

RAIED ZIENNI, THE SOLE MEMBER
OF ALABAMA'S WHOLESALE LLC,
A DISREGARDED ENTITY
3320 STILLMAN BLVD.
TUSCALOOSA, AL 35401-2704,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. MISC. 13-294

FINAL ORDER

The Revenue Department assessed Raied Zienni ("Taxpayer"), the sole member of Alabama's Wholesale LLC, a disregarded entity, for State tobacco tax for April 2009 through December 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 October 22, 2013. Brad Howell represented the Taxpayer. Assistant Counsel David Avery represented the Department.

ISSUE

The Taxpayer does not dispute the amount of tax and interest assessed by the Department. The sole issue is whether the Department properly assessed the Taxpayer for the 50 percent fraud penalty levied at Code of Ala. 1975, §40-2A-11(d).

FACTS

The Taxpayer owned and operated Alabama's Wholesale and four other retail tobacco outlets in Tuscaloosa,, Alabama during the period in issue. One of the Taxpayer's outlets, Ticia's Corner Store, was destroyed by a fire in February 2010. The Taxpayer's records for all of his outlets were also destroyed in the fire.

The Taxpayer purchased tobacco products at wholesale through Alabama's Wholesale during the period in issue. He then resold those products at retail through all of his outlets during the period. Alabama's Wholesale was located in a warehouse in the back of the building in which one of the Taxpayer's other outlets, Smokers Outlet 3, was located.

Two Revenue Department examiners visited the Taxpayer at his Smokers Outlet 3 location in late 2011 or early 2012 to perform a retail inspection of the business. The examiners asked the Taxpayer who he had purchased his non-cigarette tobacco products from during the subject period. The Taxpayer indicated that he had purchased all of his products from a single company, Eby-Brown, a large Georgia tobacco wholesaler that is licensed to sell tobacco products in Alabama.¹

The examiners noticed during their inspection that Smokers Outlet 3 offered a particular non-cigarette tobacco product for sale that they knew could not have been purchased from Eby-Brown. The examiners questioned the Taxpayer about where he had purchased the product. The Taxpayer went to the back of his store and returned with an invoice for the product from Starco Impex, a Texas tobacco wholesaler that is not licensed in Alabama. The Starco Impex invoice showed Alabama's Wholesale as the purchaser, whereas the Taxpayer's Eby-Brown invoices showed Smokers Outlet 3 as the purchaser.

¹ Out-of-state tobacco wholesalers that are licensed in Alabama are required to report and pay Alabama tobacco tax on all non-cigarette tobacco products sold in Alabama. If an unlicensed out-of-state wholesaler sells to an Alabama purchaser, the purchaser is required to report and pay the applicable Alabama tobacco tax on the product. See, Dept. Reg. 810-7-1-.08.

After receiving the Starco Impex invoice, the examiners asked the Taxpayer if Eby-Brown and Starco were the only two out-of-state wholesalers that he purchased tobacco products from, and he responded that they were.

Alabama's Wholesale was not licensed with the Department's Tobacco Tax Section when the above inspection occurred. The examiners told the Taxpayer that because Alabama's Wholesale was buying untaxed tobacco products from an unlicensed out-of-state wholesaler, it needed to be licensed and should be paying Alabama tobacco tax on the products. The examiners also asked the Taxpayer to provide them with all of Alabama's Wholesale purchase invoices and bank records for the period in issue.

The Taxpayer's wife subsequently provided the examiners with invoices from Eby-Brown and Starco for March through December 2010, i.e., the months after the Taxpayer's records were destroyed in the February 2010 fire. She also provided some bank records.

There is a discrepancy concerning what bank records the Taxpayer provided to the examiners. One of the Department examiners testified that the Taxpayer only provided bank records for the months after the fire. The Taxpayer's representative also stated at the October 22 hearing that the Taxpayer only provided bank records for March through December 2010. The examiners also subpoenaed the Taxpayer's bank records for the entire audit period, which would have been unnecessary if the Taxpayer had previously provided the records for the entire period. Conversely, the Taxpayer's wife testified that she gave the examiners the bank records for the entire period.

