ALABAMA TAX TRIBUNAL

SELMA FOOD MART, LLC, AND ITS SOLE MEMBER, ABDUL ALMOJADID,	§	
Taxpayer,	§	DOCKET NO. S. 17-1161-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

This appeal involves a final assessment of state sales tax for April 2013 through June 2016 entered by the Alabama Department of Revenue against Selma Food Mart, LLC, and its sole member, Abdul Almojadid (collectively referred to as the Taxpayer). The assessment also includes interest and the fraud penalty. A hearing was conducted on November 14, 2018, followed by the submission of briefs. Blake Madison represented the Taxpayer, and Mr. Almojadid testified at the hearing. Ralph Clements, III, represented the Revenue Department, and Monalisa Harbin and Brian Richardson testified on the agency's behalf.

Questions Presented

1) Did the Taxpayer show that the mark-up percentage used by the Revenue Department to estimate the Taxpayer's taxable sales was excessive?

2) Did the Taxpayer prove that the final assessment was incorrect based on certain procedural and other claims?

3) Did the Revenue Department prove that the Taxpayer's underreporting of taxable sales was fraudulent?

Facts and Procedural History

The Taxpayer operates a convenience store in Selma, Alabama. The store primarily sells cigarettes, tobacco, and beer, as well as gasoline.

The Revenue Department audited the Taxpayer to determine its compliance with the state's sales tax laws during the periods at issue. In the audit report, the Revenue Department's examiner, James Dyer,[1] stated that he had requested the store's sales tax-related records, including the following: all books and records used to prepare sales tax returns; z-tapes and cash register files; purchase invoices, income tax returns; and cancelled checks and bank statements. Mr. Dyer then stated that the Taxpayer provided no records. Therefore, the examiner used bank statements and cancelled checks of the Taxpayer that the Revenue Department had obtained by subpoena concerning a previous audit of a different LLC that had been operated by Mr. Almojadid. Those bank statements were reviewed for the original audit period of March 2013 through October 2015. The Taxpayer's debit card inventory purchases and cancelled checks to vendors were listed and totaled to arrive at an estimate of the goods purchased by the Taxpayer for resale. That amount was then compared to the sales amounts reported on the Taxpayer's sales tax returns, which revealed that the Taxpayer's identifiable purchases exceeded reported sales by 102% or $733,256.03. For the months of November 2015 through June 2016, the amounts purchased by the Taxpayer from vendors were estimated by taking an average of the monthly purchases from March 2013 through October 2015.

[1]At the time of this appeal, Mr. Dyer was no longer an employee of the Revenue Department. Ms. Harbin took over the case after Mr. Dyer left.

The examiner also reviewed the Taxpayer's bank deposits which consisted of cash, checks, credit card receipts, and tobacco rebates. According to the examiner's report, the deposits were adjusted for tobacco rebates, EBT transactions, and sales tax to arrive at taxable deposit amounts. Those amounts were compared to the taxable sales amounts reported on the Taxpayer's sales tax returns, which showed that the adjusted-deposits amount exceeded reported sales by 160% or $580,859.02.

The examiner then performed a purchase mark-up audit to arrive at the Taxpayer's estimated taxable sales. When such an audit is used, a retailer's sales tax liability is computed by determining the retailer's wholesale purchases and applying a retail mark-up percentage to determine the retailer's estimated retail sales. Sales tax is computed on those estimated sales. A credit for sales tax previously reported and remitted is then allowed to arrive at any additional sales tax due.

In this case, the examiner combined IRS statistical information from the "Food and Beverage Stores" and "Gasoline Stations" classifications and applied a mark-up of 35 percent to the Taxpayer's wholesale purchases, including the estimated months, to arrive at the Taxpayer's estimated retail sales. The examiner then subtracted reported sales and EBT card sales to arrive at the additional taxable measure. Additional sales tax was calculated on that amount. The examiner also applied the 50-percent fraud penalty found in Ala. Code § 40-2A-11(d). The Revenue Department entered its final assessment on August 30, 2017, from which the Taxpayer timely appealed to the Tax Tribunal.

