HOPE THOMAS 136 1/2 W. BARBOUR STREET EUFAULA, AL 36027-2033,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 10-217
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Hope Thomas ("Taxpayer'), d/b/a Lakeside Restaurant, for State sales tax for October 2003 through July 2008. 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 April 20, 2010. The Taxpayer and her representatives, Albert Adams and CPA Grady Hartzog, attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer owns and is the sole member of Lakeside Restaurant, LLC, which operates a restaurant/lounge in Eufaula, Alabama.

A Department examiner audited the restaurant for sales tax for August 2005 through July 2008. The Department examiner requested the Taxpayer's sales records, including her cash register z-tapes. The Taxpayer provided a few scattered z-tapes, some purchase invoices, and her income tax returns and bank records. The examiner determined that the records were insufficient to determine the Taxpayer's correct liability. She consequently computed the Taxpayer's liability using an indirect purchase mark-up audit.

The examiner computed the Taxpayer's wholesale food purchases for the period August 2005 through July 2008 using purchase invoices either provided by the Taxpayer and obtained from various vendors. She deleted all non-food purchases that she could

identify from the invoices. She then applied the standard IRS mark-up for restaurants/lounges of 2.6675 to determine the Taxpayer's total taxable sales for the period.

The examiner also concluded from the Taxpayer's records that she had underreported her monthly sales by more than 25 percent from October 2003 through July 2005. She thus included those months in the audit pursuant to the six year 25 percent "omission" statute of limitations at Code of Ala. 1975, §40-2A-7(b)(2)b.[1] She computed the Taxpayer's liabilities for those months based solely on the gross income amounts reported by the Taxpayer on her income tax returns.

After determining the Taxpayer's monthly sales for the expanded audit period, the examiner applied the four percent State sales tax rate to arrive at the gross tax due. She then allowed a credit for the sales tax previously paid to arrive at the additional tax due. The Department also initially added the 50 percent fraud penalty levied at Code of Ala. 1975, §40-2A-11(d). It subsequently removed the fraud penalty and instead assessed the 5 percent negligence penalty at Code of Ala. 1975, §40-2A-11(c).

To begin, the Taxpayer concedes that she failed to collect and remit sales tax on her alcohol sales during the subject months based on her erroneous belief that all tax due had already been paid on the liquor/beer. The sales tax due on those lounge sales constitute a large part of the assessed amount due.

The Taxpayer argues that the Department audit is flawed for two reasons. She first contends that she sold meals to the City of Eufaula jail in 2003, 2004, and 2005, and that

[1] January and July 2004 were omitted because the examiner determined that there was less than a 25 percent omission of the taxable base in those months.

those exempt sales should be deleted from the audit. The Taxpayer's CPA submitted a printout from the City at the April 20 hearing which shows the amounts of the monthly checks written by the City to the Taxpayer. The Department agreed at the April 20 hearing to review the printout, a copy of which is attached to this Opinion and Preliminary Order.

The Taxpayer also argues that the mark-up percentage of 2.6675 is excessive because it takes into account restaurants/lounges in metropolitan areas such as New York City, Atlanta, etc., where the mark-up is arguably greater than in a rural town in Alabama.

The Taxpayer failed to provide complete cash register tapes or other sales records from which her sales tax liablity could be exactly computed. She explained that some of her records were destroyed in a fire at the restaurant in July 2007. She also failed, however, to provide sufficient sales records after that date. In any case, the Taxpayer clearly failed to fully report her retail sales during the audit period because her wholesale food purchases alone, without considering her liquor sales, exceeded her reported retail sales during the subject months.

Because the Taxpayer failed to provide adequate records, the Department was authorized to compute the Taxpayer's liability using the best method and information available. Code of Ala. 1975,§40-2A-7(a)(1). The Department examiner accordingly estimated the Taxpayer's liability using a purchase mark-up audit, which is a commonly used and accepted method of computing a taxpayer's sales tax 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's liability should be adjusted to reflect the meals sold to the exempt City of Eufaula. No adjustment should be allowed, however, concerning the 2.6675 mark-up applied by the examiner. That mark-up is an average mark-up compiled by the IRS based on a study of numerous restaurants/lounges throughout the country. The Taxpayer's mark-up may have been lower, or it may have been higher. The Department computed the Taxpayer's liability using a reasonable method and the best information available. The resulting tax due is necessarily an estimate, but having failed to provide the examiner with adequate sales records, the Taxpayer cannot now complain that the liability as estimated by the examiner may be inexact. *Jones v. C.I.R.*, 903 F.3d 1301 (10th Cir. 1990).[2]

The Department is directed to recompute the Taxpayer's liabilities after removing the exempt sales to the City of Eufaula. It should then notify the Administrative Law Division of the adjusted amounts due. It should also indicate if the adjusted amounts due for the months before August 2005 still show a 25 percent or greater underreporting of sales. An appropriate Order will then be entered.

[2] Jones was a federal income tax case. But the principle that a taxpayer that fails to provide adequate records cannot complain about a reasonable estimate of their liability applies equally to State taxes, including the sales and use taxes.

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 May 18, 2010.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
attachment
cc: Margaret Johnson McNeill, Esq.
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