ALABAMA TAX TRIBUNAL

TRIMM LANDSCAPES, INC.,	§	
Taxpayer,	§	DOCKET NO. 16-540-CE
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Trimm Landscapes, Inc. ("Taxpayer"), for State sales and use tax and City of Trussville sales tax for the period of August 1, 2009 through December 31, 2014. A hearing was conducted on January 24, 2017. Assistant Counsel Billy Young represented the Revenue Department. Doug Hill represented the Taxpayer. No one attended the hearing to testify on behalf of the Taxpayer at the hearing.

The Taxpayer is a landscaping contractor and operates a retail nursery and garden center in Trussville, Alabama. During most of the audit period, the Taxpayer was located on Cedar Street. In May 2014, the Taxpayer moved to a location on Gadsden Highway. During the audit period, the Taxpayer maintained an inventory of trees, plants, shrubs, mulch, sand, stone, gravel, fertilizer, compost and topsoil. It withdrew materials from this inventory both to sell at retail and to fulfill its landscaping contracts. The Taxpayer also ordered materials from vendors that were delivered to job sites. It is undisputed that the Taxpayer sold items at retail at both the Cedar Street and Gadsden Highway locations.

The Taxpayer was audited to determine compliance with State and local sales and use tax laws. The audit revealed that the Taxpayer purchased items for resale and for use in fulfilling landscape contracts tax-free by presenting its vendors with an invalid sales tax

license. During most of the audit period, the Taxpayer did not file sales tax returns or remit sales tax to the State or the City of Trussville on its retail sales or its withdrawals from inventory. There is at least some evidence to indicate that the Taxpayer actually collected sales tax on some of its retail sales without reporting it or remitting it to the respective taxing authority.

It is undisputed that the Taxpayer did not maintain records sufficient to determine with certainty the Taxpayer's retail sales, its mark-up, or its withdrawals of materials from inventory to fulfill its landscaping contracts. During the audit, the Taxpayer provided some sales records for 2009 through 2013. Vendor invoices were only available for 2011, 2012, 2013, and 2014. At the time of the audit, the Taxpayer had only filed income tax returns for tax years 2009 and 2010. Because the Taxpayer did not maintain sufficient records, the Department's auditor used the best available information to determine taxable sales through a purchase mark-up audit as follows.

To determine the average mark-up on the Taxpayer's retail sales, the auditor compared purchase invoices with the limited sales information available. The auditor also purchased several plants from the Taxpayer and compared the purchase price to the Taxpayer's cost of the plants. The calculations resulted in a mark-up percentage of 214% to 314%. To simplify the calculations, the auditor applied a 200% mark-up.

The auditor determined that vendor records and the Taxpayer's 2009 and 2010 returns were the most accurate and complete information reasonably available to determine the Taxpayer's total purchases, and what purchases were items later sold at retail or withdrawn and used in installation contracts. To determine the Taxpayer's retail sales and withdrawals from inventory, the auditor reviewed the vendor invoices available

for 2011, 2012, 2013 and 2014. For these periods, the auditor scheduled the purchases as withdrawals from inventory or taxable retail sales based on the information contained on the invoice. Specifically, if the invoice indicated that purchased materials were being delivered to a job site, the auditor scheduled the purchases as withdrawals from inventory. If the invoice indicated that the materials were to be delivered to the Taxpayer's retail location, the auditor scheduled the purchases as retail sales. A breakdown revealed that purchases for resale accounted for an average of 52% of total purchases in 2011, 2012, 2013, and 2014. To simply the calculations, the auditor scheduled 50% of the Taxpayer's purchases as withdrawals from inventory and 50% as purchases for resale ("the 50/50 determination"). The auditor applied the 200% mark-up to the Taxpayer's purchases for resale to determine total taxable retail sales.

The Taxpayer's cost of goods sold as reported on its income tax returns for 2009 and 2010 were used to determine the Taxpayer's purchases in those years since vendor invoices were not available. The auditor used the 50/50 determination set forth above and scheduled 50% of the cost of goods sold as withdrawals from inventory and 50% as purchases for resale. The auditor applied the 200% mark-up to the Taxpayer's cost of goods sold attributable to purchases for resale to determine total taxable retail sales.

State and City of Trussville sales tax rates were applied to the total cost of the Taxpayer's withdrawals from inventory and the Taxpayer's taxable retail sales to determine tax due. The Department entered the final assessments consisting of tax due, interest, and late file and negligence penalties for the audit period on April 8, 2016.

The Taxpayer timely appealed the assessments. On appeal, the Taxpayer asserts that the Department's audit methodology is flawed because its determination that 50% of

the Taxpayer's purchases in the audit period were purchases for resale is unreasonable. Specifically, the Taxpayer argues that a large majority of its purchases were used in fulfilling its landscaping contracts, and that its retail sales at the Cedar Street location were very minimal because it did not have a retail shop at that location. The Taxpayer also asserts that the cost of goods sold reported on the Taxpayer's 2009 and 2010 return includes labor costs that should not be included in the calculation.

On February 23, 2017, the Department filed a post-hearing response acknowledging that the cost of goods sold reported on the 2009 and 2010 returns included labor charges that should not be included in determining the taxable measure. The Department asserted that the 2009 and 2010 final assessments should be reduced in accordance with its findings as set forth in its February 23 post-hearing response.

