ALABAMA TAX TRIBUNAL

DAVID L. LEWIS D/B/A J & C PACKAGE STORE, Taxpayer, v. STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § § §	DOCKET NO. S. 19-680-JP

OPINION AND FINAL ORDER

This appeal involves a final assessment of state sales tax for May 2012 through April 2017. A trial was held on September 27, 2022. Taylor Meadows represented the Taxpayer, and Hilary Parks and Andrew Gidiere represented the Revenue Department. David Lewis, the owner of J & C Package Store, appeared and testified. Ryan Campbell, a Revenue Department manager, also appeared and testified.

Facts

Mr. Lewis testified that he began operating a package store and a lounge in May 2012 as owner, and that the two businesses were in different locations. Sales proceeds from both locations were deposited into the same bank account. According to Mr. Lewis, he had one register in the package store but no registers in the lounge, and he accepted only cash at the lounge. He testified that he emptied the cash drawer every night, recorded the amount on paper, and took the cash home. With respect to the package store, Mr. Lewis testified that z-tapes were printed in the mornings and evenings and that those z-tapes were used to determine the sales tax measure for each month. The package store closed in May 2017.

Mr. Lewis testified that he maintained all sales records, including z-tapes and receipts, at his home, but that his home was destroyed by fire in 2015 and that most of the z-tapes had been destroyed. He presented a report from the Uniontown Volunteer Fire Department concerning the fire. However, that report listed August 15, 2016, as the date the fire was reported, despite Mr. Lewis testifying that the fire occurred in 2015. Mr. Lewis testified that he received approximately $13,000 from his insurance company as a result of the fire, but that he did not deposit that amount into his bank account. Subsequently, he kept some sales records at his store. During the trial, Mr. Lewis stated that he had found partial sales records for approximately seven months in 2015, but that he used the June and October records because they were the most complete. Mr. Lewis testified that he filed and paid sales tax every month, and Mr. Campbell confirmed that Mr. Lewis did so.

Mr. Campbell testified that no records were provided by the Taxpayer in response to the initial audit request. Instead, the auditor obtained records from the Taxpayer's vendors and then marked up the Taxpayer's purchases of merchandise that was to be resold. Mr. Campbell stated that the Taxpayer's purchases for resale for the audit period totaled $334,544.84, and that the taxable sales reported by the Taxpayer on his sales tax returns for the audit period totaled $102,093.00.

Mr. Campbell testified that the Taxpayer later provided additional information which Mr. Campbell reviewed. Specifically, the Taxpayer provided z-tapes and receipts for June and October 2015. However, the audit findings were not changed because the Taxpayer had provided receipts for the store only and none for the lounge.

Mr. Campbell also testified that a review of those records showed that the Revenue Department's sales calculations were lower than the Taxpayer's calculations for the package store.

According to Mr. Campbell, the fraud penalty was assessed because the Taxpayer initially produced no records to the auditor, because of a substantial underreporting of taxable sales; *i.e.,* that the Taxpayer underreported taxable sales by 80% of the taxable base consistently throughout the audit period, and because the Taxpayer withheld the existence of a bank account from the auditor. Specifically, Mr. Campbell testified that the auditor asked the Taxpayer if he had a bank account and that the Taxpayer answered that he did not. The auditor later determined that the Taxpayer had a bank account. Mr. Lewis disputed the auditor's claim, however, testifying that he had told the auditor that money from credit card sales went into a bank account which was held in a bank adjacent to the store.

Discussion

On appeal, the Taxpayer argues that the purchase mark-up percentage of 35% was too high. The Taxpayer asserts that the tax liability should be calculated based on the sales reported on the z-tape records provided by the Taxpayer. Specifically, the Taxpayer asserts that a sampling could be created from the months of June and October 2015. The Taxpayer also argues that the fraud penalty should be removed because the lack of records is explained by the house fire.

The Purchase Markup Audit

It is undisputed that the Taxpayer in this case failed to provide complete sales

records. In such a situation,, the Revenue Department may compute the Taxpayer's liability "using the most accurate and complete information reasonably obtainable." *Jai Shanidev Inc. d/b/a Country Corner*, S. 16-449 (Ala. Tax Tribunal 04/27/17); Ala. Code 1975, § 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) (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).
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> "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)."

Jai Shanidev Inc. d/b/a Country Corner , supra.

Because the Taxpayer in this appeal failed to maintain and produce sales records for the audit period, the Revenue Department applied a purchase markup of 35%. As the Tax Tribunal has explained in previous cases, the 35% markup is based on Internal Revenue Service information regarding percentage markups of gas stations and grocery stores. The percentages have been averaged to reach the 35% figure. *See, e.g., E&Z, Inc. v. State of Ala. Dep't of Rev.*, S. 19-989-LP (Ala. Tax Tribunal 1/12/2022). The Tribunal has previously held that that percentage is reasonable. *See, e.g., E&Z, Inc., supra.* "The tax due as computed by the audit is by its nature an estimate, but the examiner of necessity estimated the Taxpayer's

liability because the Taxpayer failed to maintain adequate records." *Id*.

Here, the Taxpayer argues that many records had been destroyed in a house fire, but that does not explain the absence of records subsequent to the fire. The Taxpayer also argues that the Revenue Department should have used the June and October z-tapes to determine the sales tax measure, citing appellate case law for the proposition that a sampling of records can suffice to calculate a taxpayer's sales-tax measure. *See State v. Ludlam*, 384 So. 2d 1089 (Ala. Civ. App. 1980), and *State v. Levey*, 29 So. 2d 129 (Ala. 1946). However, as noted by the Revenue Department, the records for those months did not include records for the lounge. Therefore, as a matter of fact, the Taxpayer's two-month sampling of records was incomplete and could not provide an accurate measure of the Taxpayer's taxable sales, even for such a short period of time.

In accordance with the Tax Tribunal's previous decisions, *see, e.g., Jai Shanidev, supra*, the Revenue Department's method of calculating taxable sales in this case was reasonable. Therefore, the tax component of the final assessment entered by the Revenue Department is upheld.

Fraud Penalty

As discussed, the Revenue Department also assessed the Taxpayer for the fraud penalty because the Taxpayer initially produced no records, because the Taxpayer underreported sales by 80% of the taxable base consistently throughout the audit period, and because the Taxpayer withheld a bank account from the auditor. The Tax Tribunal has previously explained:

"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.00R., 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…."

E&Z, Inc., v. State of Alabama Department of Revenue, 19-989-LP (Ala. Tax Tribunal 1/12/22).

In this case, the 80% underreporting of taxable sales coupled with the Taxpayer's failure to maintain complete records, especially after the fire, supports the Revenue Department's application of the fraud penalty. Thus, the Revenue Department met its burden of proving fraud. Accordingly, the fraud penalty is

upheld.

The sales tax final assessment at issue is upheld. Judgment is entered against the Taxpayer and in favor of the Revenue Department in the amount of $49,103.92 (consisting of tax in the amount of $29,425.65, interest to the date of the final assessment in the amount of $4,965.34, and a fraud penalty in the amount of $14,712.93), plus additional interest that continues to accrue from the date of entry of the final assessment until the liability is paid in full.

This Final Order may be appealed to circuit court within 30 days, pursuant to Ala. Code 1975 § 40-2B-2(m).

Entered March 23, 2023.

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

jp:ac
cc: Taylor S. Meadows, Esq.
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