In any case, the examiners reviewed the bank records and found a single July 2009 wire transfer of funds from the Taxpayer's account to Basik Trading, Inc., a tobacco

wholesaler located in Florida. The examiners subsequently obtained records from Basik Trading which showed that Alabama's Wholesale had purchased approximately \$800,000 worth of untaxed tobacco products from Basik during the subject period. The Taxpayer had not previously provided the examiners with any invoices from Basik, and otherwise had not told the examiners that he had purchased tobacco products from Basik.

The examiners computed the tax in issue based on Alabama's Wholesale's purchases from Basik. They delivered their audit report to the Taxpayer in April 2012. Before giving the Taxpayer the report, however, the examiners again asked the Taxpayer if he had purchased untaxed tobacco products from any out-of-state wholesalers other than Eby-Brown and Starco Impex. The Taxpayer again responded that he had not. The examiners then gave the Taxpayer the audit report and confronted him with his numerous untaxed purchases from Basik Trading. The Taxpayer responded that he had never heard of Basik, and had never bought anything from that company.

A. Like Steve said, we sat down at the desk, and Steve had the audit sitting there and said before we get started, I just want to ask you, did you buy from any other companies, and he said no. And he says, well, what about Basik Trading, have you ever had any purchases from Basik Trading? And Mr. Zienni stated that he had never even heard of them, didn't know who they were.

Mr. Avery: Okay.

A. And that he had never bought anything from them.

Mr. Avery: Okay

T. 67 – 68.

The examiners later returned to the Taxpayer's business to pick up additional records from the Taxpayer's wife. The wife told the examiners at that time that the

Taxpayer had denied purchasing from Basik because he was afraid he would be criminally prosecuted.

Q. All right. And Mrs. Zienni then told you what.

A. Just that – that Mr. Zienni was afraid to admit to buying the purchase from Basik Trading for fear of criminal prosecution because of what has happened recently with a couple of criminal prosecutions.

Q. Okay. Did you take that to mean that he understood that what he was doing was wrong.

A. Obviously. Yes, sir.

T. 40.

The Taxpayer's wife further explained to the examiners that after the single wire transfer from the Taxpayer's bank account to Basik in July 2009, Basik directed them to thereafter deposit cash into Basik's account and then send Basik the deposit slip. Basik would then deliver the products to the Taxpayer. By following the above procedure, there was nothing in the Taxpayer's bank records, other than the single wire transfer to Basik in July 2009, indicating that the Taxpayer had purchased tobacco products from Basik.

The Taxpayer testified that he did not provide the examiners with any invoices from Basik because he had thrown them away. He explained that he did not want the Basik invoices laying around his store because a competitor might come to the store, see a Basik invoice, and thus learn who he was buying his products from.

Finally, the Taxpayer claims that he did not pay State tobacco tax on the Basik products because he thought that State tax was not owed. In support of that claim, his representative submitted into evidence a February 13, 2013 letter from an Alabama Alcohol Beverage Control Board employee. That letter, Taxpayer Ex. 8, reads as follows:

Per our conversation, I am writing this memorandum regarding Ticia Zienni. Ms. Zienni contacted me approximately two months ago and asked if I recalled a conversation she and I had regarding licensing her location for tobacco. This conversation occurred approximately three years ago. I did recall some of the conversation due to the fact she was inquiring about a wholesale location. I had never been asked that question before so I called one of our Lts. Or Cpts. (can't remember specifically whom I spoke with) and asked if we licensed wholesale locations. I was told no. I expressed to Ms. Zienni that ABC did not require any licensing for a wholesale location.

The Department examiners added the 50 percent fraud penalty in their audit report.

The report explained the reasons for the penalty – “The civil fraud penalty has been applied to this audit due to Alabama’s Wholesale’s failure to turn over all records to examiners and failure to report purchases of tobacco products.”

