ALABAMA TAX TRIBUNAL

LINDEN FOOD MART, LLC, AND ITS SOLE MEMBER, NABIL M. ALGAHMIE,	§	
	§	
Taxpayer,		
	§	DOCKET NO. S. 19-1089-JP
v.		
	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

This appeal involves a final assessment of state sales tax for the periods November 2010 through February 2016, and a final assessment for prepaid wireless service charges for the periods September 2012 through February 2016. The case came before the Tax Tribunal for trial on October 3, 2022. The Taxpayer was represented by Blake Madison, Esq., and the Revenue Department was represented by David Avery, Esq. Nabil Algahmie testified for the Taxpayer; Sylvester Williamson, a manager with the Revenue Department's sales and use tax division, testified for the Revenue Department.

Facts

Mr. Algahmie testified that his brother-in-law and some other persons found a location in Linden, Alabama, for a convenience store and that Mr. Algahmie's brother-in-law and uncle funded the store's operation. The store opened in 2010, and Mr. Algahmie's role was to "run the store," although, in the store's formation documents, Mr. Algahmie was listed as the sole owner. The bank accounts of the store also were

in the name of Mr. Algahmie.

Mr. Algahmie ran the convenience store until 2012 but then left for Yemen to visit family. He stated that he knew nothing about the audit until returning. Mr. Algahmie also stated that he did not handle the accounting for the store. Instead, the software program for the store's sole register printed a sales report every week, and Mr. Algahmie provided those reports to his brother-in-law who forwarded sales information to an accountant. The accountant apparently filed sales tax returns.

Mr. Algahmie also testified that he stopped operating the convenience store because of his disagreement with his brother-in-law and uncle over not sharing in the store's receipts or profits and, instead, opened a restaurant nearby. The restaurant closed after a few months, and Mr. Algahmie moved to Arkansas where he lived until sometime in 2015 before moving to Oregon and then Michigan. He returned to live in Alabama in 2016.

When Mr. Algahmie attempted to register a car in Alabama in February 2016, he was arrested because of unpaid taxes relating to the operation of the convenience store in Linden. Specifically, Mr. Algahmie was indicted by a grand jury in Marengo County, Alabama, on five counts of tax evasion for "willfully attempt[ing] to evade and defeat a large part of the State sales tax imposed upon the retail sales of tangible property sold by LINDEN FOOD MART, LLC, due and owing to the State of Alabama…by causing to be prepared a false and fraudulent State of Alabama Sales Tax Return… wherein State sales tax due and owing to the State of Alabama for this month was greater than that reported to the State of Alabama Department of

Revenue…" Although Mr. Algahmie was charged with five felony counts of tax evasion (for four months in 2014 and one month in 2015), he apparently pled guilty to a misdemeanor offense of "failure to pay taxes," according to an "Explanation of Rights and Plea of Guilty" offered by the Revenue Department during the trial before the Tax Tribunal. As part of his sentencing order, Mr. Algahmie was required to pay restitution.

Before the Tax Tribunal, Mr. Algahmie testified that he was not in Alabama during the periods under indictment, but that he agreed to plead guilty because the charges would be reduced to a misdemeanor and because his brother-in-law agreed to pay the restitution. He also stated on cross-examination that he had no evidence to contest the liabilities asserted by the Revenue Department pursuant to its audit.

The Revenue Department's audit letter to the Taxpayer, dated June 25, 2015, listed the sales tax audit periods as the months of January 2011 through May 2015. The auditors' report, issued in March 2016, listed the sales tax audit periods as November 2010 through February 2016 and the prepaid wireless service charge audit periods as September 2012 through February 2016. In the audit report, the auditors stated that the Taxpayer reported sales of $1,875,809.06 for the periods of January 2010 through May 2015, but that the Taxpayer purchased $3,073,495.05 worth of items for resale from vendors for those same months. Thus, the auditors calculated that the Taxpayer purchased $1,197,685.99 more in inventory than the Taxpayer reported selling.

The audit report also stated that the Taxpayer provided no bank records of

deposits or cash payouts, and that no income tax returns had been filed by the Taxpayer.

Consequently, the auditors used the "purchase mark-up" audit method to estimate the Taxpayer's taxable sales. Because records were not provided by the Taxpayer, the auditors applied a percentage markup to the cost of inventory items to estimate monthly sales amounts. And the audit report noted that there had been no significant change in the Taxpayer's inventory over the audit period.

