CHARLES FEAGIN 4300 W. MAIN ST. DOTHAN, AL 36305-1054,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 05-711
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Dr. Charles Feagin ("Taxpayer") for use tax for July 1998 through June 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 November 10, 2005. David Johnston and Paul Turner represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

ISSUES

This case involves two issues:

(1) Is the Taxpayer liable for Alabama use tax on breast implants he purchased tax-free outside of Alabama and then used in performing cosmetic and reconstructive surgeries in Alabama; and,

(2) Did the Department correctly assess the Taxpayer for the fraud penalty?

FACTS

The Taxpayer is a plastic surgeon that practices through Feagin & Owens M.D., P.C. in Dothan, Alabama. The Department discovered in early 2004 that a California company, Inamed, was selling medical implants tax-free to the Taxpayer and several other doctors in Alabama.

The Department audited the Taxpayer's P.C. for use tax based on the information received from the California company. The Department examiners requested the P.C.'s invoices and other pertinent records. The P.C. provided its records, which did not include invoices for the implants. The examiners inquired about the implants, and were informed by a P.C. employee that the implant invoices were the Taxpayer's personal records.

The examiners subsequently met with the Taxpayer, who stated that the hospital at which he practiced, Southeast Alabama Medical Center of Dothan, had purchased the implants, and that the hospital was tax-exempt. The examiners later subpoenaed the Taxpayer's records, which he timely provided, including the records of a Florida bank account in the name of the Breast Implant Fund of Florida. The records for that account indicated that the Taxpayer had personally purchased implants from Inamed and one other out-of-state supplier.

The Department assessed the Taxpayer, individually, for use tax on the implants he had purchased from July 1998 through June 2004. It assessed the Taxpayer for six years instead of the normal three years because the Taxpayer had never filed use tax returns with the Department. It also assessed the Taxpayer for the fraud penalty because, according to the Department, the Taxpayer had denied that he had purchased the implants, and had also attempted to hide the Florida implant fund.

The Taxpayer has performed cosmetic and reconstructive surgery at the Southeast Alabama Medical Center in Dothan for many years. He testified that the Medical Center refused to provide the funds needed to maintain the inventory of implants he needed to perform his surgeries. Consequently, he used his own money to

initially purchase and then maintain an inventory of implants at the Medical Center. The Taxpayer and Dr. Owens use the implants as needed for their surgeries. Other doctors at the Medical Center also use the Taxpayer's implants, but are required to reimburse him for his cost of the items.

The Taxpayer and Dr. Owens pay a pro-rata share of the P.C.'s expenses based on the percentage of income they each contribute to the business. Consequently, to keep the money he charges for the implants separate from the charges for his professional services, the Taxpayer bills his patients for two fees, one for his services payable to the P.C., and a second for the implants payable to the Breast Implant Fund of Florida. A surgery information sheet used by the P.C. directs the Taxpayer's patients to write one check to the P.C., and a separate check for the implants to the implant fund.[1] The Taxpayer explained that he opened the implant account at a Florida bank to insure that the money paid by his patients for the implants would not be mistakenly commingled by his office staff with the money deposited into the P.C.'s account in Alabama.

ANALYSIS

Issue (1). Is the Taxpayer liable for use tax on the implants?

The Taxpayer argues that he used or consumed the implants incidental to the professional services he provided to his patients. He asserts "that when a learned professional incidentally consumes tangible personal property in the execution of his

[1] One of the Department examiners confirmed at the November 10 hearing that based on his personal experience, the Taxpayer requires his patients to make separate payments to the P.C. and to the implant fund.

learned profession, this incidental consumption is not within the purview of the State's sales and use act (sic)." Taxpayer's Brief at 4. I disagree.

The Alabama Supreme Court has held that doctors, as members of a learned profession, are not making retail sales when they provide or supply tangible property to their patients incidental to their professional services. *Hamm v. Proctor*, 198 So.2d 782 (Ala. 1967); *Haden v. McCarty*, 152 So.2d 141 (Ala. 1963). However, the use or consumption of the property by the doctors in providing the services in Alabama is clearly subject to Alabama use tax.[2]

Doctors should pay sales tax when they purchase supplies and other tangible property, i.e., breast implants, that they use or consume in providing professional services to their patients. See, Dept. Reg. 810-6-1-.55. If a doctor purchases the property outside of Alabama and the out-of-state seller fails to collect and remit Alabama tax on the transaction, or if the doctor purchases from an in-state seller but fails to pay the Alabama sales tax due, the doctor owes Alabama use tax on the subsequent use or consumption of the property in Alabama. The Taxpayer in this case is thus liable for Alabama use tax on the breast implants he purchased tax-free outside of Alabama and later used in Alabama.

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[2] The one exception involves dental appliances sold by dental laboratories to dentists. The Alabama Supreme Court held in *Hamm v. Proctor* that dental laboratories were not selling appliances to dentists at retail, but were instead providing them as a professional service. The sale by the laboratory is thus not subject to sales tax, and consequently, the subsequent use of the appliance by the dentist is not subject to use tax. I respectfully disagree with the Court's rationale in *Hamm v. Proctor* for the reasons explained in *Smartsmiles Orthodontics, P.C. v. State of Alabama*, S. 05-772 (Admin. Law Div. 12/29/05). In any case, the rationale of *Hamm* does not apply in this case. Inamed and the other out-of-state seller clearly sold the implants to the Taxpayer at retail.