The Department also argued in its Answer and in its post-hearing briefs that the fraud penalty applied because the Taxpayer had denied purchasing from Basik when the examiners delivered the audit report in April 2012. It also claims that the Taxpayer knew or should have known that State tobacco tax was owed on the tobacco products purchased from Basik, an unlicensed wholesaler, based on a Department letter sent to the Taxpayer in July 2008. The Department notified the Taxpayer in that letter that it had audited one of the Taxpayer’s suppliers, and had determined that the Taxpayer owed \$2,971.33 in tobacco tax on products purchased by the Taxpayer from the supplier. The letter reads in part – “There were eight months in which you had taxable activity and failed to file a corresponding OTP (other tobacco product) return, so a \$50 or 10% per month penalty was applied to those months.”

The Taxpayer testified that when he got the July 2008 letter, he immediately paid the amount due without question. He claims that he was not told and otherwise did not

know why he owed the tax, or that he was liable for Alabama tobacco tax on any untaxed tobacco products purchased from an unlicensed out-of-state wholesaler.

ANALYSIS

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 *Trafficant 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 argues that he was unaware that State tobacco tax was due on his Basik purchases, and that he did not willfully and intentionally attempt to hide or cover-up those purchases with the intent to evade tax. The evidence shows otherwise.

First, the Department notified the Taxpayer by letter in July 2008 that he had improperly purchased untaxed tobacco products from one of his vendors, and that he should have filed returns and paid tobacco tax on the products totaling almost \$3,000. The Taxpayer’s explanation that he paid the bill without question and was not told and did not otherwise know why he owed the money is not plausible. Any small businessman would surely take notice of and question an unexpected \$3,000 tax bill. The letter itself would also put any person selling tobacco products on notice that Alabama tobacco tax is owed on previously untaxed tobacco products.

Second, the Taxpayer initially told the Department examiners that he had only purchased tobacco products from Eby-Brown. Only when asked about a product in his store that Eby-Brown did not sell did the Taxpayer provide the examiners with the invoice from Starco Impex. Initially failing to disclose the Starco invoice shows an intent to cover-up the purchase.

The Taxpayer’s representative argues that the Taxpayer did not mention or initially provide the Starco invoice because the Taxpayer thought that the examiners were only inspecting his Smokers Outlet 3 location, and that the Starco invoice showed Alabama’s Wholesale as the purchaser, not Smokers Outlet 3. That explanation would be plausible but for the fact that the Taxpayer purchased tobacco for all of his outlets, including

Smokers Outlet 3, through Alabama's Wholesale. One of the examiners also testified that when they first visited the Taxpayer, they asked him about all of his tobacco vendors, not just those that sold to Smokers Outlet 3.

After the Taxpayer produced the Starco invoice, the examiners asked the Taxpayer if Eby-Brown and Starco were the only out-of-state vendors he had purchased from, and he responded that they were. Not telling the examiners at that time that he had purchased approximately \$800,000 in tobacco products from Basik during the subject period clearly constituted a conscious attempt to cover-up and evade tax on those purchases.

Third, the Taxpayer also denied that he had purchase tobacco from Basik when the examiners confronted him with proof of that fact in April 2012.

The Taxpayer explained that he lied when confronted with the Basik purchases because he knew that tobacco dealers had previously been prosecuted for intentionally failing to pay tobacco tax, and that he was afraid he would also be criminally prosecuted. The examiners had previously told the Taxpayer, however, that he would not be criminally charged for not reporting and paying tax on the Basik products during the period in issue. In any case, the Taxpayer's fear of being prosecuted and his knowledge of prior prosecutions only shows that he knew that failing to pay State tobacco tax on previously untaxed products was illegal, and that he could be criminally prosecuted for doing so.

The Taxpayer's claim that he threw away the Basik invoices because he did not want his competitors to know who he purchased from is also implausible. It would have been an easy matter for the Taxpayer and/or his wife to store the invoices in a drawer or other secure area away from anyone coming into his business. The Taxpayer also did not

attempt to explain why he threw away the Basik invoices, but did not also destroy any of the Eby-Brown invoices and only some of the Starco invoices.

