

RICHARD BARNETT  
d/b/a WEST POINT SUPERETTE  
141 COUNTY ROAD 1242  
CULLMAN, AL 35057-6733,

Taxpayer,

v.

STATE OF ALABAMA  
DEPARTMENT OF REVENUE.

§ STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
§ ADMINISTRATIVE LAW DIVISION

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DOCKET NO. S. 10-611

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### **OPINION AND PRELIMINARY ORDER**

The Revenue Department assessed Richard Barnett (“Taxpayer”), d/b/a West Point Superette, for State sales tax for February 2004 through June 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 December 2, 2010. The Taxpayer attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer operated a convenience store in Cullman County, Alabama during the period in issue. The Department audited the business for sales tax and requested the Taxpayer’s cash register z-tapes, sales journals, purchase invoices, and all other relevant records. He provided some purchase invoices, but failed to produce his cash register tapes or any other sales records.

The Department examiner determined that because of the lack of sales records, she would compute the Taxpayer’s liability using a purchase mark-up audit. She reviewed the Taxpayer’s purchase invoices and determined that the invoices were complete for 13 of the months in issue. She thus used those months’ invoices with the largest purchase amounts to compute the Taxpayer’s average monthly purchases. She applied that average to the

remaining months of the audit period.<sup>1</sup> She applied a mark-up of 1.27 percent to the average purchase amounts to determine the Taxpayer's monthly retail sales for the audit period. She then allowed a credit for sales tax previously reported and paid to arrive at the additional tax due.

The Taxpayer concedes that he does not have his cash register tapes or other records showing his sales during the audit period. He explained that some of his tapes were inadvertently thrown away in 2005, and that while he kept the tapes after 2005, they all became faded, and thus illegible, after several months.

The Taxpayer argues that the examiner's computation of his average monthly purchases using only the months with the largest purchase amounts is misleading and skews the average upward because he did not buy the same amount of merchandise every month. He also claims that some vendors routinely took back some out-of-date merchandise for which he was not allowed a credit.

A purchase mark-up audit is a commonly used method of computing a taxpayer's liability in the absence of adequate records. The Administrative Law Division has affirmed the purchase mark-up audit method, and the resulting additional tax due, on numerous occasions. See generally, *GHF, Inc. v. State of Alabama*, S. 09-1221 (Admin. Law Div. 8/10/10); *Thomas v. State of Alabama*, S. 10-217 (Admin. Law Div. O.P.O. 5/18/10);

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<sup>1</sup> The examiner's audit report reads in part as follows, at 3:

"Based on the purchase invoices provided, the months with the larger amounts of purchases were used to average an amount for the remaining months where invoices were not provided or where the amounts were so small it was determined that the full amount of invoices were not provided for examination. Purchases for months February 2004, January 2005 thru April 2007 and May 2008 are an averaged amount from the remaining months (23) of invoices."

*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).

This case is different than the above-cited purchase mark-up audit cases because in the prior cases, the Department used the taxpayer's purchase invoices and/or vendor records to determine the taxpayer's actual monthly purchases. That is, no average monthly purchase amounts were used. In this case, however, as discussed, the Department used the Taxpayer's invoices for certain high purchase amount months to compute the average monthly purchase amount. It then applied the average to all months in the audit period. I agree that doing so may have skewed the average upward.

The examiner performed an otherwise good audit, but instead of estimating the Taxpayer's monthly purchases using an average of the high purchase amount months, she should have obtained the vendors' records showing his exact purchases for the subject months.<sup>2</sup> The vendors should also have records showing the dollar value of the merchandise that the Taxpayer had returned to the vendors during the audit period, which should also reduce his purchase amounts.

Code of Ala. 1975, §40-2A-7(b)(1)a. provides that if the amount of tax reported on a return is incorrect, "the department may calculate the correct tax (due) based on the most accurate and complete information reasonably obtainable. . . ." The Taxpayer's vendors were required to keep accurate records of their sales to the Taxpayer, see Code of Ala.

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<sup>2</sup> The Department examiner, when asked why she didn't get the purchase information from the Taxpayer's primary vendors, responded that that would have required subpoenaing the records from the vendors.

1975, §40-2A-7(a)(1). The Department is also authorized to review those records, Code of Ala. 1975, §40-2A-7(a)(2). The vendors' records in issue were thus "reasonably obtainable" by the Department, and thus should have been obtained and used to perform the purchase mark-up audit of the Taxpayer.

The Taxpayer purchased from approximately eight major vendors during the audit period. The Department should obtain those records and also any "buy back" records that the vendors may have concerning the Taxpayer, either by letter request, or, if necessary, by subpoena. The Department should then recompute the purchase mark-up audit and notify the Administrative Law Division of the adjusted amount due.

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 January 27, 2011.

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BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: J. Wade Hope, Esq.  
Richard Barnett  
Joe Cowen  
Mike Emfinger