STATE OF ALABAMA DEPARTMENT OF REVENUE,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. U. 87-211
MORRIS SHEA BRIDGE CO., INC. 813 Shades Creek Parkway Birmingham, AL 35209,	§ §	
Taxpayer.	§	

ORDER

The Department entered separate assessments for State, City of Anniston, Lee County, City of Opelika, Shelby County and Bayou La Batre use tax against Morris Shea Bridge Company, Inc. ("Taxpayer") for all or part of the period April 1, 1982 through December 31, 1986. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on March 7, 1988. The Taxpayer was represented at the hearing by David M. Wooldridge, Esq. Assistant counsel J. Wade Hope appeared for the Department. Based on the evidence submitted by the parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer is a general contractor and was during the period in question engaged in the construction of bridges and buildings in Alabama and throughout the Southeast.

In early 1987, the Department initiated a use tax audit of the Taxpayer involving the period January 1, 1984 through December 31, 1986. The Department's examiner initially considered that any tax due prior to January 1, 1984 was barred from assessment by the

three-year statute of limitations set out at Code of Ala. 1975, §40-23-76.

However, the examiner discovered during the course of the audit that tax had not been paid on a number of taxable transactions prior to January 1, 1984. The examiner further discovered that the Taxpayer had consistently filed quarterly reports showing zero tax due, and also that the Taxpayer had been audited and assessed for additional tax due of $2,243.00 for the period July, 1978 through June, 1981. Based thereon, the examiner requested and received permission to expand the audit to include the period April 1, 1982 through December 31, 1983.

The audit was based on the Taxpayer's purchase invoices from out-of-state vendors. The Taxpayer processed approximately 16,000 invoices, both taxable and nontaxable, during the period in question. Of that number, additional tax was determined to be due on 55 invoices involving approximately 3.6 million dollars. Based thereon, the Department assessed use tax and interest, plus a 25% fraud penalty as allowed by Code of Ala. 1975, §40-23-80.

The Taxpayer does not dispute that tax should have been paid on the 55 invoices in question. Accordingly, the Taxpayer paid the additional tax and interest assessed on all transactions after January 1, 1984. However, the Taxpayer disputes the fraud charge and Contends that the 25% fraud penalty is improper and also that any tax assessed for the period prior to January 1, 1984 is barred by the statute of limitations set out at Code of Ala. 1975, §40-23-

76.[1]

The Taxpayer had filed zero tax due reports during the subject period on the assumption that all tax had been paid to the out-of-state vendors. Mr. Mike Briscoe, the Taxpayer's treasurer, testified that all vendors were instructed to include all applicable tax on the invoice. The Taxpayer thus assumed that all tax was being paid to the vendors and subsequently remitted by the vendors to the Department.

All invoices were reviewed by an accounts payable clerk to insure that the proper tax had been charged by the vendor. The accounting department routinely discovered and corrected numerous tax errors contained in the invoices. The Taxpayer explains that

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[1]Section 40-23-76 is imprecise and provides only that a notice of additional tax due shall be mailed within 3 years after a return is filed. However, the Taxpayer agreed at the administrative hearing that any tax assessed for the period subsequent to January 1, 1984 was properly due.

tax was not initially paid on the 55 invoices in issue due to inadvertence by the accounting department. Contributing factors were the large number of vendors involved, the large number and wide variety of both taxable and non-taxable invoices processed during the subject period, and a large turnover in accounting personnel.

CONCLUSIONS OF LAW

The determinative issue is whether the filing of zero returns and the failure to pay tax on the 55 transactions in issue constitutes fraud pursuant to §40-23-76. Only if fraud is involved can the Department assess a fraud penalty and additional tax for the period prior to January 1, 1984. Section 40-23-76 reads as follows:

> Except in the case of a fraudulent return, or neglect or refusal to make a return, every notice of a determination of an additional amount due shall be mailed within three years after the return is filed.

The term "fraudulent" is not defined by the Alabama revenue code, nor have Alabama's appellate courts decided any tax fraud cases. However, §6653 of the Internal Revenue Code levies a civil fraud penalty which has been interpreted on numerous occasions by the federal courts. In such cases, federal authority should control. Best v. State, 417 So.2d 197 (1981).

Fraud has been defined as an intentional wrongdoing motivated by a specific purpose to evade a known tax liability. Irolla v. U.S., 390 F.2d 951 (1968); Powell v. Granquist, 252 F.2d 56

(1958). The government must establish by clear and convincing evidence that a taxpayer has committed a knowing falsehood with the specific intent to evade a tax. Considine v. U.S., 683 F.2d 1285 (1982).