The Taxpayer's reference to "incidental consumption" in his Brief is misleading. Alabama sales tax applies to sales by retailers in the business of selling at retail. Code of Ala. 1975, §40-23-2(1). Conversely, incidental or casual sales of property in Alabama by persons not in the business of selling at retail are not subject to Alabama sales tax. If property is purchased outside of Alabama in an incidental or casual sale that would not have been subject to sales tax if made in Alabama, the subsequent use of the property in Alabama also is not subject to Alabama use tax. *Bay Towing and Dredging Co.*, 90 So.2d 743 (Ala. 1956). But if property is purchased at retail from a seller in the business of making such sales, as in this case, the subsequent use of the property in Alabama is subject to use tax, even if the property is used by a doctor "incidental" to the providing of professional services. The Taxpayer's use or consumption of the implants in Alabama is thus clearly subject to Alabama use tax, just as the retail purchase of the implants would have been subject to Alabama sales tax if the sales had occurred in Alabama. The use tax assessed by the Department is due to be affirmed.

Issue (2). The fraud penalty.

Code of Ala. 1975, §40-2A-11(d) levies a 50 percent penalty on any underpayment of tax due to fraud. The section further provides that the term "fraud" shall be given the same meaning as ascribed under 26 U.S.C. §6663.

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).

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), citing *Traficant v. Commissioner*, 884 F.2d 258, 263 (6th Cir. 1989). Consequently, fraud may be established from "any conduct, the likely effect of which would be to mislead or conceal." *Walton*, 909 F.2d at 926, quoting *Spies v. United States*, 63 S.Ct. 364, 368 (1943). The failure to keep adequate records and the consistent underreporting of tax is strong evidence of fraud. *Wade v. C.I.R.*, 185 F.3d 876 (1999) ("There is no dispute (taxpayer) kept inadequate books and records, further suggesting fraud.").

The Department assessed the Taxpayer for the fraud penalty because it claims that the Taxpayer attempted to hide the implant fund and intentionally misinformed the examiners that the hospital had purchased the implants. I disagree.

First, the evidence does not establish that the Taxpayer tried to hide the implant fund bank account. The Taxpayer explained that he opened the fund at a Florida bank because he did not want the implant money to be mistakenly commingled with the P.C.'s money in Alabama. That is a plausible explanation.

The Department examiners knew from the records of the California seller that the Taxpayer had personally purchased the implants, not his P.C. It is not unreasonable that the Department initially contacted and audited the Taxpayer's P.C., but the examiners should not have been unduly surprised to learn that the Taxpayer, not the

P.C., had the implant invoices. Both examiners also acknowledged at the November 10 hearing that the Taxpayer timely provided all of his records, including the implant fund bank account records, as soon as they asked him to do so.

One of the examiners also knew from first-hand experience that the Taxpayer required his patients to pay for the implants separately by writing a check (or providing certified funds) to the Florida implant fund. A standard form used by the P.C. specified that the Taxpayer's patients should pay the Florida implant fund for the implants, not the P.C. From the above evidence, it does not appear that the Taxpayer was attempting to hide the existence or purpose of the Florida implant fund.

The Taxpayer told the examiners that the hospital had purchased the implants, and that the hospital is tax-exempt. The hospital is exempt, but clearly the Taxpayer, not the hospital, purchased the implants. However, that one statement by the Taxpayer, which was made during a short two or three minute conversation in the Taxpayer's office, does not establish that the Taxpayer knew that use tax was due on the implants, and that he willfully and knowingly failed to report and pay the use tax due.

The Taxpayer explained that the implants were stored at the hospital, and that hospital personnel monitored the inventory. If additional implants were needed, the "[g]irls at the hospital" would either order implants directly from the supplier or notify the Taxpayer's office personnel, who would make the order. (T. 82, 83.) In retrospect, it appears that the Taxpayer made the comment off-the-cuff and with no premeditated attempt to mislead the examiners. It also makes no sense that the Taxpayer would have attempted to mislead the examiners when he knew that his bank and other records clearly showed that he had purchased the implants.

The Taxpayer's lack of intent to defraud is supported by his lack of knowledge or involvement concerning his taxes. He testified that before the Department audit, he did not know what a use tax was. There is no direct or circumstantial evidence indicating otherwise.

Viewing the evidence together, the fraud penalty does not apply. Rather, the Taxpayer is liable for the 10 percent failure to timely pay and the 5 percent negligence penalties levied at Code of Ala. 1975, §§40-2A-11(b) and (c), respectively. The final assessment is reduced accordingly. Judgment is entered against the Taxpayer for tax, penalty, and interest of $68,142.44. Interest is also due from the date the final assessment was entered, June 9, 2005.

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

Entered January 18, 2006.

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BILL THOMPSON
Chief Administrative Law Judge