In the report, the auditors referenced the statute in the Taxpayers' Bill of Rights that authorizes the imposition of a fraud penalty in tax assessments. And the auditors listed specific reasons why they believed that the fraud penalty applied.

On May 6, 2019, the Revenue Department entered a preliminary assessment against the Taxpayer for sales tax in the total amount of $195,315.55. The assessment included tax, interest, a late-payment penalty, and a fraud penalty. On that same date, a preliminary assessment for the prepaid wireless service charge also was entered against the Taxpayer. That assessment included tax, interest, a late-filing penalty, and a negligence penalty. Corresponding final assessments were entered in August 2019.

<u>Issues and Analysis</u>

The Taxpayer makes the following arguments on appeal: (1) the final assessments are invalid because the preliminary assessments were not delivered to the Taxpayer by the Revenue Department; (2) many of the assessed taxes have been paid; (3) the final assessments are time-barred because the preliminary assessments

were not entered within 2 years of the discovery of alleged fraud; (4) the Revenue Department may assess periods after May 6, 2013, only if it shows that the Taxpayer omitted more than 25% of the taxable base on each return for that period; (5) the markup percentages are excessive; (6) the sales calculations should have been reduced for theft and spoilage; (7) the fraud penalty is inappropriate because of the doctrine of *res judicata*; and (8) the fraud penalty is inappropriate because of the absence of fraudulent intent. However, the Tax Tribunal's opinion will focus only on issues (3), (4), (5), and (6).

Section 40-2A-7(b)(2) provides, in pertinent part:

> Any preliminary assessment shall be entered within three years from the due date of the return, or three years from the date the return is filed with the department, whichever is later, or if no return is required to be filed, within three years of the due date of the tax, except as follows:
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> > a. A preliminary assessment may be entered at any time if no return is filed as required, or if a false or fraudulent return is filed with the intent to evade tax.
> >
> > b. A preliminary assessment may be entered within six years from the due date of the return or six years from the date the return is filed with the department, whichever is later, if the taxpayer omits from the taxable base an amount properly includable therein which is in excess of 25 percent of the amount of the taxable base stated in the return.

Here, the Taxpayer acknowledged that it did not file returns concerning the prepaid wireless service charge. Therefore, those preliminary and final assessments are not time-barred. *Id.* Apparently, however, the Revenue Department has not contended that the Taxpayer filed its sales tax returns untimely. (The sales tax assessments do not contain a late-filing penalty.) Thus, if the sales tax returns were

filed timely, the general three-year limitation period first must be considered. As stated, the sales tax preliminary assessment was entered on May 6, 2019, but the final period included in that assessment was February 2016. Thus, the preliminary assessment was entered outside of the three-year statute of limitations and, therefore, was untimely, unless one of the two exceptions was met.

First, the Tax Tribunal has recognized that, within Title 40, there is "a specific exception to the 3-year statute of limitations for entering a tax assessment …, such that '[a] preliminary assessment may be entered at any time … if a false or fraudulent return is filed with the intent to evade tax.'" Donald V. Watkins v. State Dep't of Rev., case no. INC 21-1365-JP (quoting Ala. Code 1975 § 40-2A-7(b)(2)a.). However, the Tax Tribunal also recognized a decision of the Alabama Court of Civil Appeals in which that court held that the general fraud statute in Ala. Code 1975, § 6-2-3, with its two-year limitation, controlled the entry of a tax assessment based on fraud, despite the tax-specific provision in the predecessor to § 40-2A-7(b)(2)a. The Court of Civil Appeals stated:

> We are obliged to construe the provisions of § 40-23-18(b) and § 6-2-3 in favor of each other to form one harmonious statute of limitations by which the Department may operate. Opinion of the Justices, supra. In construing § 40-23-18(b) and § 6-2-3 in pari materia, we find that § 6-2-3 applies in sales tax cases involving a false or fraudulent return. We, therefore, hold that in the case of a false or fraudulent return with intent to evade payment of taxes, the tax may be assessed or a proceeding in court may be begun at any time; however, if the tax is assessed or a proceeding is begun outside the three-year limitation imposed by § 40-23-18(b), that action must be begun within two years from the time the fraud is deemed to have been discovered. See, Gray v. Liberty Nat'l Life Ins. Co., 623 So. 2d 1156 (Ala. 1993); Dickens v. SouthTrust Bank of Alabama, N.A., 570 So. 2d 610 (Ala. 1990); Lader v. Lowder Realty Better Homes & Gardens, 512 So. 2d 1331 (Ala. 1987). It would be

> illogical to hold that once the Department discovers fraud, it could wait indefinitely, accruing interest pursuant to § 40-1-44, before beginning an action to collect the taxes. This would be contrary to legislative intent and manifestly unfair, especially to the state agencies dependent upon the prompt payment and collection of state sales tax.

