MOSELEY'S FEED STORE, INC. 6349 2ND AVENUE THOMASTON, AL 36783,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 12-237
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Moseley's Feed Store, Inc. ("Taxpayer") for State and local sales tax for August 2008 through December 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 August 30, 2012. The Taxpayer's owner, Al Moseley, and retired Circuit Court Judge Claud Nielson attended the hearing. Assistant Counsel Christy Edwards represented the Department.

The undisputed facts and the disputed issue are concisely stated in the Department's Post-Hearing Brief, at 1 – 4, as follows:

Statement of the Facts

> Mr. Moseley, shareholder and manager of the Taxpayer, operates an agricultural supply store and sells products such as livestock feed, deer feed, dog feed, cat feed, seed, fertilizer, farm equipment and farm supplies at retail. The Department conducted a sales tax audit and determined that the Taxpayer's purchases exceeded its reported retail sales. Because the Taxpayer had insufficient records to determine the retail price of the products it sold, a purchase markup audit was conducted to determine the correct amount of sales tax owed. The audit revealed two reasons for the underpayment of sales tax: first, the Taxpayer's purchases exceeded reported sales, and second, the Taxpayer incorrectly determined that sales of certain items were exempt, such as feed and fertilizer purchases for non-agricultural use.
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> At the beginning of the audit, Mr. Moseley supplied the auditor with the following records: monthly sales journals, purchase invoices, bank statements, and income tax returns. It is undisputed that Mr. Moseley did not have a cash

register and did not keep daily worksheets showing daily sales. It is undisputed that Mr. Moseley did not document individual sales. Mr. Moseley did provide monthly sales worksheets. Those worksheets contained monthly sales by category, e.g., feed, fertilizer, supplies, etc. Mr. Moseley did not provide documentation to show how those monthly sales were calculated, and the auditor was unable to determine how the totals were calculated. At the end of each month, Mr. Moseley would take the totals from these worksheets and report the totals from each category it determined taxable as gross sales of taxable items.

Purchase invoices evidencing taxable sales for the period of January 2011 through July 2011 were compared to the taxable sales reported by the Taxpayer for those periods and the auditor determined that reported sales were less than purchases. It appeared from the purchase invoices that the Taxpayer purchases large amounts of feed, but there was no category on the monthly worksheets for such items. Mr. Moseley indicated that he reported such items under the supplies category, but the category of supplies reported was not large enough to include these items. Also, the Taxpayer's sale of propane refills for propane bottles was not reported on the monthly worksheets.

For the overall audit period, taxable purchases totaled $578,288.07 and reported taxable sales totaled $83,315.30. Because of the limited availability of records, a purchase markup audit was determined to be the best method to determine total taxable sales. The auditor compared items on purchase invoices with the shelf price of the corresponding items and determined that the Taxpayer had an overall average markup of 20%. No adjustments were given for on hand inventory because the beginning inventory and ending inventory were about the same. The Taxpayer was allowed a 5% spoilage/spillage allowance. After all adjustments were made, sales tax was calculated by multiplying the tax rate by total taxable sales. Credit was given for taxes paid and no penalties were assessed, as Mr. Moseley was very corporative and forthcoming with what records it had.

Issues in Dispute

The Taxpayer, through its representative, argued in its notice of appeal, and again at the hearing, that the auditor incorrectly included sales of fertilizer bagged as deer plot fertilizer in her determination of taxable sales. The Taxpayer argues that it also sold fertilizer bagged as deer plot fertilizer to farmers for agricultural use and that such sales were not taxable sales. Mr. Moseley did not dispute that he did not keep a single record regarding who the Taxpayer sold fertilizer to, whether bagged as deer plot fertilizer or simply as 16-4-8 fertilizer. It appears that this issue is the only issue the Taxpayer asserts on appeal.

