MUKESH J. ZAVERI, d/b/a R&R WHOLESALE 3412 HARTWOOD CIR. APT. 8 HOOVER, AL 35216-7809,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 12-185
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Mukesh J. Zaveri ("Taxpayer"), d/b/a R & R Wholesale, for State sales tax for September 2007 through August 2010. 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 August 28, 2012. The Taxpayer and his representative, Warren Maze, attended the hearing. Assistant Counsel Christy Edwards represented the Department.

The Taxpayer sold candy, phone cards, tobacco products, health and beauty products, and various other items out of a van during the period in issue. The Department concedes that "[i]t does appear that the taxpayer only sold to . . . convenience stores. . . ." (T. at 4). The Taxpayer did not have an Alabama sales tax license/number during the period in issue, and consequently did not file Alabama sales tax returns during the period.

Two Department examiners audited the Taxpayer for sales tax for the subject period. The examiners requested the Taxpayer's sales tax-related records. The Taxpayer provided sales invoices for some of the months in issue, but the invoices did not show the customer's full name, address, or sales tax number. The Taxpayer also provided some purchase invoices.

The examiners determined that the Taxpayer's records were insufficient to do a direct audit. They consequently conducted an indirect purchase mark-up audit. The examiners explained their audit procedures in their confidential audit report, as follows:

Audit Procedures

> Since the purchase records obtained are greater than the sales invoices provided, a purchase markup audit was conducted. Sales to R & R Wholesale were requested from Clear Connect Communications. They provided a sales total for September 2007 through December 2009 and a second total for January 2010 through August 2010. These totals were prorated for each period in the audit. All the purchase invoices provided, excluding Clear Connect Communications, were listed on the Schedule **Purchase for Resale (Excluding Clear Connect Communications)**. The purchases from Clear Connect Communications were added to the other purchases to arrive at total purchases. The total purchases were then multiplied by the markup percentage to arrive at estimated sales. This is shown on the Schedule **Estimated Taxable Sales**. The markup percentage was computed by sampling sales invoices for the sample months of January 2009, January 2010, and July 2010. Sales invoices were listed showing item description, quantity sold, price each, and total sales price. Purchase invoices were then matched to the items sold and the cost of the items sold was listed. The cost was then compared to the sales price to arrive at the markup percentage. This is shown on the schedule **Computation of Markup Percentage**.

Reason for Assessment of Additional Tax

> Wholesale sales exempt from sales tax must be documented. R & R Wholesale has not maintained records documenting exempt wholesale sales. R & R Wholesale has been audited in the past and instructed to maintain records documenting exempt sales, but the records have still not been properly maintained. Since the invoices provided do not identify the customer, they cannot be used to document exempt sales. Mr. Zaveri was given the opportunity to provide sales tax numbers and addresses for his customers, but has failed to do so. Mr. Zaveri stated if he asks for sales tax numbers, his customers would not buy from him.

The Taxpayer's representative contends that all of the Taxpayer's sales were tax-free wholesale sales for resale to convenience stores. He also argues that the Taxpayer's

purchase records showed more purchases than sales because some of the Taxpayer's vendors forced him to take false invoices. The representative submitted a news article showing that one of the Taxpayer's vendors was indicted for tax evasion, which included giving false invoices to customers. The representative's appeal letter reads in pertinent part as follows:

> Because purchase records furnished by the taxpayer reflected purchases that exceeded sales, the auditor verified sales from one vendor then added markup to all purchases. The taxpayer indicated to me he told the auditor extra purchase invoices were included in his purchase records because two major distributors were padding his invoices with extra invoices for merchandise he neither sales (sic) or ever received or paid for. Mr. Zaveri indicated the distributors insisted he take the invoices so he did what they ask. It appears from my conversation with the taxpayer, the auditor shrugged his shoulders at this information and chose to ignore it. I assume the auditor just took it as a false claim on the part of the taxpayer but it appears to me to be a serious accusation that should have been of interest at least. I viewed a sampling of the invoices and there were definitely instances of invoices for merchandise that appeared to have no relation to the taxpayer's merchandise line. I will be investigating the taxpayer's claim regarding these two distributors.

The representative provided additional records at the August 26, 2012 hearing. The Department reviewed the records and responded as follows – "The Department accepted only the invoices provided at the hearing that could be verified as wholesale sales by matching the customer's name on the invoices with a customer with a sales tax number. The remainder of the invoices could not be verified as invoices for wholesale sales and were not allowed to further reduce the assessment."

If the Taxpayer sold exclusively to convenience stores, the sales would constitute tax-free wholesale sales for resale and the Taxpayer would have no sales tax liability. The problem is that only sales to licensed retailers qualify as tax-free wholesale sales, *State v.*

Advertiser Company, 337 So.2d 442 (1976), and the Taxpayer generally failed in his duty to keep records identifying his customers as licensed retailers. The Department thus cannot confirm that the Taxpayer only sold to licensed retailers for resale.

