

GREGORY ARMSTEAD  
D/B/A MAYSVILLE SHACK  
637 HOUSTON STREET  
MOBILE, AL 36606-4320,

Taxpayer,

v.

STATE OF ALABAMA  
DEPARTMENT OF REVENUE.

§  
§  
§  
§  
§  
§

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 07-973

### FINAL ORDER

The Revenue Department assessed Gary Armstead ("Taxpayer"), d/b/a Maysville Shack, for State sales tax for January 2004 through December 2006. 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 March 18, 2008. Bob Galloway represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer operated a restaurant in Mobile County, Alabama during the period in issue. The Department audited the Taxpayer for sales tax and requested his sales and other relevant records for January 2004 through December 2006. The Taxpayer provided some purchase invoices and his 2005 Alabama income tax return. He failed to provide any cash register z-tapes because he did not use a cash register at the business. He also failed to provide any other sales records.

The examiner reviewed the invoices provided by the Taxpayer and also purchase information from his vendors. He determined that the Taxpayer had purchased substantially more in food products in each month than he had reported as sales on his monthly sales tax returns. He consequently determined that the returns were incorrect, and computed the Taxpayer's liability using a purchase mark-up audit.

The examiner determined the Taxpayer's monthly wholesale purchases using the Taxpayer's purchase invoices and additional vendor records. He then estimated the Taxpayer's retail sales by applying the standard 268.9 percent IRS mark-up for restaurants. He allowed a credit for sales tax previously paid to arrive at the additional tax due.

All taxpayers subject to sales tax are required to keep complete 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 (10<sup>th</sup> 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).

In this case, the Department examiner determined that the Taxpayer had not correctly reported his monthly sales because his monthly wholesale purchases, without

mark-up, greatly exceeded his reported monthly sales. The Taxpayer's wholesale purchases exceeded his reported retail sales by \$106,648.97 during the 36 month audit period. The examiner thus correctly computed the Taxpayer's liability using a purchase mark-up audit.

The Taxpayer argues (1) that the mark-up used by the examiner is excessive, and (2) that he paid sales tax when he purchased various items at retail from Sam's Club.

Concerning the mark-up, the examiner estimated that the Taxpayer got 10 chicken wings per pound. That estimate was based on information obtained from a local meat market. The Taxpayer claims that he gets only 8 or 9 wings per pound. He provided a menu and various purchase invoices to the Department during the assessment process. The examiner reviewed the information and responded as follows in a December 3, 2007 inter-office memorandum.

I have examined the additional records provided by Mr. Armstead regarding the purchase markup audit done of his business, the Maysville Shack, for the period January 2004 through December 2006.

As you are aware, for the audit of the period January 2004 through December 2006 Mr. Armstead was unable to provide any cash register Z-tapes or records of individual sales made by his business. Further, in EVERY SINGLE MONTH of the audit period, the purchases made by Mr. Armstead were greater than the reported Gross Sales. For the 36 months examined, the total purchases exceeded the reported Gross Sales by \$106,648.97. Since no sales records were available and the purchases so greatly exceeded the reported Gross Sales, the IRS Statistical Markup Percentage for Eating Places of 268.942238% was used to more accurately determine his Gross Sales.

In the additional records provided by Mr. Armstead was a menu which provided selling prices for the various items sold by the business. This menu was not provided during the audit process. The invoices provided by Mr. Armstead for chicken wings were purchased after the audit period in question, but can be used to determine a markup percentage in this case.

As the attached spreadsheet shows, for Chicken Wings it was determined

that a single wing costs 18 cents. This figure was calculated by taking the average price per pound of \$1.80 and dividing by the average number of wings in a pound of 10. According to Mr. Armstead's menu, 6 wings sell for \$3.65, 12 for \$5.55, 20 for \$8.20, and 30 for \$13.25. The corresponding costs for those sales were 6 wings cost \$1.08, 12 cost \$2.16, 20 cost \$3.60 and 30 cost \$5.40. The average markup for these wings sales was 267%.

For Chicken Nuggets, it was determined that a single nugget costs 9 cents. This figure was calculated by taking the average price of a case of nuggets sold by American Foods of \$44.45 and dividing by the average number of nuggets in a case of 480. According to Mr. Armstead's menu, 6 nuggets cost \$2.65, 12 cost \$3.75 and 24 cost \$5.00. The corresponding costs for those sales were 6 nuggets cost \$.54, 12 cost \$1.08, and 24 cost \$2.16. The average markup for those nugget sales was 356%.

For the above calculation, no fries or tots were included in the calculation as Mr. Armstead's menu does not list the amount of fries or tots sold.

As the above calculations show, the 268.942238% Markup Percentage for Eating Places appears to be close to Mr. Armstead's actual markup of items sold. I feel that the Department should not change the assessment based on the information provided.

Concerning the sales tax the Taxpayer claims he paid to Sam's Club, the examiner reviewed all sales receipts provided by the Taxpayer and agreed that the Taxpayer should be allowed a \$316.37 credit.

The Taxpayer should as a practical matter use a cash register because using a register would allow him to easily and accurately record his sales. But use of a register is not required. What is required, however, is that a retailer must keep some form of accurate, consistent, and verifiable sales records. Code of Ala. 1975, §40-2A-7(b)(1). The Taxpayer failed to do so in this case.

The above-quoted response by the Department examiner verifies that the standard mark-up used by the examiner is reasonable. The Department also cannot allow a credit for sales tax paid to Sam's Club unless the Taxpayer provides a sales receipt or other valid evidence that sales tax was in fact paid. The Taxpayer can thus only be allowed the

\$316.37 credit allowed by the examiner.

The final assessment, less the \$316.37 credit, is affirmed. Judgment is entered against the Taxpayer for State sales tax, penalty, and interest of \$27,988.74. Additional interest is also due from the date the final assessment was entered, October 2, 2007.

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

Entered June 6, 2008.

---

BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: Duncan R. Crow, Esq.  
Robert M. Galloway, Esq.  
Joe Cowen  
Mike Emfinger