

ABDIRAHMAN A. ALI, D/B/A
DELTA FOOD MART
703 ST. STEPHENS STREET
PRICHARD, AL 36610,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 03-238

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Abdirahman Ali ("Taxpayer"), d/b/a Delta Food Mart, for State and City of Prichard sales tax for August 1997 through March 2002. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 16, 2005 in Mobile, Alabama. Bob Galloway represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer operated a convenience store in Prichard, Alabama during the period in issue. The store primarily sold gasoline, beer, cigarettes, and various grocery items.

The Department audited the Taxpayer for sales tax and requested the Taxpayer's purchase invoices, sales records, bank statements, and other records from which his sales tax liability could be determined. The Taxpayer provided a few invoices and some bank statements, but no sales records. The Department examiner determined that the Taxpayer's records were incomplete, and that his liability could not be accurately determined from the records provided. Consequently, he computed the Taxpayer's liability using a purchase mark-up audit.

In a mark-up audit, a retailer's liability is computed by determining the retailer's total purchases using purchase invoices and other vendor information. All exempt or nontaxable items are deleted, and a credit may be allowed for theft or spoilage, if applicable. An adjustment is also made if the beginning and ending inventory amounts are different. A percentage mark-up is applied to the remaining purchases to arrive at taxable sales. The applicable tax rate is applied to determine the total tax due. A credit for tax previously paid is then allowed to arrive at the additional tax due.

In this case, the Department examiner obtained purchase information from the Taxpayer's beer, cigarette, and other vendors. The purchase information indicated that the Taxpayer had substantially underreported his sales tax during the subject period. The examiner thus referred the matter to the Department's Investigations Division. That Division filed criminal charges against the Taxpayer. The Taxpayer subsequently pled guilty in Mobile County Circuit Court in September 2002 to filing false sales tax returns. He paid approximately \$41,000 to the Department in conjunction with the guilty plea.

After the criminal case was resolved, the examiner completed his purchase mark-up audit using the invoices provided by the vendors, and also some provided by the Taxpayer.¹ The examiner determined that some of the vendor information was incomplete. He thus used the available information to project or estimate additional purchases by the Taxpayer. For example, if a vendor generally delivered a product to the Taxpayer three

¹ Because the Taxpayer had pled guilty to filing false returns, and also because he had underreported his tax by more than 25 percent, the examiner expanded the audit period back to when the Taxpayer had opened the store in August 1997. See generally, Code of Ala. 1975, §40-2A-7(b)(2).

times a week, but the examiner only had purchase information showing one delivery in some weeks, he assumed that the vendor had made two other deliveries during those weeks. He thus projected additional purchases for those assumed deliveries.

After determining the Taxpayer's total purchases during the period, the examiner allowed a credit for merchandise stolen during a break-in that had been reported to the City of Prichard Police Department. He then applied the standard IRS mark-up of 24 percent applicable to gasoline stations. The IRS mark-up for grocery stores is 34 percent. The examiner used the lower mark-up to give the Taxpayer the benefit of the doubt. The examiner then allowed the Taxpayer a credit for tax previously paid to arrive at the additional tax due.

All taxpayers subject to sales tax are required to keep complete and accurate records from which the Department can accurately determine the taxpayer's correct liability. Code of Ala. 1975, §§40-2A-7(a)(1) and 40-23-9; *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982). If a taxpayer fails to keep adequate records, the Department can use any reasonable method to compute the taxpayer's liability. The taxpayer cannot later complain that the liability so computed by the Department is inexact. *Jones v. C.I.R.*, 903 F.3d 1301 (10th Cir. 1990).

The Department's use of a purchase mark-up audit is a commonly used and accepted method of computing a taxpayer's liability in the absence of adequate records. See generally, *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04); *Arnold v. State of Alabama*, S. 03-1098 (Admin. Law Div. 7/27/04); *Moseley's One Stop, Inc. v. State of Alabama*, S. 03-316 (Admin. Law Div. 7/28/03); *Pelican Pub & Raw Bar, LLC v. State of Alabama*, S. 00-286 (Admin. Law Div. 12/15/00); *Joey C. Moore v. State of Alabama*, S. 99-

126 (Admin. Law Div. 8/19/99); *Robert Earl Lee v. State of Alabama*, S. 98-179 (Admin. Law Div. 6/28/99); *Red Brahma Club, Inc. v. State of Alabama*, S. 92-171 (Admin. Law Div. 4/7/95); and *Wrangler Lounge v. State of Alabama*, S. 85-171 (Admin. Law Div. 7/16/86).

The Taxpayer argues that the Department's estimate of his monthly sales is unreasonably large. The additional State tax assessed by the Department is over \$224,000. That equates to unreported taxable sales of approximately \$5.6 million over the 56 month audit period, or \$100,000 in unreported sales each month. The Taxpayer contends that his small store could not have made that amount of sales per month. In support of that claim, the current store owner testified that since he took over the store, he has averaged approximately \$25,000 in monthly sales. He also testified that his average mark-up was 16 percent.

Considering the current owner's believable testimony that his average monthly sales are only \$25,000, the audit finding that the Taxpayer failed to report taxable sales of \$100,000 a month seems excessive. But if a purchase mark-up audit is correctly performed, it will reasonably and accurately estimate a retailer's liability. As indicated, the burden is then on the taxpayer to present evidence showing that the audit results are incorrect.

The examiner in this case correctly used a purchase mark-up audit because the Taxpayer failed to maintain any sales records. The mechanics of a purchase mark-up audit are simple. The examiner determined the Taxpayer's total purchases by using vendor information and some invoices provided by the Taxpayer. He then allowed the Taxpayer credit for merchandise stolen in a break-in that was reported to the Prichard police. The Taxpayer claims there were numerous other break-ins that were not reported. However,

there is no evidence supporting that claim. The Taxpayer also contends that his ending inventory was larger than his beginning inventory, in which case some of the merchandise purchased during the period would not have been sold. But again, the Taxpayer failed to present any records showing additional ending inventory. Finally, the examiner correctly used the 24 percent IRS mark-up. The IRS mark-up table is commonly used, and is reasonable. The 24 percent used is also less than the 34 percent mark-up applicable to grocery stores, which the examiner could have reasonably applied.

The examiner performed a thorough, technically correct audit, except, however, concerning his projection of additional purchases by the Taxpayer for which he had no purchase records. As discussed, the examiner determined that some vendors sold goods to the Taxpayer on a regular basis. Consequently, if the examiner did not have records for periods in which the vendors usually sold merchandise to the Taxpayer, he projected an average amount of purchases for those periods using the available information. But while some vendors generally sold merchandise to the Taxpayer on a regular basis, there is no evidence that they always did. Some vendors may have varied their sales to the Taxpayer, depending on whether the Taxpayer needed to purchase additional inventory at the time.

Projecting a retailer's sales for periods in which no records are provided is reasonable and necessary in some instances. For example, if a vendor's records are not available for several months of an audit period, and it is established that the taxpayer purchased merchandise from the vendor during the period, estimating the purchases using records from other periods is acceptable. In this case, however, there is no evidence that the Taxpayer purchased goods except on those days for which invoices or other purchase information was obtained. Consequently, projecting sales based on unsupported

assumptions may result in an overstatement of sales.

The Department should recompute the Taxpayer's liability by using only the actual purchase information obtained from the vendors or provided by the Taxpayer. Otherwise, the Department audit findings are affirmed. A Final Order will be entered after the Department notifies the Administrative Law Division of the adjusted State and City of Prichard amounts due.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered August 2, 2005.

BILL THOMPSON
Chief Administrative Law Judge