The method used by the Taxpayer to pay Basik also shows an intent to cover-up the Basik purchases. The Taxpayer initially paid Basik with a wire transfer from his bank account. He thereafter paid by depositing cash into a Basik bank account and then sending Basik the deposit slip. Importantly, none of the deposits into the Basik account were by check or transfer out of the Taxpayer's account. Consequently, there was no paper trail in the Taxpayer's bank account showing that the Taxpayer had purchased from Basik, which is further evidence that the Taxpayer was attempting to hid the transactions with the intent to evade.

The Taxpayer's representative argues that if the Taxpayer was attempting to evade tax, he would not have freely provided his bank records from which the examiners found the single wire transfer to Basik. The wire transfer occurred in July 2009. As discussed, it is unclear if the Taxpayer provided his bank records for the entire audit period, or only for the months after the February 2010 fire. In any case, if the Taxpayer had refused to provide his bank records after being asked to do so by the examiners, that would have alerted the examiners to a possible cover-up, and in itself would have been evidence of fraud. In effect, the Taxpayer had no choice but to provide the bank records when asked to do so.

The Taxpayer's representative argues that the reasons specified in the audit report for applying the fraud penalty differ from the reasons stated in the Department's Answer. As discussed, the audit report indicated that the fraud penalty was applied "due to

Alabama's Wholesale's failure to turn over all records to examiners and failure to report purchases of tobacco products." The Department's Answer also cited as support for the fraud penalty that (1) the Taxpayer had lied to the examiners about the Basik purchases when they delivered the audit report in April 2012, and (2) the Taxpayer had been put on notice by the 2008 Department letter that tax was due on tobacco products purchased from out-of-state wholesalers.

I agree that the Department's Answer and briefs assert additional reasons for the fraud penalty that were not in the Department audit. That does not, however, invalidate either the audit report or the finding of fraud.

The audit report correctly states that the Taxpayer failed "to turn over all records" to the examiners because the Taxpayer initially failed to disclose and turn over the Starco invoice. And importantly, when the examiners applied the fraud penalty, they only knew that the Taxpayer had purchased approximately \$800,000 in tobacco products from Basik, and that he had failed to provide them with any Basik invoices for those purchases. That is, the examiners did not know when they prepared the audit report that the Taxpayer had destroyed the Basik invoices (assuming that he had already done so). They thus reasonably assumed that the Taxpayer still had the Basik invoices and had intentionally failed to produce them.

The audit report is also correct that the Taxpayer failed to report and pay tax on his purchases of tobacco products during the period. I agree that the audit report could have been more detailed and specific, but it was sufficient as written to put the Taxpayer on notice as to why the fraud penalty was applied.

The fact that the Taxpayer denied the Basik purchases when the examiners confronted him with those purchases further supports the finding of fraud. Likewise, although the examiners did not know about the Department's 2008 letter to the Taxpayer during the audit, that letter is further evidence that the Taxpayer had been notified, and thus knew that he owed Alabama tobacco tax on products purchased from unlicensed out-of-state wholesalers, i.e., Basik Trading.

Finally, the Taxpayer's claim that he did not think State tobacco tax was due on the Basik products based on a conversation his wife had over three years ago with an ABC employee also is not plausible. To begin, the letter from the ABC employee to the Taxpayer's representative is inadmissible hearsay. In any case, the substance of the letter only indicates that the ABC Board does not issue licenses to tobacco wholesalers. That has no bearing on the fact that a tobacco wholesaler by law must pay Alabama tobacco tax on non-cigarette tobacco products purchased from an unlicensed out-of-state vendor.

The facts in this case, when viewed together, show that the Taxpayer willfully failed to report and pay tax on his purchases from Basik with the intent to evade tax on those purchases. The fraud penalty was thus properly assessed. The final assessment is affirmed. Judgment is entered against the Taxpayer for tax, interest, and the fraud penalty of \$62,507.70. Additional interest is also due from the date the final assessment was entered, February 4, 2013.

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

Entered February 7, 2014.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: David E. Avery, III, Esq.
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