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| MASOUD MORSHEDI, THE SOLE MEMBER OF M&S FOOD MART LLC, A DISREGARDED ENTITY, d/b/a JET PEP #434 1608 BESSEMER ROAD BIRMINGHAM, AL 35208-4011, | § | STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION |
| Taxpayer, | § | DOCKET NO. S. 12-1073 |
| v. | § | |
| STATE OF ALABAMA DEPARTMENT OF REVENUE. | § | |

**FINAL ORDER**

The Revenue Department assessed Masoud Morshedi ("Taxpayer"), the sole member of M&S Food Mart LLC, for State sales tax for June 2008 through November 2011. 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 7, 2013. The Taxpayer and his representative, Taylor Meadows, attended the hearing. Assistant Counsel Craig Banks represented the Department.

The Taxpayer owns and operates a convenience store/gas station at 1608 Bessemer Road, Birmingham, Alabama. He opened the store in January 2005.

A Revenue Department examiner audited the Taxpayer for sales tax for June 2008 through November 2011. The Taxpayer failed to provide the examiner with any sales or other records. The examiner consequently computed the Taxpayer's liability for the audit period using a purchase mark-up audit.

The examiner requested information from eight of the Taxpayer's major vendors concerning the merchandise purchased by the Taxpayer and delivered to his store at 1608 Bessemer Road in Birmingham during the audit period. Seven of the vendors provided the

purchase information for the entire audit period. Sam's Club failed to provide the information for the last three months (September – November 2011) of the period. The examiner consequently estimated the Taxpayer's Sam's Club purchases for those months using the average of his Sam's Club purchases in the other months of the audit period. The vendor records showed that the Taxpayer had purchased $1,407,128 in merchandise from the vendors at wholesale during the audit period. The Taxpayer had reported and paid sales tax on retail sales of $875,712 during the period.

The examiner applied a 33.61 percentage mark-up to the Taxpayer's wholesale purchases to determine his retail sales during the period. The standard IRS mark-up for convenience stores/gas stations is 48 percent, which generally takes into account merchandise loss for spoilage, theft, etc. The examiner explained in her audit report, Department Ex. 3 at 2, that "[t]o account for spoilage of inventory, the mark-up percentage used (33.61 percent) is below the IRS statistical tables (48 percent) for the food and beverage stores category."

After computing the Taxpayer's estimated retail sales, the examiner applied the four percent State sales tax rate to determine the total tax due for the period. She then allowed a credit for sales tax previously paid for the period, which resulted in additional tax due of $43,087.99.

The Taxpayer's representative subsequently provided the examiner with the Taxpayer's bank statements and a spreadsheet based on those bank records showing what the representative claimed were the Taxpayer's retail sales for the audit period. The

representative also objected that the Sam's Club purchases for the last three months of the audit period should not be used because they were estimates.

The Department examiner reviewed and rejected the bank statements and spreadsheet because (1) the bank deposits included both taxable and non-taxable sales, (2) there were no documents supporting the spreadsheet, (3) the Taxpayer paid some vendors in cash, and (4) all of the cash received by the business could not be verified. The examiner did, however, remove the Sam's Club estimates for September – November 2011, which reduced the tax due, as reflected on the final assessment in issue, to $40,042.20.

The Taxpayer's representative argues that the Department's purchase mark-up audit is based on estimates, and that his spreadsheet based on the Taxpayer's bank statements more accurately shows the Taxpayer's retail sales during the audit period. He cites numerous cases in which the Administrative Law Division has accepted the Department's use of a taxpayer's bank records as the best information available to compute the taxpayer's sales tax liability. He also argues that the 33.61 percent mark-up is too high, and that some of the vendor purchase records used in the audit may have involved purchases by other similarly named stores in the area.

The Department has sometimes used a taxpayer's bank records to compute a taxpayer's sales tax liability when the taxpayer failed to keep accurate and complete sales records. See, *Sports Page Downtown Athletic v. State of Alabama*, Docket S. 00-775 (Admin. Law Div. 6/5/2001); *State of Alabama v. Red Brahma Club, Inc.*, Docket S. 92-171 (Admin. Law Div. 4/7/1995). But in those cases, however, other records were also used to

supplement and/or verify the bank information. In any case, the fact that the Department has occasionally used a taxpayer's bank records to compute the taxpayer's sales tax liability does not mandate that the Department must use such bank records. Rather, the Department is empowered to use any reasonable method under the circumstances. In *Ashland Enterprises, Inc. v. State of Alabama*, Docket S. 12-236 (Admin. Law Div. 1/16/2013), the taxpayer operated various retail outlets in Alabama. As in this case, it failed to provide the Department with any sales or purchase records. The Administrative Law Division affirmed the Department's use of a purchase mark-up audit, as follows:

