JERMAINE GARRETT 707 COOSA STREET W. TALLADEGA, AL 35160-1920,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 05-1114
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Jermaine Garrett ("Taxpayer") for State sales tax for November 2001 through October 2004. 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 July 11, 2006. The Taxpayer and his representative, Wayman Powell, attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer owns and operates a convenience store in Talladega, Alabama. He sells beer, wine, cigarettes, and various grocery items at the business. The Department audited the Taxpayer for the period in issue and requested records from which his sales tax liability could be determined. The Taxpayer provided the Department examiner with his purchase invoices and some sales records for the period.

The examiner found that the Taxpayer had failed to file returns and pay his sales taxes for January through August 2004. Consequently, he elected to verify the Taxpayer's sales tax liability using a purchase mark-up audit.

The examiner used the purchase invoices provided by the Taxpayer, which were substantially complete. He then applied the standard IRS mark-up of 35 percent applicable to convenience stores. Credits for non-taxable food stamp sales and sales tax previously paid were allowed to arrive at the additional tax due. The examiner added a 5 percent

negligence penalty for the months from November 2001 through November 2003. He applied the 50 percent fraud penalty for December 2003 through October 2004 "due to the gross underreporting of sales and apparent evasion of sales tax by stating that the business was closed during January and February 2004, . . ." See, Dept. Ex. 1, Confidential Audit Report at 3.

The Taxpayer argues that the examiner should have allowed at least a 7 percent credit for theft, breakage, etc. He also claims that a more reasonable mark-up would be 26.5 percent, not the 35 percent used by the examiner. Finally, the Taxpayer asserts that the fraud penalty was incorrectly assessed.

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 Department did not allow the Taxpayer a credit for theft, breakage, etc. because he had no records proving the amounts. Unfortunately, shoplifting routinely occurs at convenience stores, but for obvious reasons cannot be accurately recorded or measured. Some merchandise is also usually damaged or otherwise cannot be sold. It is reasonable under the circumstances to allow a 5 percent inventory reduction for theft, spoilage, etc.

As indicated, the Department applied the standard 35 percent IRS mark-up to the wholesale cost of the Taxpayer's goods. The Taxpayer contends that a smaller 26.5 percent mark-up should apply. I disagree.

The Taxpayer failed to provide adequate sales records from which his monthly sales could be accurately verified. He cannot now complain that the average IRS mark-up percentage is too high. A 35 percent mark-up is reasonable, and without records or other evidence to the contrary, is affirmed.

Code of Ala. 1975, 40-2A-11(d) levies a 50 percent penalty for any underpayment due to fraud. 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 Department is required to prove fraud by clear and convincing evidence. *Bradford v. C.I.R.*, 796 F.2d 303 (1986). "The burden is upon the commissioner to prove affirmatively by clear and convincing evidence actual and intentional wrongdoing on the part of the (taxpayer) with a specific intent to evade the tax." *Lee v. U.S.*, 466 F.2d 11, 14

(1972), citing *Eagle v. Commissioner of Internal Revenue*, 242 F.2d 635, 637 (5th Cir. 1957). The existence of fraud must be determined on a case-by-case basis, and from a review of the entire record. *Parks v. Commissioner*, 94 T.C. 654, 660 (1990).

The Department assessed the Taxpayer for the fraud penalty for the last eleven months of the audit period. The examiner stated in his audit report that the Taxpayer had told him that the business was closed in January and February 2004. However, the examiner discovered that the business had purchased merchandise and made food stamp sales in those months. The Taxpayer also failed to file returns for January through August 2004. The examiner concluded from the above that the Taxpayer had intentionally attempted to evade his sales tax in those months.

The Taxpayer testified at the July 11 hearing that he became ill in late December 2003, and was unable to operate the business for an extended period. He explained that while he was not at the store in January and February 2004, the business may have purchased merchandise and made some few sales in those months because he has relatives that sometimes operate the store when he is not there.

The Taxpayer also explained that he routinely gave his tax preparer his monthly sales figures. The preparer completed the monthly returns and informed the Taxpayer of the amount due. The Taxpayer then paid the preparer, who in turn filed the return and remitted the amount due to the Department.

The Taxpayer testified that he continued to pay the preparer during the months in issue, and that he had no reason to believe that the preparer was not filing the returns and paying the tax due. He claims that as soon as the Department contacted him concerning the delinquent returns, he inquired with both the Department and his preparer. It was only

then that he discovered that the preparer was suffering from Alzheimer's, and that she had not filed his returns or paid the tax due. The Taxpayer does not dispute that he owes the tax for January through October 2004. He contends, however, that he did not willfully or intentionally fail to file his returns and pay the tax due with the intent to defraud.

Fraud generally entails deception by the taxpayer. The evidence in this case does not establish that the Taxpayer purposefully intended to deceive the Department. The Department audit shows that from November 2001 through November 2003, the Taxpayer substantially reported and paid his correct sales tax liability to the Department. However, no returns were filed for January through August 2004. The Taxpayer certainly knew or should have known that if he suddenly stopped filing returns without closing his account, the Department would be on notice and investigate, which it did. Only then did the Taxpayer learn that his tax preparer had not filed his returns and paid the tax due. Under the circumstances, the Taxpayer's failure to file returns and/or pay any tax for January through August 2004 does not establish that he knowingly and willfully attempted to evade his liability in those months. He also adequately explained his comment to the examiner that he had not personally operated the business in January and February 2004. The 5 percent negligence penalty should thus apply, not the fraud penalty.

The Department is directed to recompute the Taxpayer's liability as indicated above. An appropriate Order will then be entered.

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 July 24, 2006.

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BILL THOMPSON
Chief Administrative Law Judge