ALABAMA TAX TRIBUNAL

ABDUL ALMOJADID,	§	
Taxpayer,	§	DOCKET NO. S. 18-183-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

The Alabama Department of Revenue entered two final assessments of tax against Abdul Almojadid, doing business as A1 Food Mart, from which Mr. Almojadid (the Taxpayer) timely appealed to the Alabama Tax Tribunal. One final assessment was for state sales tax and totaled $851,908.81. The other final assessment was for "local" tax and totaled $587,845.76. Both assessments covered the periods of January 2012 through October 2015, and both included interest and the fraud penalty. When the Revenue Department answered the Taxpayer's Notice of Appeal, it agreed that its assessment for local tax should be voided because it no long administered taxes for that locality. Therefore, this opinion will focus solely on the assessment for state sales tax. A hearing was held on October 30, 2018, followed by certain adjustments to the sales tax final assessment agreed upon by the parties and then by the submission of briefs. The Taxpayer testified at the hearing, as did the Revenue Department's examiner and its Sales and Use Tax hearings officer.

Questions Presented

Because of the Taxpayer's lack of sales records, the Revenue Department conducted a purchase mark-up audit, by which the Revenue Department attempted to

determine the Taxpayer's monthly wholesale purchases during the audit period. Those purchase amounts were then increased – or marked up – by 35 percent to determine the Taxpayer's taxable sales. The questions presented are:

1) Whether the Taxpayer proved that the Revenue Department's estimates of the Taxpayer's taxable sales were excessive?
2) Whether the Taxpayer documented the amount of liquor excise tax that it claimed should be removed from the tax base?
3) Whether the Revenue Department proved that the Taxpayer's underreporting of taxable sales was fraudulent?

Law

Alabama law imposes a privilege or license tax – known as the sales tax – on those who are "engaged . . . in the business of selling at retail any tangible personal property whatsoever. . ." *See* Ala. Code § 40-23-2(1). The seller is required to add the tax to the sales price of the item and collect the tax from the purchaser, pursuant to Ala. Code § 40-23-26(a). Then, the seller generally is required to report and remit the tax monthly. Ala. Code § 40-23-7(a).

The pertinent statutes regarding the Revenue Department's audit and assessment functions read as follows:

> (1) In addition to all other recordkeeping requirements otherwise set out in this title, taxpayers shall keep and maintain an accurate and complete set of records, books, and other information sufficient to allow the department to determine the correct amount of value or correct amount of any tax, license, permit, or fee administered by the department. . .
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> (2) The department may examine and audit the records, books, or other relevant information maintained by any taxpayer or other person for the

purpose of computing and determining the correct amount of value or correct amount of any tax, license, or fee administered by the department. . .

Ala. Code § 40-2A-7(a)(1) – (2).

(b) *Procedures governing entry of preliminary and final assessments; appeals therefrom.*

(1) ENTRY OF PRELIMINARY ASSESSMENT; FINAL ASSESSMENT OF UNCONTESTED TAX; EXECUTION OF PRELIMINARY AND FINAL ASSESSMENTS.

a. If the department determines that the amount of any tax as reported on a return is incorrect, or if no return is filed, or if the department is required to determine value, the department may calculate the correct tax or value based on the most accurate and complete information reasonably obtainable by the department. The department may thereafter enter a preliminary assessment for the correct tax or value, including any applicable penalty and interest.

. . .

(2) TIME LIMITATION FOR ENTERING PRELIMINARY ASSESSMENT. Any preliminary assessment shall be entered within three years from the due date of the return, or three years from the date the return is filed with the department, whichever is later, or if no return is required to be filed, within three years of the due date of the tax, except as follows:

a. A preliminary assessment may be entered at any time if no return is filed as required, or if a false or fraudulent return is filed with the intent to evade tax.

b. A preliminary assessment may be entered within six years from the due date of the return or six years from the date the return is filed with the department, whichever is later, if the taxpayer omits from the taxable base an amount properly includable therein which is in excess of 25 percent of the amount of the taxable base stated in the return.

. . .

Ala. Code § 40-2A-7(b)(1) – (2).