A consistent and substantial understatement of liability is evidence of fraud, as is the inadequacy or nonexistence of proper records. Lollis v. C.I.R., 595 F.2d 1189 (1979). However, the understatement of income alone is not sufficient to establish fraud. Merritt v. C.I.R., 301 F.2d 484 (1962). Civil fraud is not committed when the understatement of liability is due to inadvertent negligence or honest error. Moore v. U.S., 360 F.2d 353 (1965). As stated in Moore, at page 355:

> "Repeatedly it has been held that civil fraud is not committed when an understatement of income or an overstatement of deductions is due to "inadvertence, negligence or honest error." See, e.g., Archer v. Commissioner of Internal Revenue, 227 F.2d 270, 274 (5th Cir. 1955). To constitute civil fraud it must be shown that there was conduct variously described as being "evil," "in bad faith," "deliberate and not accidental," or "wilful." Balter, Tax Fraud and Evasion 2.2 (1963). The criminal evasion statute specifically turns on"willfulness," one of the terms used to define civil fraud, and "willfulness" in turn is described in evasion cases as acting "with a bad heart, and a bad intent; it means having the purpose to cheat or defraud * * *. It is not enough if all that is shown is that the defendant was stubborn or stupid, careless, negligent, or grossly negligent." Gaunt v. United States, 184 F.2d 284, 291 n. 4 (1st Cir. 1950), cert. denied, 340 U.S. 917, 71 S.Ct. 350, 95 L.Ed. 662 (1951). See Wardlaw v. United States, 203 F.2d 884 (5th Cir. 1953).'"

In the present case, the Taxpayer filed zero tax due returns for the entire period July, 1978 through December, 1986. The Department initially audited the period July, 1978 through June,

1981 and found additional tax due of $2,243.00. No fraud penalty was assessed and the Taxpayer was not informed that its practice of paying tax directly to the vendors and subsequently filing zero tax due returns was improper. The Taxpayer thus continued the procedure during the period July, 1981 through December, 1986.

The Department contends that it was unreasonable for the Taxpayer to assume that all out-of-state vendors were registered with and paid tax to the Department. That is, the Taxpayer should have known that some tax should have been paid directly to the Department. The Department further argues that the procedures followed by the Taxpayer's accounting section were so lax and negligent so as to constitute an intentional attempt to evade tax.

The Taxpayer was clearly negligent in failing to pay tax on the 55 transactions in issue. However, negligence, even gross negligence, does not constitute fraud, see Moore v. U.S., supra. The evidence does not indicate that the Taxpayer's accounting personnel knowingly intended to evade tax.

The Taxpayer should certainly have known that some out-of-state vendors were not registered with and did not pay tax to the Department. Tax should have been paid by the Taxpayer directly to the Department in those instances. However, the Taxpayer was never informed by the Department prior to the 1987 audit that its procedure for paying tax was incorrect.

The Taxpayer's accounting section routinely checked every

invoice to insure that the proper tax was paid. Numerous errors were discovered and corrected. Unquestionably, tax should have been paid on the 55 transactions in question. However, there is no evidence that the accounting personnel intentionally overlooked those invoices.

Further, the filing of zero tax due returns does not in itself indicate a willful attempt to evade tax. Rather, it may reflect the Taxpayer's belief that all taxes had been properly remitted to the vendors. Tax fraud would normally include some surreptitious or misleading action by the taxpayer. The filing of zero tax due reports may have been improper under the circumstances, but certainly was not misleading. The Taxpayer never attempted to conceal any of its actions.

The Taxpayer also maintained complete and accurate records, whereas attempted fraud is usually accompanied by shoddy and incomplete bookkeeping. An attempt to conceal the understatement of income is usually present in fraud cases. As stated in Merritt v. C.I.R., supra, at page 487:

> The mere understatement of income, standing alone, is not enough to carry the burden cast upon the Commissioner in seeking to recover fraud penalties. But each case is to be considered in the light of its own facts. Consistent and substantial understatement of income is by itself strong evidence of fraud. This proof, coupled with the showing that the records were both incomplete and inaccurate, and that the petitioner did not supply the bookkeeper with all of the data necessary for maintaining complete and accurate records, is enough to warrant the Tax Court in finding fraud. Reaves v. Commissioner, 5th

Cir. 1961, 295 F.2d 336; Cefaula V. Commissioner, supra; Bryan v. Commissioner, supra.

The Department's examiner initially requested records for January 1, 1984 through 1986. The Taxpayer not only produced all of the requested records, but also provided invoices for part of 1983. Any taxpayer that has knowingly attempted to evade tax would not voluntarily provide additional, unsolicited records by which the fraud could be detected.

The above considered, it is hereby determined that the Taxpayer's actions, although negligent, did not constitute fraud as envisioned by the statutes in question. Consequently, that portion of the assessment for the period prior to January 1, 1984 is barred by the statute of limitations set out at §40-23-76. Any tax due subsequent to that period would be subject to the 10% negligence penalty levied by §40-23-70, and not the 25% fraud penalty. The assessments in issue should be adjusted accordingly and thereafter made final.

Done this 18th day of April, 1988.

BILL THOMPSON
Chief Administrative Law Judge