The Department does not dispute that the fertilizer bagged as deer plot fertilizer during the months when deer plots are typically planted is the same product bagged simply as 16-4-8 fertilizer during other times of the year. Mr. Moseley testified at the hearing that during the months that he makes purchases of deer plot fertilizer from the vendor, he also purchases and stocks fertilizer bagged by the vendor as 16-4-8, and that he has both bag types on his shelves at the same time. Because Mr. Moseley could not provide documentation evidencing who the fertilizer was sold to, or that it was sold for agricultural use, the Department included sales of fertilizer bagged as deer plot fertilizer in the Taxpayer's taxable sales. The auditor determined from the Taxpayer's purchase invoices that the Taxpayer had $177,593.40 in taxable sales of fertilizer bagged as deer plot fertilizer during the audit period, and that the Taxpayer purchased fertilizer bagged as deer plot fertilizer only in the months of September and October of the audit period, which is the time of year hunters fertilize plots they have prepared to feed and attract deer. Of the $20,971.45 assessed for state sales tax due, $7,103.74 was a result of the auditor's inclusion of fertilizer bagged as deer plot fertilizer in taxable sales. Of the $15,703.04 assessed for local sales tax due, $5,327.78 was a result of the auditor's inclusion of fertilizer bagged as deer plot fertilizer in taxable sales.

ANALYSIS

The sale of fertilizer used for agricultural purposes is exempt from sales tax. Code of Ala. 1975, §40-23-4(a)(2). Department Reg. 810-6-3-.01.01 defines "agriculture" as "the art or science of cultivating the ground, and raising and harvesting crops, including also feeding, breeding, and management of livestock and poultry; tillage; husbandry, farming." Department Reg. 810-6-3-.01.02(1) defines "livestock" to include "cattle, swine, sheep, goats and members of the equidae family of mammals such as horses, mules and donkeys." Paragraph (2) of that regulation also provides that all animals not listed in paragraph (1) are not livestock. Based on the above, I agree with the Department "that the planting of fields or plots for the purpose of feeding or attracting deer does not meet the regulatory definition of agriculture." Department's Post-Hearing Brief at 5. Consequently, the sale of fertilizer used for feeding and/or attracting deer is not exempt from sales tax.

The disputed issue in this case is whether the burden was on the Taxpayer to maintain records showing that the deer plot fertilizer it sold during the audit period was to be used for exempt agricultural purposes, or whether the burden was on the Department to prove that the deer plot fertilizer was not used for agricultural purposes, i.e., was used to feed and attract deer for hunting purposes.

As discussed below, Alabama law is clear that the burden and duty is on a taxpayer to keep adequate records allowing the Department to compute the tax owed by the taxpayer, and also proving or verifying that the taxpayer is entitled to a claimed exemption or deduction.

Code of Ala. 1975, §40-2A-7(a)(1) provides generally that "taxpayers shall keep and maintain an accurate and complete set of records, books, and other information sufficient to allow the department to determine the . . . correct amount of any tax" due the Department. Code of Ala. 1975, §40-23-9 also specifies that any retailer subject to Alabama sales tax has a duty to keep suitable records showing the correct amount of sales tax due. Inherent in the above recordkeeping requirements is the duty to keep records showing that an otherwise taxable retail sale is exempt from tax.

Alabama's courts have also interpreted the above recordkeeping statutes as requiring taxpayers to maintain adequate records proving that they are entitled to a statutory exemption. In *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App. 1980), the Alabama Court of Civil Appeals, quoting *State v. T.R. Miller Mill Co.*, 130 So.2d 185, 190 (1961), stated that "[t]he State is not required to rely on verbal assertions of the taxpayer in maintaining the correctness of the tax return, but records should be available disclosing the business transacted. Where there are no proper entries on the records. . . , the taxpayer

must suffer the penalty of noncompliance and pay on the sales not so accurately recorded as exempt." *Ludlum*, 284 So.2d at 1091.

The Taxpayer in this case admittedly failed to keep any cash register tapes, sales invoices, or other contemporaneous sales records. Specifically, the Taxpayer failed to maintain any records showing that some or all of the deer plot fertilizer in issue was sold for an exempt agricultural purpose. Consequently, based on the above statutes and case law, it would appear that there is no question that the Department correctly assessed the Taxpayer on the undocumented deer plot fertilizer sales.

The issue is complicated, however, by Department Reg. 810-6-3-.20.01. That regulation provides for a safe harbor agricultural exemption certificate that, if executed by the purchaser and maintained by the retailer, relieves the retailer from liability if it is later determined that the purchaser did not use the product for an exempt agricultural purpose.

Retailers are not required to use the agricultural exemption certificate, and paragraph (3) of the regulation specifies that the items listed in the relevant agricultural exemption statutes are still exempt when used for agricultural purposes, even if the exemption certificate is not executed at the time of sale. The second sentence in paragraph (3) also provides – "Liability for sales or use tax on such items will later arise only if the Revenue Department determines that the item purchased, in fact, was not used for an agricultural purpose."

