ALFRED L. RANDOLPH 625 N. DR. THOMAS AVENUE MOBILE, AL 36610-4114,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 06-291
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Alfred L. Randolph ("Taxpayer"), d/b/a Happy Hill Superette, for State sales tax for July 1999 through March 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 June 19, 2006. The Taxpayer attended the hearing. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer operates a convenience store in Mobile, Alabama at which he sells beer, wine, and various grocery items. The Taxpayer's wife, who is now deceased, helped the Taxpayer at the business during the period in issue – July 1999 through March 2005. The Taxpayer's son also sometimes worked at the store.

The Department audited the Taxpayer's business for the subject period and requested his cash register tapes, purchase invoices, bank statements, and other relevant records. The Taxpayer responded that he did not have any cash register tapes, purchase invoices, or other sales records, and that the Department examiner should contact his vendors concerning his purchases. The Taxpayer did, however, provide some income tax returns for prior years and also grocery invoices for March 2005.

The Department examiner determined the Taxpayer's monthly beer and wine purchases from records provided by the Taxpayer's beer and wine vendors. The examiner

compared the Taxpayer's beer and wine purchases, without mark-up, to his reported monthly sales. The comparison showed that the Taxpayer's beer and wine purchases alone greatly exceeded his total reported monthly sales. The examiner subsequently computed the Taxpayer's liability using a purchase mark-up audit.

The examiner was unable to obtain complete purchase information from the Taxpayer's food vendors. Consequently, he used the March 2005 invoices provided by the Taxpayer to project the Taxpayer's average monthly grocery purchases. He then applied the standard IRS mark-up of 1.345 percent to determine that the Taxpayer's average grocery sales were $647.18 per month during the audit period.

The examiner also contacted the USDA to determine the amount of food stamps redeemed by the Taxpayer. Food items purchased with food stamps are exempt from sales tax. The examiner allowed the Taxpayer credit for the lesser of the food stamps redeemed by the Taxpayer in a month or the Taxpayer's projected average food sales in the month. That is, if the redeemed food stamps totaled less than the projected food sales of $647.18 in a month, the examiner allowed the lesser food stamp amount. If the redeemed food stamps were greater than the projected food sales, the entire $647.18 in estimated food sales was deleted from the audit. The examiner did not allow a credit for food stamps over the projected food sales amounts because that would have allowed the Taxpayer a credit against his beer and wine sales, which cannot be purchased with food stamps.

The examiner multiplied the Taxpayer's total beer and wine purchases by the IRS mark-up of 1.345 percent. He then added the Taxpayer's net monthly food sales to arrive at the Taxpayer's estimated monthly sales. A credit for tax paid was allowed to arrive at the

additional tax due. A 50 percent fraud penalty was applied because "the difference between the gross sales as reported and the total purchases was so great." Department's audit report, Dept. Ex. 2 at 3.

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 objects to the assessment for three reasons. He first argues that the audit is flawed because the examiner failed to establish a beginning inventory. The examiner explained, however, that the Taxpayer failed to provide any records from which annual beginning and ending inventories could be established. The few income tax returns

provided by the Taxpayer also indicated that the beginning and ending inventory amounts were the same.

The Taxpayer's son stated at the June 19 hearing that the store's ending inventory may have been less than the beginning inventory in some years. In that case, however, the Taxpayer's sales during the year would have been greater than the amounts estimated by the examiner. Under the circumstances, and without evidence to the contrary, the examiner reasonably assumed that the Taxpayer's beginning and ending inventories were the same.

The Taxpayer next argues that he should have been allowed some amounts for theft because his business is in a high crime area. The examiner refused to allow any credit for theft because the Taxpayer failed to provide any police reports or other evidence of break-ins.

The Department concedes that the Taxpayer's business is in a high crime area. It is thus reasonable to assume that some theft, pilferaging, shoplifting, etc. occurred during the audit period. A five percent credit for theft, pilferage, etc. is reasonable under the circumstances.

Finally, the Taxpayer asserts that the examiner inaccurately computed his tax-exempt food stamp sales during the audit period. I disagree. The examiner allowed the Taxpayer all of his redeemed food stamp sales in the subject months up to his total estimated food sales. The examiner correctly refused to allow a credit for food stamp sales over the Taxpayer's estimated food sales in a month because food stamps can only be used to purchase food, not beer and wine. Also, the fact that the amount of food stamps redeemed in some months was greater than the estimated food sales in those months

indicates that the estimated monthly food sales of $647.18 was probably low, which benefited the Taxpayer.

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 Taxpayer failed to provide the examiner with any cash register z-tapes or other sales records from which the Taxpayer's gross sales could be established or verified. Failure to maintain adequate records is evidence of fraud. *Wade v. C.I.R.*, 185 F.3d 876 (1999). Importantly, the Taxpayer's monthly beer and wine purchases, without mark-up, greatly exceeded his reported monthly sales. No retailer can consistently pay more for merchandise than he sells in a month and stay in business. Based on the above, the examiner thus reasonably concluded that the Taxpayer had willfully failed to correctly report and pay his sales tax liabilities during the audit period. The fraud penalty was thus properly applied. See also, *Seales v. State of Alabama*, S. 05-515 (Admin. Law Div. 12/16/2005);

Hesser v. State of Alabama, S. 05-225 (Admin. Law Div. 8/17/2005); *Melton v. State of Alabama*, S. 05-281 (Admin. Law Div. 4/6/2005).[1]

The Department is directed to recompute the final assessment in accordance with the above. A Final 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 14, 2006.

_____
BILL THOMPSON
Chief Administrative Law Judge

[1] Because the fraud penalty applies, no other penalties may be assessed. Code of Ala. 1975, §40-2A-11(g). Consequently, the total penalty should be 50 percent of the adjusted tax due.