The evidence presented indicates that the Taxpayer is a "dual business," i.e. a contractor and a retailer. As such, the Taxpayer should have obtained a valid sales tax license from the Department and purchased all materials tax-free using that license. Dept. Reg. 810-6-1-.56. The Taxpayer then should have filed monthly returns and remitted sales tax on (1) the gross proceeds derived from its retail sales, and (2) its wholesale cost of those materials withdrawn from inventory and consumed on the furnish-and-install contracts.

The dual business regulation reads in pertinent part:

> (1) The term "dual business" as used in this rule shall mean a business which both makes retail sales of tangible personal property to the public on a recurring basis and withdraws tangible personal property for use from the same stock of goods.
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> (2) Dual businesses in Alabama shall obtain a sales tax license and purchase all of the items they sell and withdraw for use at wholesale, tax-

> exempt. These businesses shall collect sales tax on their retail sales to nonexempt customers and compute sales tax on items which they withdraw from stock for use. The taxes collected on their sales to nonexempt customers and the taxes computed on their withdrawals shall be reported on their sales tax returns and remitted to the Department of Revenue. State and local sales taxes are due on withdrawals at the time and place of the withdrawal from inventory and shall be computed on the cost of the property to the business making the withdrawal. The sales taxes applicable to withdrawals are those taxes applicable in the jurisdiction where the withdrawal occurs. (Sections 40-23-1(a)(9), 40-23-1(a)(10), and 40-23-6, Code of Alabama 1975)
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> (3) To qualify as a dual business, the business must have a substantial number of retail sales. Contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling do not qualify as a dual business. Where only isolated sales are made, tax should be paid on all of the taxable property purchased with no sales tax return being required of the seller making such isolated or "accommodation" sales. (Section 40-23-1(a)(10), Code of Alabama.

If a contractor also qualifies as a dual business pursuant to Reg. 810-6-1-.56, as in this case, the contractor is not required to pay sales tax pursuant to the contractor provision when it purchases components and materials from its vendors. Rather, pursuant to paragraph (2) of the dual business regulation, the dual business contractor must purchase all items tax-free at wholesale. It should then collect and remit sales tax on the gross proceeds from its over-the-counter retail sales in Alabama, and also report and remit sales tax on its wholesale cost of the items it withdrew from inventory in Alabama and used on its furnish and install contracts.[1]

[1] The practical and obvious purpose for the dual business regulation is that if a contractor also makes over-the-counter retail sales, the contractor cannot know when it purchases building materials whether it will sell the materials at retail or use them to fulfill a furnish and install contract. Consequently, the contractor is required to purchase materials tax-free and then later report and pay tax based on whether the items are sold at retail or used and consumed by the contractor on a contract or otherwise.

In this case, the Taxpayer correctly purchased all items tax-free, albeit with an invalid sales tax number that it had previously closed with the Department. Unfortunately, the Taxpayer failed to obtain a valid sales tax account number, file returns, and remit tax on both its retail sales and its withdrawals from inventory. The Taxpayer also admittedly failed to keep records to adequately establish what wholesale purchases it withdrew and used fulfilling its landscaping contracts and what purchases were later sold at retail in its retail garden center. The Taxpayer also failed to keep records to establish its gross proceeds from retail sales.

All retailers subject to Alabama sales tax are statutorily required to keep complete accurate sales, purchase, and other records from which their correct sales tax liability can be computed. Code of Ala. 1975, §§40-2A-7(a)(1) and 40-23-9. A retailer's duty to keep sales records is straightforward and simple. The retailer must record all sales on a cash register z-tape and/or on customer invoices or receipts, which may then be compiled onto a monthly sales journal. It is commonly understood that such records must be maintained to allow the Department to verify that the correct amount tax has been reported and paid on the taxpayer's retail sales.

The Taxpayer in this case admittedly failed to provide complete sales records. In such cases, 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 auditor did so in this case by using information contained on vendor invoices, 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 its 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 estimated the Taxpayer's liability because the Taxpayer failed to maintain adequate records.

It certainly may be true that the examiner's 50/50 determination results in imputing more purchases to purchases for resale than were actually sold at retail by the Taxpayer. However, because the Taxpayer failed to maintain adequate records, as required by Alabama law, it cannot now complain that the Department's computations must be rejected as inexact estimates. The Department's audit was reasonably conducted using the best available information. What breakdown is more reasonable than a 50/50 breakdown when an auditor has no records to go by? The Taxpayer has failed to produce evidence to prove that the audit methodology was unreasonable or that it was not based on the best available information.

The final assessments based on the audit, as adjusted to exclude labor charges in the cost of goods sold in tax years 2009 and 2010, is affirmed. The Department is directed to recompute the final assessments accordingly and to respond to the Tax Tribunal by **August 17, 2018**. A Final Order will then be entered.

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, § 40-2B-2(m).

Entered July 31, 2018.

/s/ C. O. Edwards
CHRISTY O. EDWARDS
Associate Tax Tribunal Judge

cc: Doug Hill
Mary Martin Mitchell, Esq.