(d) *Underpayment due to fraud.* If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of that portion of the underpayment which is attributable to fraud.

> For purposes of this section, the term "fraud" shall have the same meaning as ascribed to the term under 26 U.S.C. Section 6663, as in effect from time to time.

Ala. Code § 40-2A-11(d).

Facts

The Taxpayer testified that he moved to the United States with his parents in 1991, when he was about twelve years of age. A few years later, he moved to North Carolina and worked for his brothers in their convenience-store business. From there, the Taxpayer moved to Alabama in late 2006. He opened his first convenience store in January of 2007 – in Tuscaloosa. The audit at issue here involved six convenience stores owned by the Taxpayer – four in Selma, one in Birmingham, and the one in Tuscaloosa. The Taxpayer owned a seventh store, whose audit and assessment were the subject of *Selma Food Mart, LLC, and its sole member, Abdul Almojadid v. State of Alabama Dep't of Revenue,* Alabama Tax Tribunal, S. 17-1161-JP (Opinion and Preliminary Order, September 9, 2020).

Concerning the stores under audit here, the Taxpayer stated that he did not maintain any sales records by which his actual taxable sales could be determined. For example, he discarded his cash register "z tapes," which record each retail transaction that is processed by the register, because he said that the volume of paper was excessive, and he thought he would not need them. Instead, each month, the Taxpayer provided his bookkeeper with wholesale purchase invoices from the Taxpayer's vendors, and the bookkeeper used those wholesale amounts as the basis for reporting taxable retail sales on the Taxpayer's monthly returns. According to the Taxpayer, the bookkeeper applied some mark-up percentage to the wholesale purchase amounts and reported those numbers on the sales-tax returns as the Taxpayer's taxable sales, although the Taxpayer's testimony was unclear whether the

bookkeeper's mark-up percentage was the sales-tax rate or an estimated average-profit percentage. However, when the Taxpayer made a retail sale, he testified that he added sales tax to the retail selling price and collected the tax from his customers. All sales proceeds, including the collected tax, were deposited into the Taxpayer's bank account and were used to pay tax and bills of the business. The Taxpayer stated that he filed sales-tax returns every month and remitted the amounts shown due on those returns.

To perform its audit, the Revenue Department requested the Taxpayer to provide the following: all records that were used to prepare sales-tax returns, sales invoices and journals, z-tapes and recaps of sales, purchase invoices, income tax returns, and bank statements with cancelled checks, among other items. The Taxpayer provided some, but not all, monthly sales recap sheets and purchase invoices, along with bank statements (without cancelled checks), and income tax returns for 2012 and 2013. The Revenue Department subpoenaed the cancelled checks from the Taxpayer's bank.

Concerning one particular monthly sales recap sheet, which the Revenue Department introduced as Exhibit 3, the examiner testified that it was provided by the bookkeeper and that the amounts listed on it as "gross sales" actually were the amounts of items purchased at wholesale for the four Selma stores for that month. Food-stamp sales were subtracted from "gross sales" to arrive at "net sales" amounts. The examiner confirmed that the Taxpayer provided no actual sales records by which taxable sales could be determined. And, despite being requested to provide all recap sheets for all months under audit, there were only four months for which reports were provided for all six stores. Of those, only two matched the taxable sales amounts reported on the returns.

Because of the lack of sales documentation from the Taxpayer, the examiner totaled the purchase invoices and compared those totals with the amounts reported on the returns. The examiner also compared those totals with the Taxpayer's bank deposits and income-tax returns. She subsequently adjusted (lowered) the purchase totals based on additional information provided by the Taxpayer. The examiner testified that the Taxpayer's purchases greatly exceeded the amount of sales reported. Specifically, purchases for all six stores during the audit period totaled $12 million, but the Taxpayer reported only about $4 million in taxable sales during that same period. Consequently, a purchase mark-up audit was performed, followed by the entry of the final assessment.