> In such cases, the Department is authorized to compute a taxpayer's correct liability using the most accurate and complete information obtainable. Code of Ala. 1975, §40-2A-7(b)(1)a. The Department can also use any reasonable method to compute the liability, and the taxpayer, having failed in the duty to keep good records, cannot later complain that the records and/or method used by the Department is improper or does not reach a correct result. *Jones v. CIR*, 903 F.3d 1301 (10th Cir. 1990); *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980) (A taxpayer must keep records showing the business transacted, and if the taxpayer fails to keep such records, the taxpayer must suffer the penalty for noncompliance). The Department examiner thus properly conducted a purchase mark-up audit to compute the Taxpayer's liability for the subject period.
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> The purchase mark-up audit is a simple, oft-used Department method of determining a taxpayer's sales tax liability when the taxpayer fails to keep accurate sales records. 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); *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04).

*Ashland Enterprises* at 4 – 5.

The vast majority of sales tax audit cases heard by the Administrative Law Division have involved purchase mark-up audits because that audit method is straight-forward, simple, and generally accurate. The taxpayer's wholesale purchases are computed using

reliable records from impartial third party vendors. A historically accurate average mark-up is then applied to reasonably estimate the taxpayer's retail sales.

In this case, the Department examiner obtained complete purchase information from seven of the Taxpayer's eight biggest vendors. The eighth vendor, Sam's Club, provided exact information for all but three months of the audit period. The examiner initially estimated the Taxpayer's purchases for those three months, but removed the estimates when the Taxpayer's representative complained, which reduced the Taxpayer's liability accordingly. The examiner also found that the Taxpayer had purchased goods from other vendors during the period. But she did not include those in the audit, which again benefitted the Taxpayer. Finally, the examiner applied a 33.61 percent mark-up, which was substantially less than the 48 percent mark-up applied by the IRS.

It is true that the mark-up percentage used in a purchase mark-up audit is, by its nature, an estimate. But an estimate is required in a mark-up audit only because the taxpayer failed to keep accurate sales records, as in this case. And on balance, a purchase mark-up audit is more reliable than a bank records audit because there is no guarantee that all of the retailer's sales proceeds had been deposited into the bank account.

The Taxpayer's tax preparer testified that she computed the Taxpayer's monthly sales tax liabilities using his bank statements. Consequently, it is not surprising that the tax due as shown on the spreadsheet prepared by the Taxpayer's representative using the bank records approximated the tax reported by the Taxpayer during the period. But again, the fatal flaw in the Taxpayer's position is that there is no way of knowing if some of the

store's cash receipts were diverted for various purposes and not deposited into the bank account.

The Taxpayer's representative also speculated that some of the vendor records obtained by the examiner may have actually reflected merchandise purchased by other stores in the area. But as indicated, the examiner requested purchase records in the Taxpayer's specific name, and for deliveries made specifically to the Taxpayer's store address, 1608 Bessemer Road, Birmingham, Alabama. Without evidence to the contrary, the vendor purchase information obtained from the vendors and used by the examiner is the best information available, and must be accepted as correct.

The reduced 31.66 percent mark-up used by the examiner is also reasonable under the circumstances, and is in fact below the mark-up percentages used in prior convenience store audits. See, *Quick N Ez v. State of Alabama*, Docket S. 10-245 (Admin. Law Div. 8/23/2011) (51%); *Farace v. State of Alabama*, Docket S. 05-451 (Admin. Law Div. 8/22/2005) (35%).

The Taxpayer clearly underreported his taxable sales during the period because he purchased over $1.4 million in inventory at wholesale, without mark-up, during the 42 month audit period, but only reported taxable sales of just over $875,000 for the period. That is, he purchased an average of over $33,500 in merchandise each month, yet reported on average less than $21,000 in retail sales each month. Clearly, the Taxpayer could not have done so and stayed in business, much less paid the other operating expenses required to keep the business open.

The final assessment is affirmed. Judgment is entered against the Taxpayer for State sales tax, penalty, and interest of $45,885.49. Additional interest is also due from the date the final assessment was entered, August 9, 2012.

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

Entered April 2, 2013.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Craig A. Banks, Esq.
Taylor Meadows, Esq.
Joe Walls
Mike Emfinger