

**ALABAMA TAX TRIBUNAL**

GELATO JOE’S, LLC,	§	
Taxpayer,	§	DOCKET NO. COUNTY 18-103-CE
v.	§	
BALDWIN COUNTY SALES & USE TAX DIVISION	§	

**FINAL ORDER**

The Baldwin County Sales & Use Tax Division (“Division”) denied a sales tax refund request submitted by Gelato Joe’s, LLC (“Taxpayer”) for a previously paid fraud penalty assessed against the Taxpayer. The Taxpayer timely appealed the Division’s denial of its refund request to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(c)(5). A hearing was conducted on September 20, 2018. Attorney David Conner represented the Division. Attorney S. C. Middlebrooks represented the Taxpayer.

The Taxpayer operated a restaurant in the City of Foley in Baldwin County, Alabama. The Alabama Department of Revenue (“Revenue Department”) audited the Taxpayer to determine compliance with State sales tax laws. The Revenue Department’s audit revealed that the Taxpayer underreported its sales to the State by 74% for the period of July 2009 through June 2015. Specifically, the Revenue Department’s audit revealed that the Taxpayer’s taxable gross proceeds from sales during the audit period were \$2,653,613.49, but that the Taxpayer only reported sales in the amount of \$679,661.35. The Taxpayer did not dispute the Revenue Department’s audit with respect to its determination of total taxable sales.

Following the Revenue Department's audit, and using its determination of total taxable sales, the Division entered a preliminary assessment for Baldwin County sales tax. In addition to tax and interest totaling \$81,043.93, the Division assessed a 50% fraud penalty in the amount of \$28,581.79.

After the preliminary assessment was entered, the Division waived a portion of the fraud penalty. On July 20, 2016, the Division entered a final assessment against the Taxpayer in the amount of \$99,625.72, consisting of tax and interest in the amount of \$81,043.93 and a reduced fraud penalty in the amount of \$18,591.79. The Taxpayer paid the tax and interest assessed and appealed the fraud penalty to the Tax Tribunal on May 22, 2017. The appeal was docketed and assigned docket number County 17-103-CE. On August 24, 2017, the Tax Tribunal dismissed the Taxpayer's appeal because it was not filed within the 30-day appeal period.

On September 14, 2017, the Taxpayer paid the fraud penalty as assessed in the preliminary assessment. On October 2, 2017, the Taxpayer petitioned the Division for a refund of the previously paid fraud penalty in the amount of \$28,581.79. The Division denied the Taxpayer's request by letter dated March 26, 2018. The Taxpayer appealed the Division's denial to the Tax Tribunal on April 18, 2018.

The Division assessed the Taxpayer for the fraud penalty because it failed to maintain records, and because it consistently and grossly underreported its sales to Baldwin County. All taxpayers are required to maintain adequate records from which their correct tax liability can be accurately ascertained. Code of Ala. 1975, §40-2A-7(a)(1). Code of Ala. 1975, §40-2A-11(d) levies a 50 percent fraud penalty for any underpayment

of tax due to fraud. For purposes of the penalty, “fraud” is given the same meaning as ascribed in the federal fraud provision, 26 U.S.C. §6663. Consequently, federal authority should be followed in determining if the fraud penalty applies. *Best v. State, Dept. of Revenue*, 423 So.2d 859 (Ala. Civ. App. 1982).

The existence of fraud must be determined on a case-by-case basis from a review of the entire record. *Parks v. Commissioner*, 94 T.C. 654, 660 (1990). Because fraud is rarely admitted, “the courts must generally rely on circumstantial evidence.” *U.S. v. Walton*, 909 F.2d 915, 926 (6<sup>th</sup> Cir. 1990). Consequently, fraud may be established from “any conduct, the likely effect of which would be to mislead or conceal.” *Id.* The mere under reporting of gross receipts is itself insufficient to establish a finding of fraud, unless there is evidence of repeated understatements in successive periods when coupled with other circumstances showing an intent to conceal or misstate sales. *Barrigan v. C.I.R.*, 69 F.3d 543 (1995).

A taxpayer’s failure to keep adequate books and records, a taxpayer’s failure to furnish auditors with records or access to records, the consistent underreporting of tax, and implausible or inconsistent explanations regarding the underreporting are strong indicia of fraud. See *Solomon v. C.I.R.*, 732 F.2d 1459 (1984); *Wade v. C.I.R.*, 185 F.3d 876 (1999). Ignorance is not a defense to fraud where the taxpayer should have reasonably known that its taxes were being grossly underreported. *Russo v. C.I.R.*, T.C. Memo 1975-268; *Temple v. C.I.R.*, 67 T.C. 143 (1976).

It is undisputed that the Taxpayer consistently and grossly underreported its sales to the Division. At the hearing, the Taxpayer’s owner, Joe LaSala, testified openly. He

did not dispute that the Taxpayer underreported its sales in the amount determined by the Revenue Department, but he offered no explanation for the Taxpayer's consistent and gross underreporting of sales for a period of nearly six years. LaSala also could not testify as to how sales tax was collected on the Taxpayer's retail sales other than that his bookkeeper was reporting incorrectly. He merely pled that he was completely ignorant regarding the restaurant's sales and his staff's reporting of those sales to the State and to the Division.

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). The fact that the Taxpayer's retail sales were more than 50 percent underreported, that the underreporting was consistent throughout the audit period, and that the Taxpayer refused to offer a single, plausible explanation for such significant and consistent underreporting supports a finding that the Division correctly applied the fraud penalty in this case.

The testimony regarding the Division's waiver of a portion of the penalty is conflicting. Based on the lack of evidence regarding the waiver, I decline to increase the amount of the final assessment entered on July 20, 2016 to include the full amount of the fraud penalty.

The Division's denial of the Taxpayer's refund request is partially affirmed in the amount of \$18,581.79, which represents the portion of the fraud penalty assessed against

the Taxpayer in the final assessment entered against it on July 20, 2016. The Taxpayer is due a refund in the amount of \$10,000, plus interest, which represents the amount he overpaid when he paid the assessment on October 2, 2017. Judgment is entered accordingly.

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

Entered January 14, 2019.

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

cc: S.C. Middlebrooks, Esq.  
David J. Conner, Esq.