the standard IRS mark-up of 1.41 percent to arrive at the store's estimated retail sales. The Taxpayer's attorney objected that the mark-up was excessive. The examiner consequently agreed to recompute the mark-up by comparing the Taxpayer's wholesale cost of his merchandise with the actual prices the Taxpayer was charging his customers for the merchandise. The comparison resulted in a reduced 1.33 percent mark-up, which the examiner then applied to the Taxpayer's wholesale purchases to estimate his total retail sales for the audit period.

After completing the audit for the original audit period May 2008 through April 2011, the Department reviewed the subsequent months of May 2011 through July 2013 to determine if the Taxpayer had also underreported his sales during those months. The examiner determined that the Taxpayer had continued to underreport his sales. She consequently computed the Taxpayer's average monthly purchases during the initial audit period and projected those estimated purchases over the extended audit period. She then applied the 1.33 percent mark-up to determine the additional tax due for the extended audit period.

The Department also applied the 50 percent fraud penalty levied at Code of Ala. 1975, §40-2A-11(d) because the Taxpayer's wholesale purchases during the audit period

substantially exceeded his reported retail sales.

The Taxpayer's representative disputes the final assessment on three grounds. He first contends that the 1.31 percent mark-up, although based on the Taxpayer's actual wholesale costs and retail selling prices, is excessive. He next asserts that the Department examiner failed to consider or allow him credit for at least three break-ins and considerable employee theft and pilferage during the audit period. He finally argues that the fraud penalty was improperly applied because the Taxpayer did not knowingly or intentionally underreport his sales during the period.

The Department is authorized to compute a taxpayer's correct liability using the most accurate and complete information obtainable. Code of Ala. 1975, §40-2A-7(b)(1)a. The Department can also use any reasonable method to compute the liability, and the taxpayer, having failed in the duty to keep good records, cannot later complain that the records and/or method used by the Department is improper or does not reach a correct result. *Jones v. CIR*, 903 F.3d 1301 (10th Cir. 1990); *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980) (A taxpayer must keep records showing the business transacted, and if the taxpayer fails to keep such records, the taxpayer must suffer the penalty for noncompliance).

The purchase mark-up audit is a simple, oft-used Department method of determining a taxpayer's sales tax liability when the taxpayer fails to keep accurate sales records. See generally, *GHF, Inc. v. State of Alabama*, S. 09-1221 (Admin. Law Div. 8/10/10); *Thomas v. State of Alabama*, S. 10-217 (Admin. Law Div. O.P.O. 5/18/10); *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04).

Because the Taxpayer in this case failed to maintain adequate records from which his sales could be accurately computed or verified, the Department examiner correctly conducted a purchase mark-up audit to reasonably compute the Taxpayer's liability for the audit period. The tax due as computed by the audit is by its nature an estimate, but the examiner of necessity was required to estimate the Taxpayer's liability because the Taxpayer failed to maintain adequate records. As discussed, because the Taxpayer failed to maintain good records, as required by Alabama law, he cannot now complain that the Department's computations must be rejected as inexact estimates.

The Taxpayer's store may have lost considerable merchandise through break-ins and employee theft because the store is located in a high crime area. Unfortunately, the Taxpayer failed to provide police reports or other evidence documenting the break-ins and identifying the amount or value of the merchandise taken. Under the circumstances, the tax and interest as assessed by the Department must be affirmed.

As discussed, the Department assessed the Taxpayer for the fraud penalty because his wholesale purchases substantially exceeded his reported retail sales. The Department's Administrative Law Division, now the Tax Tribunal, has affirmed the fraud penalty numerous times in similar cases, see *Zienni v. State of Alabama*, Misc. 13-294 (Admin. Law Div. 2/7/2014); *Carter Enterprises v. State of Alabama*, S. 11-965 (Admin. Law Div. 6/25/2012); *Melton v. State of Alabama*, S. 05-281 (Admin. Law Div. 4/26/2005). But while the above fact is strong evidence of fraud, it is not conclusive.

The Taxpayer used his savings to purchase the store in issue in 2005. He was working as an over-the-road truck driver at the time. He continued driving his truck, and hired relatives to run the store. According to the Taxpayer, his relatives and their friends

constantly stole merchandise from the store.

The Taxpayer stopped driving his truck in 2010 due to an illness. He started working at the store full-time at that time, but still employed his relatives to help at the business. Unfortunately, the store continued to lose merchandise through theft and pilferage.

The Taxpayer testified that he relied on his tax preparer to prepare and file his monthly sales tax numbers, and that he assumed she was correctly doing so. He claimed that he knew the store was losing money, but that he still tried to keep the store open because he did not want to lose his investment in the store. When asked why he kept the business open despite losing money, the Taxpayer replied – "Because I bought that building and I didn't want to loses my little retirement money. . . ." (T. 39).

Under the circumstances, I do not believe that the Taxpayer intentionally underreported his sales tax with the intent to fraudulently evade tax. Rather, he was simply negligent in failing to keep sales records and employing untrustworthy individuals to operate the business. Under the specific facts of this case, I find that the fraud penalty should not apply.

The tax and interest due as assessed by the Department is correct. The fraud penalty is reduced to the five percent negligence penalty levied at Code of Ala. 1975, §40-2A-11(c). Judgment is entered against the Taxpayer for tax of $20,773.99, penalty of $1,038.70, and interest of $2,036.24, for a total amount due of $23,848.93. Additional interest is also due from the date the final assessment was entered, September 24, 2014.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2B-1(m).

Entered May 6, 2015.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Duncan R. Crow, Esq.
Michael S. McNair, Esq.