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| BAD HABITS, INC. | § | STATE OF ALABAMA |
| 5085 MOORES MILL ROAD | | DEPARTMENT OF REVENUE |
| HUNTSVILLE, AL 35811-1000, | § | ADMINISTRATIVE LAW DIVISION |
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| Taxpayer, | § | DOCKET NO. S. 05-1269 |
| | | |
| v. | § | |
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| STATE OF ALABAMA | § | |
| DEPARTMENT OF REVENUE. | | |

FINAL ORDER

The Revenue Department assessed Bad Habits, Inc. ("Taxpayer") for sales tax for March 2002 through August 2004, December 2004, and January and February 2005. 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 February 23, 2007. Ashley Jones represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

The Taxpayer sold beer and cigarettes at its business in Huntsville, Alabama during the periods in issue. The Taxpayer maintained two cash registers at the business. It recorded its retail cigarette sales on one of the registers, and its wholesale cigarette sales on the other. The Taxpayer claims that its employees wrote the wholesale purchaser's name on the wholesale register's z-tape when they sold cigarettes at wholesale.

The Department audited the Taxpayer for sales tax and requested the Taxpayer's cash register z-tapes, purchase invoices, etc. The Taxpayer provided the Department examiner with all of the z-tapes from the retail register, and tapes for four or five months from the wholesale register. It failed to provide all of the wholesale register z-tapes because it claimed that those tapes were destroyed in a fire. It also otherwise failed to identify the wholesale purchasers, or the amounts sold at wholesale. The Department examiner consequently treated all of the Taxpayer's sales as taxable retail sales because

the Taxpayer failed to provide records identifying the wholesale purchasers or the amounts purchased at wholesale.¹

The owner's son managed the business. He testified at the February 23 hearing that there was a fire at the store on November 1, 2004. The Department audit was scheduled to begin the next week. The manager testified that the fire destroyed many of the business' records that had been stored in a back room where the fire started, including the wholesale register z-tapes. As indicated, however, none of the retail register z-tapes were destroyed.

The manager testified that the business sold substantial amounts of cigarettes at wholesale during the audit period. The Taxpayer's largest wholesale purchaser was Chuck's Tobacco Outlet. The manager explained that Chuck's had gotten into a dispute with R.J. Reynolds Tobacco Company, and that Reynolds stopped selling cigarettes to Chuck's in 2002. The Taxpayer thereafter agreed to purchase additional cigarettes from Reynolds and then resell them at wholesale to Chuck's for a small profit.

The manager testified that he personally delivered cigarettes to Chuck's on numerous occasions. The person that managed Chuck's from 2000 until it closed in late 2004 also testified that Chuck's had purchased large volumes of cigarettes at wholesale from the Taxpayer, beginning in 2002. She estimated that the Taxpayer delivered a van load of cigarettes to Chuck's every week or two from 2002 until 2004, and that the wholesale cost of each load was between \$8,000 and \$18,000. No records were submitted, however, supporting her testimony.

¹ The Taxpayer's liability for the last three months in the audit period, December 2004 and January and February 2005, were estimated based on prior months because the Taxpayer failed to file returns for those months.

A retailer in Alabama is required to maintain records showing the amount of all non-taxable wholesale sales, and in the absence of records, the retailer must suffer the consequences and pay tax on those sales not accurately recorded as exempt or non-taxable. *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980). In this case, there is testimony that the Taxpayer made substantial wholesale sales during the subject months. Unfortunately, the Taxpayer does not have records identifying the wholesale purchasers or the amounts sold at wholesale. In substance, the Taxpayer's position is that because there is evidence that it made wholesale sales, the Department should accept the wholesale sales amounts as reported on its returns as correct. The Department is not required to do so.

In income tax cases, the *Cohan* Rule provides that if a taxpayer fails to maintain records identifying the exact amount of a deduction, the deduction may still be allowed; provided, the taxpayer must present sufficient evidence from which the amount of the deduction can be reasonably estimated. *Cohan v. Commissioner*, 39 F.2d 540 (1930). For a discussion of and cases applying the *Cohan* Rule, see *Trigon Insurance Co. v. United States*, 234 F.Supp.2d 581 (2002). Because Alabama's income tax system is modeled after the federal system, the Administrative Law Division has applied the *Cohan* Rule in numerous income tax cases. See, *Johnson v. State of Alabama, Inc.* 06-383 (Admin. Law Div. 2/15/2007); *Ridge v. State of Alabama, Inc.* 04-453 (Admin. Law Div. 6/1/2005), and *Broadfoot v. State of Alabama, Inc.* 04-709 (Admin. Law Div. 3/14/2005).

The Administrative Law Division has never applied the *Cohan* Rule in a sales tax case², but even assuming that the *Cohan* Rule should apply in sales tax cases, the Rule cannot be applied in this case because there is no evidence from which the Taxpayer's wholesale sales can be reasonably estimated.

Chuck's Wholesale Outlet was identified as a wholesale purchaser at the February hearing. However, no purchase invoices or other records from Chuck's were submitted from which the amount of the Taxpayer's wholesale sales to Chuck's could be reasonably estimated. The Taxpayer also failed to present invoices or other records from any of its other wholesale purchasers from which its wholesale sales could be reasonably estimated. Without any records from which the Taxpayer's wholesale sales can be reasonably estimated, the tax and interest assessed by the Department must be affirmed. Under the circumstances, the penalty assessed by the Department is waived for cause.

The final assessment, less the penalty, is affirmed. Judgment is entered against the Taxpayer for \$50,279.26. Additional interest is also due from the date the final assessment was entered, November 4, 2005.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered May 22, 2007.

BILL THOMPSON
Chief Administrative Law Judge

² The Alabama Court of Civil Appeals has held, however, that less than perfect records, however "inartfully kept," may be sufficient for sales tax purposes, as long as the records are "at least sufficient to constitute a 'semblance of a record.'" *State v. Ludlum*, 384 So.2d 1089, 1091 (Ala. Civ. App. 1980), citing *State v. Levey*, 29 So.2d 129 (1946); see also, *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982).

bt:dr

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