Analysis

The Revenue Department's mark-up percentage

The Taxpayer argues that the Revenue Department's mark-up percentage was

excessive, especially for a store located in Dallas County, Alabama. During the hearing, the Taxpayer introduced four exhibits (A through D) that purported to show that the Taxpayer's mark-up percentage for cigarettes, beer, and various candy and food items was well below 35 percent. Therefore, the Taxpayer argued that its estimated sales and thus its sales tax liability were overstated.

First, Alabama's sales-tax law is clear that retail sellers of tangible personal property, such as the Taxpayer, are required to add sales tax to the gross proceeds of a taxable sale. *See* Ala. Code § 40-23-26(a). "It shall be unlawful for any person . . . to fail or refuse to add to the sales price and collect from the purchaser the amount required by this section to be so added to the sales price and collected from the purchaser. . ." Ala. Code § 40-23-26(b). Here, though, the Taxpayer did not report its taxable sales to the Revenue Department in such a manner. Instead, Mr. Almojadid testified that the Taxpayer's reported sales were derived by marking up its purchase invoices by 18 percent. That approach clearly was unlawful.

Second, Alabama law required the Taxpayer to maintain complete records to determine the correct amount of sales tax due. *See* Ala. Code § 40-2A-7(a)(1). But the Taxpayer did not do so, testifying instead that it threw away the records, known as z-tapes, that would have eliminated the need for the Revenue Department to estimate the Taxpayer's sales. And concerning Taxpayer's exhibits A through D, all relate to periods subsequent to the periods under assessment.

Having failed in its duties to properly report the tax and to keep accurate records, the Taxpayer's claim that the Revenue Department's estimation is excessive is

unpersuasive. *See State v. Ludlum*, 384 So.2d 1089, 1091 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980) (stating that a taxpayer must keep records showing its business transacted, and if the taxpayer fails to keep such records, the taxpayer must suffer the penalty for noncompliance). Thus, the Revenue Department's mark-up percentage is upheld.

The Taxpayer's procedural and other claims

The Taxpayer argues that it never received the preliminary assessment and, consequently, that the final assessment is void. Alabama's Taxpayers' Bill of Rights requires the Revenue Department to mail a preliminary assessment to a taxpayer's last known address or to personally serve the assessment on a taxpayer. Ala. Code § 40-2A-7(b)(3). During the hearing, the Taxpayer confirmed that the Revenue Department had the Taxpayer's correct mailing address and that, if the Revenue Department had mailed the preliminary assessment to that address, it is possible that one of the Taxpayer's employees received the preliminary assessment. Further, it is indisputable that the final assessment, which contained the same address of the Taxpayer, actually was received by the Taxpayer, because the Taxpayer timely appealed that assessment to the Tax Tribunal. Suffice it to say that the Taxpayer did not prove its claim regarding the Revenue Department's mailing of the preliminary assessment.

The Taxpayer also claims that the Revenue Department's sales calculations should have been reduced for theft or spoilage. The Revenue Department responds that its 35 percent mark-up already includes such an allowance. Regardless, as noted by the Revenue Department, the Taxpayer presented no evidence to show any amount or rate of theft or spoilage and, if the Taxpayer had kept records, there would have been no need for

an estimation of the Taxpayer's sales. The Revenue Department is correct. With no proof of theft or spoilage provided by the Taxpayer, there is no factual basis for such an adjustment.

The Taxpayer claims that the Revenue Department erroneously included purchase invoices in the Taxpayer's audit that related to a separate entity known as Fast Mart, LLC, and that these invoices totaling approximately $8,000 should be removed from the mark-up calculations. (The invoices were introduced in the hearing as Taxpayer's Exhibit E.) But the Taxpayer's testimony concerning Fast Mart was inconclusive. Mr. Almojadid testified that he did not personally order the items for Fast Mart, but the Taxpayer could not specify how it obtained Fast Mart's invoices (which totaled less than $2,000). Nor could the Taxpayer answer the Tax Tribunal's question of why the Taxpayer would pay for items that were sold by Fast Mart. The Taxpayer also stated that it was possible that the items on the Fast Mart invoices actually were delivered to the Taxpayer and sold by the Taxpayer. Obviously, the Taxpayer's claim here is unproven and no adjustment is warranted.

