L & J DIRT, INC. 463 5TH AVENUE CHICKASAW, AL 36611,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. MISC. 10-823
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

This appeal involves a final assessment of Alabama uniform severance tax entered against L & J Dirt, Inc. ("Taxpayer") for October 2004 through December 2007. The uniform severance tax is levied "on the purchaser of all severed materials severed from the ground and sold as tangible personal property." Code of Ala. 1975, §40-13-52. Like the sales tax levied at Code of Ala. 1975, §40-23-1 et seq., the person or entity that sells the severed materials is required to collect the tax and remit it to the Department. There is an exemption, however, for all materials "used for fill by an operator, producer or any other person. . . ." Code of Ala. 1975, §40-13-53(b)(2).

The Taxpayer in this case operated a "dirt pit" in Mobile County, Alabama. It sold some of the severed materials, and also sometimes used the materials on contracts with its customers. A portion of the materials was used as fill, either by the Taxpayer or its customers.

The primary legal issue is whether the "fill" exemption applies only if the materials are both severed and also used as fill by the same entity or person, as argued by the Department, or whether the statute exempts all materials sold and used as fill, as contended by the Taxpayer. The Administrative Law Division entered an Opinion and Preliminary Order on April 18, 2011 holding that the exemption broadly applied to all

materials sold and used as fill, regardless of who severed the materials.

The Taxpayer had not kept separate records of its taxable and exempt sales during the period in issue because it believed in good faith, based on a memorandum issued by the Department and the written advice of an attorney, that the business was not subject to the severance tax in issue. Consequently, the April 18, 2011 Order, at p. 7, allowed the Taxpayer "to gather affidavits, potential witnesses, or other evidence verifying that the materials sold to the customers during the period in issue were used as fill, and thus exempt."

The Taxpayer responded in May 2011 by submitting sworn affidavits from seven of its customers stating that the customers had purchased severed materials from the Taxpayer during the assessment period, and that the materials had been used exclusively as fill. The affidavits were submitted to the Department for review and response.

The Department's response in substance disputed the Administrative Law Division's legal conclusions in the April 18, 2011 Opinion and Preliminary Order, but did not address the affidavits.

The Taxpayer submitted twelve more sworn affidavits in mid-July 2011 for more customers that, according to the affidavits, had purchased materials from the Taxpayer during the audit period that were used exclusively as fill. Those affidavits were also submitted to the Department for review and response.

The Department responded that the affidavits were insufficient. "To now allow a taxpayer to substitute affidavits for actual records is not good tax policy. Anyone can get someone to sign an affidavit. There is no way to challenge the affidavits and they are self-serving." Department's July 27, 2011 Letter at 1.

The Taxpayer in turn responded in part as follows:

> It is true that the Taxpayer did not keep records specifically identifying which transactions involved fill materials because, as he testified at the hearing, all transactions from this operation involved fill material. This was, as noted in the Opinion, a good faith mistake in the Taxpayer's bookkeeping but, based on the type of materials and the customer base served, it was never anticipated that such a distinction would be necessary. The Judge allowed the Taxpayer time to document and verify as best possible that his testimony was true and all materials severed and sold from this operation was sold as fill. The Taxpayer undertook this task with thought and seriousness and with assistance of undersigned counsel initiate a plan to contact all customers of the company for the audit period and have them execute an affidavit verifying that the material sold by the Taxpayer was utilized by that customer as fill. Despite the passage of time and the changes that have occurred with these companies the effort to contact them and obtain this testimony was very successful. Now having completed this task at great expenses the Department's response is simply to hurl insults not just at the Taxpayer but also toward a couple dozen Mobile area business owners, two by name.

I agree that under normal circumstances, affidavits should not be accepted in lieu of accurate, contemporaneous records. But under the unusual circumstances in this case, I would have thought that the Department would have accepted the affidavits submitted by the Taxpayer's customers. As discussed in the April 18, 2011 Opinion and Preliminary Order at 2, in July 2004, the Department notified the Taxpayer and all others subject to the newly enacted severance tax that "the severance tax does not apply to severed materials used as fill. . . ." Based on that statement, the Taxpayer and others subject to the tax would reasonably believe and understand that materials they sold to customers that intended to use the materials as fill would be exempt.

The Department claims that it clarified the issue with a second notice mailed in September 2004 that stated – "In addition, the severance tax does not apply to materials severed and used by a producer, operator, or any other person for fill." (emphasis added) But that clarification only restated in substance the statutory exemption, which provides that

severed materials sold to and used by any person as fill is exempt.

As discussed in the April 18, 2011 Opinion and Preliminary Order, if the Department's position is correct that the exemption applies only if the person or entity that severs the materials also uses the materials as fill, then the "fill" exemption would have no field of operation.

> The above finding is further bolstered by the fact that the tax is levied on the purchaser, §40-13-52, and applies only to severed materials that are "sold as tangible personal property." Section 40-13-53(a). Severed materials that are used by an operator/producer as fill are not sold, and thus are not subject to the tax to begin with. Construing the exemption to apply only to materials that are not taxed to begin with would render the exemption meaningless. (footnote omitted) The exemption thus must apply to materials sold to customers and used as fill.

Opinion and Preliminary Order at 5.

Unfortunately for the Taxpayer, Alabama law is clear that the burden is on the Taxpayer to prove that certain of its sales were exempt from tax. In *Alabama Department of Revenue v. The National Peanut Festival Assoc., Inc.*, 51 So.3d 353 (Ala. Civ. App. 2010), the issue was whether some of the Festival's gate receipts were exempt from tax. The Court stated the applicable law, as follows:

> Generally speaking, Alabama law places the burden on the taxpayer to clearly establish its right to an exemption. See *Flav-O-Rich, Inc. v. City of Birmingham*, 476 So.2d 46, 48 (Ala. 1985). When the taxpayer generates income, some of which is taxable and some of which is not taxable, the burden rests on the taxpayer to prove that portion which is not taxable. See, e.g., *John Gary Ellis, Southern Breeze, LLC v. State of Alabama*, Administrative Law Division Dkt. No. S. 07-834 (entered on August 25, 2008). That burden of proof coincides with the general duty of a taxpayer that is subject to an amusement tax to maintain suitable records "as may be necessary to determine the amount of tax for which he is liable." § 40-23-9, Ala. Code 1975. Based on that legal authority, we conclude that the taxpayer bore the burden of proving on remand the portion of the gate admission receipts that were exempt from taxation pursuant to § 40-9-1(12).

National Peanut Festival, 61 So.3d at 357.

While the Taxpayer in this case has presented evidence via the affidavits that some of its sales were exempt pursuant to the "fill" exemption at §40-13-53(b)(2), there is no evidence showing the amount of the exempt sales. Without such evidence, I cannot find that the Taxpayer has carried its burden of proving it is entitled to the exemption. Consequently, while I sympathize with the Taxpayer's owner, the final assessment must be affirmed.

Under the circumstances, the penalty is waived for cause. The final assessment, less the penalty, is affirmed. Judgment is entered against the Taxpayer for tax and interest of $31,203.91. Additional interest is also due from the date the final assessment was entered, August 13, 2010.

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

Entered June 26, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
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