All taxpayers are required to keep records from which the Department can determine their correct liability. Code of Ala. 1975, §40-2A-4(a)(1). If a taxpayer has taxable and non-taxable sales, but fails to keep records identifying the non-taxable sales, "[t]he taxpayer must suffer the penalty and pay on the sales not so accurately recorded as exempt." *State v. Ludlum*, 384 So.2d 1089, 1091 (Ala. Civ. App. 1980), quoting *State v. T.R. Miller Mill. Co.*, 130 So.2d 185, 190 (Ala. 1960).

It appears that some of the Taxpayer's customers were attempting to fraudulently evade sales tax during the subject period because the only reason a retailer would not give a vendor its sales tax number would be to prevent the Department from tracking its purchases. Be that as it may, the Taxpayer, like all other businesses selling tangible personal property for resale, was under a duty to keep accurate records showing the amount of his sales and his customers' names, locations, and sales tax numbers. The Taxpayer failed to do so during the audit period, even though he was instructed in a prior Department audit to keep such records. Consequently, the Taxpayer must be held liable for sales tax on his sales that he cannot prove were to licensed retailers for resale.

The Department contends that the 50 percent fraud penalty should apply because the Taxpayer was told in the prior Department audit that he should keep records, but failed to do so.

Code of Ala. 1975, §40-2A-11(d) levies a 50 percent penalty for any underpayment due to fraud. For purposes of the penalty, "fraud" is given the same meaning as ascribed in the federal fraud provision, 26 U.S.C. §6663. Consequently, federal authority should be followed in determining if the fraud penalty applies. *Best v. State, Dept. of Revenue*, 423 So.2d 859 (Ala. Civ. App. 1982).

The Department is required to prove fraud by clear and convincing evidence. *Bradford v. C.I.R.*, 796 F.2d 303 (1986). "The burden is upon the commissioner to prove affirmatively by clear and convincing evidence actual and intentional wrongdoing on the part of the (taxpayer) with a specific intent to evade the tax." *Lee v. U.S.*, 466 F.2d 11, 14 (1972), citing *Eagle v. Commissioner of Internal Revenue*, 242 F.2d 635, 637 (5th Cir. 1957). The existence of fraud must be determined on a case-by-case basis, and from a review of the entire record. *Parks v. Commissioner*, 94 T.C. 654, 660 (1990).

Because fraud is rarely admitted, "the courts must generally rely on circumstantial evidence." *U.S. v. Walton*, 909 F.2d 915, 926 (6th Cir. 1990), citing *Traficant v. Commissioner*, 884 F.2d 258, 263 (6th Cir. 1989). Consequently, fraud may be established from "any conduct, the likely effect of which would be to mislead or conceal." *Walton*, 909 F.2d at 926, quoting *Spies v. United States*, 63 S. Ct. 364, 368 (1943). The failure to keep adequate records and the consistent underreporting of tax is strong evidence of fraud. *Wade v. C.I.R.*, 185 F.3d 876 (1999) ("There is no dispute (taxpayer) kept inadequate books and records, further suggesting fraud.").

The Taxpayer in this case maintained some purchase and sales records. The problem is that his sales invoices failed to adequately identify his customers or include their

sales tax numbers. But while the failure to maintain records is an element of fraud, the facts in this case, when considered together, do not show that the Taxpayer fraudulently intended to evade tax.

The Taxpayer apparently speaks only broken English at best. The Department examiner that previously audited the Taxpayer also stated in his audit report that "Mr. Azeri and I had difficulty communicating because of a language barrier." The above does not excuse the Taxpayer for failing to keep records, but it suggests that he may not have fully understood his duty to do so.

Importantly, the Taxpayer believed that his sales to his convenience store customers were tax-free sales for resale, and in fact, most of the items he sold to his convenience store customers were probably resold. Consequently, if he had kept complete and accurate records, he would most likely owe little if any additional tax. In other words, it is only because of the Taxpayer's failure to keep adequate records that he is liable for sales tax to begin with.

It is believable that some of the Taxpayer's customers may have provided him with false purchase invoices, thus inflating the Taxpayer's actual sales. It is also believable that those same customers would refuse to give the Taxpayer their sales tax numbers. As stated in the Department's audit report, the Taxpayer explained to the examiners that if he asked for sales tax numbers, his customers would not buy from him. While I do not condone the Taxpayer's failure to maintain complete and accurate records, it is understandable why he did so under the circumstances.

Under the circumstances, I find that the Taxpayer did not fraudulently fail to report and pay sales tax on his sales during the audit period. Rather, his failure to maintain records only caused him to be liable for sales tax on his sales that were most probably otherwise tax-free sales for resale. The Taxpayer is on notice, however, that his failure to keep complete and accurate records in the future may result in the assessment of the fraud penalty.

The tax and interest as assessed by the Department is affirmed. The fraud penalty is waive for cause. Judgment is entered against the Taxpayer for $311,247.41. Additional interest is also due from the date the final assessment was entered, December 28, 2011.

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

Entered February 20, 2013.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Christy O. Edwards, Esq.
Warren Maze
Joe Walls
Mike Emfinger