

HARPER & DAY, INC.
D/B/A MOONDOG'S LOUNGE
P.O. BOX 934
CULLMAN, AL 35056-0934,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 09-982

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Harper & Day, Inc., d/b/a Moondog's Lounge ("Taxpayer"), for State sales tax for March 2003 through February 2009. 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 4, 2010. The Taxpayer's owners, Grant Day and James Harper, and their representative, Gene Bowman, attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer operated a bar in Huntsville, Alabama during the period in issue. The bar sold food, beer, and liquor. Another entity, Huntsville Gaming, provided coin-operated pool tables, bowling machines, golf, trivia, and other game machines at the bar. The bar also had a coin-operated phone card machine.

The Department initially audited the bar for sales tax for March 2006 through February 2009. As explained below, the Department examiner expanded the audit to include March 2003 through February 2006 after he determined that the Taxpayer had consistently underreported its monthly sales tax by more than 25 percent. See, Code of Ala. 1975, §40-2A-7(b)(2)b.

The examiner requested the Taxpayer's cash register tapes, sales journals, income tax returns, bank statements, and other relevant records. The Taxpayer provided the examiner with its bank statements, canceled checks, and sales and income tax returns. It failed to provide any cash register tapes because, as explained by the Taxpayer's owners, they discarded the tapes each month after they used them to compute their gross sales for the month.¹

The examiner determined from a cursory review of the Taxpayer's bank statements that the Taxpayer's monthly deposits were greater than the gross sales reported in each month. He thus decided to reconstruct the Taxpayer's sales using the Taxpayer's bank records, with various adjustments.

The examiner started with the Taxpayer's monthly bank deposits. The Taxpayer failed to provide its bank statements for several months during the audit period. The examiner estimated those monthly deposits using the same months from the prior year for which records were available.

The Taxpayer's accountant estimated that the business paid out \$25,000 in cash to employees and vendors in a given year. The examiner accordingly added those cash payouts to total receipts.

The examiner also obtained the Taxpayer's purchase records from the ABC Board. He compared the records with the Taxpayer's canceled checks, and determined that the

¹ An accountant prepared the Taxpayer's monthly sales tax returns during the period in issue. The accountant never received any sales records from the Taxpayer. Rather, a Taxpayer employee computed the business's monthly sales and telephoned the amount to the accountant.

Taxpayer had paid cash for some purchases. He also added those cash purchases to total receipts.

The examiner deducted as nontaxable deposits several income tax refunds that had been deposited into the account, and also some loans for which the Taxpayer provided sufficient records.

After determining the Taxpayer's adjusted receipts/deposits, the examiner backed out the eight percent State and local sales tax to arrive at the Taxpayer's taxable sales for the period. The examiner then compared the Taxpayer's monthly sales per the audit to its reported monthly sales and determined that the Taxpayer had consistently underreported by more than 25 percent. He consequently expanded the audit to six years, and computed the Taxpayer's liability for the prior three years by the same method discussed above.

The Taxpayer disputes the audit finding on several grounds.

First, it contends that sales tax has already been paid on its game receipts because the owner of the machines, Huntsville Gaming, removed the money from the machines each week, deducted the tax from the gross amount, and then gave the Taxpayer one-half of the net. The Taxpayer thus argues that its game receipts should be deducted from its total receipts.

The Department responded to the above contention by arguing that there is no evidence that Huntsville Gaming actually reported and paid the tax on the machine receipts to the Department. I agree. But that fact is irrelevant to the Taxpayer's liability because the owner/operator of the machines, Huntsville Gaming, and not the Taxpayer, was solely liable for the tax on the machine gross receipts. *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982).

In *Mack*, the taxpayer owned game machines that it placed at various locations. One of the issues in the case was whether the taxpayer owed the amusement sales tax on its total machine receipts, including any amounts paid to the local businesses where the machines were located. The Court confirmed that the machine owner was liable for the total tax. “The Department contends, and we agree, that Mack (the machine owner) is required by §40-23-2(2), Code 1975, to report the total gross receipts from his machines regardless of any commissions paid to location owners.” *Mack*, 411 So.2d at 803.

At the February 4 hearing, the Taxpayer provided the weekly receipts it received from Huntsville Gaming showing its share of the weekly gaming receipts. Those records were submitted to the Department examiner. Those amounts should be deleted from the Taxpayer’s gross receipts. For those few periods for which gaming receipts were not provided, the examiner should estimate the amounts using the available records.

The Taxpayer next contends that the examiner did not remove all loan amounts that were deposited into its account. As indicated, however, the examiner considered all loans for which the Taxpayer provided valid loan documents.

The Taxpayer claims that it received approximately \$27,000 as a loan from Huntsville Gaming that it used to enlarge its store building. It concedes that there was no written loan agreement, but argues that it repaid the loan with checks written to Huntsville Gaming.

The Department acknowledged that it reviewed some of the Taxpayer’s checks written to Huntsville Gaming, but did not treat the checks as loan repayments because it did not know what the checks were for.

The examiner correctly did not consider loans for which the Taxpayer did not provide proper documentation. But the fact that the Taxpayer wrote large checks to Huntsville Gaming sufficiently establishes that that entity had loaned the Taxpayer money to expand its facility, and that the checks to Huntsville Gaming constituted at least the partial repayment of the loan. Those amounts should thus be removed from gross proceeds.

The Taxpayer should provide the checks payable to Huntsville Gaming to the Administrative Law Division by March 31, 2010. They will be forwarded to the Department for review.

Finally, the Taxpayer claims that some of the cash it used to purchase liquor from the ABC Board came out of its checking account, and thus is being included twice in its net receipts. It also acknowledged, however, that some of the cash came from the bar's daily receipts.

I have no reason to doubt that some of the cash used to purchase liquor at the ABC store passed through the Taxpayer's checking account. But there is no evidence showing the amount that came from the bank account and the amount that came from the bar's receipts. The burden is on a taxpayer to keep records from which its correct liability can be determined. Code of Ala. 1975, §40-2A-7(a)(1). And if a taxpayer fails to maintain adequate records, the taxpayer must suffer the consequences. *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.) cert. denied 384 So.2d 1094 (Ala. 1980). Consequently, because there are no records showing the source and amount of the cash used to purchase liquor, the audit cannot be adjusted.

The Department examiner performed a good audit using the best information available. The checks payable to Huntsville Gaming will be submitted to the Department

examiner when received. The examiner should then recompute the Taxpayer's adjusted monthly liabilities by making the above adjustments. He should also notify the Administrative Law Division if the adjusted monthly amounts due exceed the reported tax due in each month by more than 25 percent.

The Taxpayer may also submit any other records that it deems relevant, with an explanation as to why the records should be considered. In that case, those records will also be submitted to the examiner for review.

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 March 16, 2010.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: J. Wade Hope, Esq.
Gene Bowman, Esq.
Joe Cowen
Mike Emfinger