ALABAMA TAX TRIBUNAL

JAI KRU, LLC,	§	
Taxpayer,	§	DOCKET NO. S. 18-387-LP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

This appeal involves a final assessment of State sales and local tax for April 2012 through August 2016, including a fraud penalty. A hearing was conducted on February 12, 2019. The Taxpayer was notified of the hearing, but failed to attend. Assistant Counsel Hilary Parks represented the Revenue Department. Department examiner Bill Crownover also attended the hearing.

The Taxpayer operated a convenience store within the city limits of Wetumpka, Alabama, during the period at issue. The store primarily sold the following: gasoline, tobacco products, groceries, wine, beer, and prepaid wireless.

The Department's examiner, Bill Crownover, audited the store to determine compliance with State sales tax laws during the subject periods. The examiner requested the store's sales tax-related records, including the following: all books and records used to prepare sales tax returns; sales invoices and sale journals; cash register z-tapes; purchase invoices; income tax returns; and cancelled checks and bank statements. The Taxpayer provided some bank records, income tax records, sales tax reports, EBT information, and check stubs. The Taxpayer did not provide the examiner with any cash register z-tapes.

Because the examiner was not provided complete information regarding the Taxpayer's purchases, and was provided no sales records, he estimated the Taxpayer's liability using a purchase mark-up audit. The examiner obtained the Taxpayer's purchase information for the audit period from the Taxpayer's vendors. He compared the purchases per the vendors' records with the purchase information provided by the Taxpayer and determined that the records provided by the Taxpayer were grossly incomplete. The auditor compared the Taxpayer's total purchases, calculated by invoices supplied by the Taxpayer's vendors, to the Taxpayer's reported sales and determined that the Taxpayer's purchases far exceeded its reported sales for the audit period.

The examiner next applied the standard IRS mark-up of 1.47 percent to arrive at the store's estimated retail sales. The Taxpayer's representative objected in his notice of appeal that the mark-up was excessive. Prior to the entry of the final assessments, the markup was reduced to 35 percent.

Having determined that he had adequate purchase invoices from the Taxpayer's vendors, the examiner determined that the best audit method to determine taxable sales was a purchase mark-up audit. The purchase invoice cost information and the observed selling prices of the items were used to calculate a weighted average profit-over-cost mark-up for each vendor. The mark-up for each vendor was applied to the Taxpayer's purchases from that vendor during the audit period to calculate total sales.

The audit revealed that the Taxpayer's sales were over 50 percent underreported. Because the Taxpayer's wholesale purchases during the audit period substantially and consistently exceeded its reported retail sales, the examiner also applied the 50 percent fraud penalty levied at Ala. Code § 40-2A-11(d).

The Taxpayer was billed for the additional tax due, interest and a fraud penalty. Billing progressed to entry of State and local final assessments on March 7, 2018, in the amounts of $215,744.57 and $215,744.57, respectively.

The Taxpayer timely appealed. In its Notice of Appeal, the Taxpayer's representative asserted that the Taxpayer was not liable for the fraud penalty because it did not knowingly or intentionally underreport its sales during the period.

The Department timely filed its Answer, asserting that the Taxpayer failed to maintain records and that it substantially and consistently underreported sales without single explanation. This conduct, it argues, is strong evidence of fraud. For this and other reasons set forth below, I agree.

The Department is authorized to compute a taxpayer's correct liability using the most accurate and complete information obtainable. Ala. Code § 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) (holding that 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. However, out of necessity, the examiner was required to estimate the Taxpayer's liability because the Taxpayer failed to maintain adequate records.

As discussed, the Department assessed the Taxpayer for the fraud penalty because it failed to maintain records, and because its wholesale purchases substantially and consistently exceeded its reported retail sales. Ala. Code § 40-2A-11(d) levies a 50 percent fraud penalty for any underpayment of tax due to fraud. The burden of proof in an assessment of a fraud penalty falls on the Department. Ala. Code § 40-2B-2(k)(7). 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 (6th 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).

The Department's Administrative Law Division, now the Tax Tribunal, has affirmed the fraud penalty numerous times in similar cases, see *GHF, supra*, and *Alsedeh, supra*. 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 Department correctly applied the fraud penalty in this case. The Department thus met its burden to prove fraud. As indicated, the Taxpayer failed to attend the February 12, 2019, hearing and has otherwise failed to prove that the remaining aspects of the prima facie correct final assessments are incorrect.

The State and local final assessments are affirmed. Judgment is entered against the Taxpayer for tax, interest, and the fraud penalty in the amounts of $215,744.57 and $215,744.57, respectively. Additional interest is also due from the date the final assessments were entered, March 7, 2018.

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

Entered March 18, 2019.

/s/ Leslie H. Pitman
LESLIE H. PITMAN
Associate Tax Tribunal Judge

lhp:dr
cc: Alpesh Patel, CPA
Hilary Y. Parks, Esq.