At first blush, the above sentence seems to shift the burden to the Department to prove that the item in issue was not used for an exempt agricultural purpose. I agree with the Department, however, that if that interpretation is accepted, the result would be absurd. All retailers selling fertilizer or other agricultural products could refuse to keep sales records

and refuse to have their customers complete the Reg. 810-6-3-20.01 exemption certificate, yet still not be liable for sales tax on the undocumented sales because the Department could not as a practical matter prove that the products were not used for an exempt agricultural purpose. An interpretation of a statute or regulation that leads to an absurd result must be rejected. *Sizemore v. Franco Distributing Co., Inc.*, 594 So.2d 143 (Ala. Civ. App. 1991).

A Department regulation must be followed unless it is unreasonable or contrary to a statute. *Ex parte White*, 477 So.2d 422 (Ala. 1985). Normally, a Department regulation is struck down if it imposes an unreasonable burden on a taxpayer subject to the regulation. In this case, however, if the regulation is interpreted to require the Department to prove that the deer plot fertilizer in issue was not used for an exempt agricultural purpose, the regulation would require the Department to prove how the Taxpayer's customers used the fertilizer. That requirement would obviously be unreasonable because (1) the Taxpayer failed to keep records identifying its customers that purchased the deer plot fertilizer, and (2) even if the Department could identify the customers, it could not prove months or years after the fact how the customers used the fertilizer.

In any case, the interpretation of the regulation argued by the Taxpayer must be rejected because it would be contrary to the recordkeeping statutes cited above. As discussed, Alabama's courts have construed those statutes as requiring a taxpayer to maintain records showing that it is entitled to an exemption from taxation. A Department regulation that is contrary to a statute must be rejected, regardless of which party the regulation may benefit or harm.

The above considered, the second sentence of paragraph (3) of Reg. 810-6-3-20.01 must be construed to mean that where a purchaser has executed an agricultural exemption certificate, liability will arise only if the Department later discovers that the item was, in fact, not used for agricultural purposes. In that case, however, the purchaser and not the retailer will be liable for the tax.

Because the Taxpayer in this case failed to have its customers execute the safe harbor agricultural exemption certificates, and because it also otherwise failed to keep records showing that the fertilizer in issue was sold and used for an exempt agricultural purpose, the tax assessed on the deer plot fertilizer must be affirmed.

I note that while the Taxpayer failed to keep records or provide the agricultural exemption certificates for any of its fertilizer sales during the audit period, the Department only assessed the Taxpayer on its sales of deer plot fertilizer. Technically, the Department could have assessed the Taxpayer on all of its undocumented fertilizer sales. It elected not to.

I note further that the Taxpayer's purchase invoices showed that it purchased $578,288 in merchandise at wholesale for resale during the audit period, but reported and paid sales tax on only $83,315 in retail sales during the period. The above shows that the Taxpayer substantially underreported its taxable sales during the audit period. In numerous prior appeals heard by the Administrative Law Division, the Department has assessed, and the Administrative Law Division has affirmed, the fraud penalty in such cases of substantial underreporting. *Melton v. State of Alabama*, Docket. S. 10-376 (Admin. Law Div. 11/4/2010); *GHF, Inc. v. State of Alabama*, Docket S. 09-1221 (Admin. Law Div. 8/10/2010); and *Khanthavongsa v. State of Alabama*, Docket. S. 07-728 (Admin.

Law Div. 6/16/2008), to cite only a few.

In this case, the Department decided not to assess the fraud or any other penalties because the Taxpayer's owner was very cooperative and forthcoming with records, and apparently the owner in good faith but erroneously believed that the fertilizer and various other items he sold were not subject to sales tax. I do not question the owner's good faith and honesty. I do believe, however, that under the circumstances, the Taxpayer has not been unfairly assessed by the Department.

The State and local sales tax final assessments in issue are affirmed. Judgment is entered against the Taxpayer for $22,744.69 and $17,030.86, respectively. Additional interest is also due from the date the final assessments were entered, January 20, 2012.

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

Entered November 5, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Christy O. Edwards, Esq.
Al Moseley
Joe Walls
Mike Emfinger