Analysis

Estimating the Taxpayer's taxable sales

The Taxpayer argues that the Revenue Department's estimation of his taxable sales is too high for three reasons – the Taxpayer's actual mark-up is lower than 35 percent; there was no allowance for theft or spoilage; and occasional sales were extrapolated over the entire audit period. Because a final assessment is presumed correct, the burden is on the Taxpayer to prove that the assessment is incorrect. *See* Ala. Code § 40-2A-7(b)(5)c.3.

In his brief, the Taxpayer states that he cannot mark up his items that are for sale by a percentage as high as 35 because his stores are located in low-income neighborhoods. But the Taxpayer offered no proof of the actual mark-up percentage that he used during the audit period and, as stated, he maintained no sales records by which the Revenue Department could determine his actual sales. The Taxpayer also offered no proof of any amount of theft or spoilage by which the Revenue Department's estimates should be

reduced. The Taxpayer claims that the extrapolation of occasional or seasonal sales over the entire audit period artificially increased the Revenue Department's estimates of taxable sales. However, the examiner testified that she worked with the Taxpayer's representative after the audit to revise the purchase estimates and that most of the occasional and seasonal sales were addressed in those revisions. Therefore, the Taxpayer has not met his burden as to these claims.

The liquor excise tax

The Taxpayer states that private retail sellers of liquor are not required to collect sales tax on the excise tax that is included in the cost of liquor. Thus, the Taxpayer claims that the Revenue Department should have lowered the Taxpayer's liquor purchases by the excise-tax amounts before applying the mark-up percentage. During the hearing, the Revenue Department's representative agreed in principle, but neither party knew how much liquor excise tax had been paid. In its post-hearing brief, the Revenue Department changed its position on whether the excise tax is to be included in the taxable measure for sales-tax purposes. It is unnecessary, however, to address that legal question, because the Taxpayer was unable to determine the amount of excise tax he paid during the audit period. Therefore, the Taxpayer has not made the requisite factual showing to prove his claim.

The fraud penalty

Ala. Code § 40-2A-11(d) levies a 50-percent penalty for any underpayment of tax due to fraud. The burden of proof in an assessment of a fraud penalty 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. 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 underreporting 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).

Here, the Taxpayer, who had prior experience in the convenience-store business, maintained no sales records for any of the 46 months in the audit period. Instead, he supplied his bookkeeper with some wholesale purchase invoices for the purpose of

reporting sales tax which, by law, is based on the price at which the Taxpayer sold items at retail. In fact, the Taxpayer collected sales tax from his customers based on those retail prices. But the Taxpayer did not remit those tax collections to the Revenue Department. As stated, though, the examiner testified that even the numbers supplied by the Taxpayer were significantly understated. The Taxpayer's wholesale purchases during the audit period totaled approximately $12 million, but the Taxpayer reported retail sales during that time of only $4 million. And the $12 million was the Revenue Department's determination of the Taxpayer's wholesale purchases using vendor records and cancelled checks that it obtained. That amount did not include the 35 percent mark-up. Thus, the Taxpayer underreported his own purchases – not just his retail sales – by $8 million.

When asked during the hearing about the $8 million discrepancy, the Taxpayer stated that most of it was based on estimates and that the examiner had extrapolated occasional purchases over the entire audit period. But the examiner stated that, of the $12 million in purchases determined by the Revenue Department, only $500,000 was based on estimates. The remainder was based on vendor invoices and cancelled checks obtained by the Revenue Department. Also, the examiner stated that the $12 million amount already had been revised to account for such things as occasional sales. Therefore, the Revenue Department met its burden of proving fraud.

Conclusion

After the hearing, the Revenue Department notified the Tax Tribunal that it had lowered the mark-up percentage applicable to the Taxpayer's package store, as agreed, and that the lower percentage reduced the final assessment to $822,568.69, including tax,

interest, and the fraud penalty. Based on the law and the facts of this case, as discussed in this opinion, the state sales tax final assessment, as reduced, is affirmed. Judgment is entered in favor of the Revenue Department and against the Taxpayer in the amount of $822,568.69, plus additional interest. The final assessment for local tax is voided. Judgment is entered accordingly.

It is so ordered.

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

Entered October 13, 2020.

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

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