

**ALABAMA TAX TRIBUNAL**

SAKU LLC, §  
Taxpayer, § DOCKET NO. S. 19-420-LP  
v. §  
STATE OF ALABAMA §  
DEPARTMENT OF REVENUE.

**FINAL ORDER**

This appeal involves disputed final assessments of State sales tax and prepaid wireless service charge for February 1, 2015, through February 28, 2017. A hearing was conducted on October 3, 2019. The Taxpayer’s owner, Sultanalay Berani, attended the hearing. Assistant Counsel Mary Martin Mitchell represented the Alabama Department of Revenue. Department examiner Marie Vernon also attended the hearing.

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

The Revenue Department’s examiner, Marie Vernon, audited the stores to determine compliance with State sales tax laws during the subject periods. The examiner requested the stores’ 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 records that the examiner determined were incomplete. The Taxpayer also submitted some sales journals and z-tapes, which had numerous months missing.

Because the examiner was not provided complete information regarding the Taxpayer's purchases, she compared the reported sales from the Taxpayer's sales tax returns against the available records to determine if the records supported the reported sales figures. Those comparisons revealed that the sales were substantially underreported. For example, the Taxpayer's records indicated \$195,968.75 in taxable sales, but only \$102,808.02 in sales was reported for the three month sample of April 2015, February 2016, and August 2016. The Department then reviewed the adjusted z-tapes, which showed taxable sales of \$201,170.15, but, again, only \$102,808.02 in sales was reported on the returns. The examiner next applied the standard IRS mark-up of 1.35 percent on purchases to arrive at the stores' estimated retail sales.

The Taxpayer subsequently submitted z-tapes for three months outside of the audit period. Prior to the entry of the final assessments, the markup was reduced to 1.27 percent to align with these additional records.

The audit revealed that the Taxpayer's purchases for the audit period were over \$2 million, but it only reported sales of \$1.4 million. 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).

As to the Prepaid Wireless 911 Charge, the Taxpayer failed to file returns for the period in issue. The examiner contacted the Taxpayer's vendor to request purchase records. She determined monthly transactions by the monthly purchases and listed those on a Schedule C. The final assessment is based on that Schedule C.

The Taxpayer was assessed for the additional sales tax due, interest, and a fraud penalty of \$73,991.17, and Prepaid Wireless 911 Charge of tax, interest, and a late-filing penalty of \$987.39.

The Taxpayer timely filed a notice of appeal. The Taxpayer does not contest that it owes the tax due but has requested that the fraud penalty be waived.

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

As discussed, the Department assessed the Taxpayer for the fraud penalty because it failed to maintain adequate 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 (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).

Any retailer should know with certainty that sales records must be maintained for audit purposes. When asked why the Taxpayer failed to maintain complete z-tapes or sales journals, Mr. Berani did not have an explanation. He stated that he let his store manager report the sales to his CPA directly. He could not explain how the manager determined the sales figures. Mr. Berani did not inspect records or otherwise verify the sales figures. Rather than researching the possible causes and offering testimony as to why the Taxpayer's sales were consistently and significantly underreported, a fact with which he agrees, Mr. Bernani merely pled that he was completely ignorant regarding his stores' sales and his manager's reporting of those sales to the State.

The Department's Administrative Law Division, precursor to 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, that the Taxpayer failed to provide complete records, 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.

It is reasonable that the Taxpayer should have known the taxes were grossly underreported. The Department thus met its burden to prove fraud.

The State sales tax and Prepaid Wireless 911 Charge final assessments are affirmed. Judgment is entered against the Taxpayer for \$73,991.17 and \$987.39, respectively. Additional interest is also due from the date the final assessments were entered, February 19, 2019.

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

Entered October 4, 2019.

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

lhp:dr

cc: Sultanaly N. Berani  
Mary Martin Mitchell, Esq.