Next, the Taxpayer claims that the Revenue Department failed to remove from its calculations certain credits that were granted to the Taxpayer by its vendors. Taxpayer's Exhibit F lists vendor invoices which contain two credit entries. But a Revenue Department witness testified that, according to the auditor's report, vendor invoices were reviewed to confirm purchase information from the Taxpayer's bank statements and that data provided by vendors generally shows the net amount paid by retailers to their vendors. Thus, any credits given to the Taxpayer here by its vendors would have been included in the data obtained by the Revenue Department. Also, the debit amounts in bank statements used by the auditor would have reflected such net amounts. Again, the Taxpayer has not proven

that an adjustment is warranted.

The Taxpayer also argues that it was not credited for sales tax it paid, as shown on its Exhibit G. In its brief, the Revenue Department agrees that these amounts should be removed from the audit and that the final assessment should be adjusted accordingly. Therefore, the Revenue Department will be directed to make such adjustments.

The fraud penalty

The Taxpayer argues that the Revenue Department has failed to meet its burden of proving that the Taxpayer committed fraud. At the most, the Taxpayer states that it was negligent in its underreporting of taxable sales.

Alabama Code § 40-2A-11(d) levies a 50-percent penalty for any underpayment of tax that is due to fraud. The burden of proof in such an assessment falls on the Revenue 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.

Federal case law declares fraud to exist when a "taxpayer has engaged in conduct with the intent to evade taxes that he knew or believed to be owing." *U.S. v. Walton*, 909 F.2d 915, 926 (6th Cir. 1990). 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*, supra. at 926. Consequently, fraud may be established from "any conduct, the likely effect of which would be to mislead or conceal." *Id.* The mere underreporting of gross receipts is insufficient to establish a finding of fraud, unless there is evidence of repeated underreporting in successive periods along with other circumstances

that show an intent to conceal or misstate sales. *Barrigan v. C.I.R*., 69 F.3d 543 (1995).

It is well settled that 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, 1461 (6th Cir. 1984); *Wade v. C.I.R*., 185 F.3d 876 (10th Cir. 1999). Ignorance is not a defense to fraud where a taxpayer reasonably should have known that its taxes were being grossly underreported. *Russo v. C.I.R.,* T.C. Memo 1975-268 (U.S.T.C. 1975); *Estate of Temple v. C.I.R*., 67 T.C. 143 (U.S.T.C. 1976).

Here, the Revenue Department showed that the Taxpayer consistently purchased significantly more inventory than it reported to the Revenue Department as sales proceeds over a multi-year period. In fact, the original audit numbers showed that the Taxpayer purchased approximately $1.37 million dollars of inventory during the audit period. But, during that same period, the Taxpayer reported gross sales of only $600,000 on its returns. There was not a single month during the audit period when the Taxpayer's reported sales exceeded or even equaled the Taxpayer's purchases of inventory for that month. During the hearing, Mr. Almojadid had no explanation for how the Taxpayer's returns were so consistently and grossly understated, choosing instead to vaguely question the numbers. Also, despite owning several other businesses in the Selma and Tuscaloosa areas, Mr. Almojadid stated that, prior to receiving the final assessment in this case, he consistently discarded cash register z-tapes and maintained no sales records for the audit period at issue.

The facts that the Taxpayer's retail sales were grossly underreported, that the underreporting was consistent throughout the audit period, that the Taxpayer maintained no records to determine its liability, and that the Taxpayer refused to offer a single, plausible explanation for such significant and consistent underreporting show that the Revenue Department met its burden of proving fraud. Therefore, the fraud penalty is upheld.

Conclusion

The final assessment is affirmed in all respects except as to the issue concerning sales tax paid by the Taxpayer, as mentioned. The Revenue Department is directed to recalculate the final assessment to give the Taxpayer credit for any such tax paid. A Final Order then will be entered based on this opinion. The Revenue Department is directed to notify the Tax Tribunal of the recalculated amount no later than **October 16, 2020**.

It is so ordered.

Entered September 9, 2020.

/s/ *Jeff Patterson*
JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:dr
cc: Blake A. Madison, Esq.
Ralph M. Clements, III, Esq.