New Joy Young Restaurant, Inc. v. State Dept. of Revenue, 667 So. 2d 1384, 1387-88 (Ala. Civ. App. 1995).[1]

The Taxpayer specifically argues that the preliminary and final sales tax assessments are time-barred because the Revenue Department was deemed to have discovered the alleged fraud by November 28, 2015, which was the date that criminal charges were filed against Mr. Algahmie. And, as noted, the audit report dated March 24, 2016, listed specific reasons why the fraud penalty should be applied to the Taxpayer. In fact, a Revenue Department billing sheet dated November 10, 2016, included the fraud penalty in the billing of the Taxpayer.

> Fraud is deemed to have been discovered when it ought to have been discovered. Facts which provoke inquiry in the mind of a man of reasonable prudence, and which, if followed up, would have led to a discovery of the fraud, constitute sufficient evidence of discovery.

New Joy Young, 667 So. 2d at 1388 (quoting Johnson v. Shenandoah Life Ins. Co., 291 Ala. 389, 397, 281 So. 2d 636, 643 (1973)....)"

Here, the Revenue Department admits in its Response to Taxpayer's Post-Hearing Brief that, during its audit it "found what was thought to be criminally fraudulent activity involving tax evasion." The Revenue Department then referred the matter to a local district attorney who obtained an indictment on November 17,

[1] The Tax Tribunal's disagreement with the appellate decision in New Joy Young was explained in Donald V. Watkins, supra.

2015. The Revenue Department's recognition of the criminally fraudulent activity such that it referred the case to the local district attorney, coupled with the district attorney's attainment of a criminal indictment, make it clear that the Revenue Department had knowledge of fraud or, at least, "[f]acts which provoke inquiry in the mind of a man of reasonable prudence, and which, if followed up, would have led to a discovery of the fraud" no later than November 17, 2015. New Joy Young, 667 So. 2d at 1388. And the Revenue Department's own audit report and billing sheet show that the Revenue Department had knowledge of alleged fraud by November 2016 at the latest.

Because the preliminary assessment of sales tax was not entered until May 6, 2019, which was outside of the two-year limitation period for fraud actions, the Revenue Department's assessment based on fraud was untimely. Thus, as acknowledged by the Taxpayer, the timeliness of the sales tax assessments depends on whether the second statutory exception to the three-year limitations period has been met; *i.e.*, whether "the Taxpayer omitted from the taxable base an amount properly includable therein which [was] in excess of 25 percent of the amount of the taxable base stated in the return." § 40-2A-7(b)(2)b. As the Taxpayer correctly points out, "[t]he assessment[] [is] … untimely for the periods in which the due date of the return or the date the return was filed with the [Revenue] Department was before May 6, 2013," even if the 25-percent underreporting rule was invoked. For subsequent periods, the Revenue Department argues that the 25% threshold was met

or all months except November and December 2015. This issue depends, of course, on the amount of the Taxpayer's underreporting of its correct taxable base.

It is undisputed that the Taxpayer failed to provide complete sales records. When a taxpayer fails to do so, the Revenue Department may compute the taxpayer's tax liability "based on the most accurate and complete information reasonably obtainable…" Jai Shanidev Inc. d/b/a Country Corner, S. 16-449 (Ala. Tax Tribunal 04/27/17); Ala. Code 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).
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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).

Jai Shanidev Inc. d/b/a Country Corner , supra.

Because the Taxpayer failed to maintain sales records for the audit period, the Revenue Department applied a purchase markup of 35%. As the Tax Tribunal has explained in previous cases, the 35% purchase markup is based on Internal Revenue Service information regarding percentage markups of gas stations and grocery stores. The percentages have been averaged to reach the 35% figure. The Tax Tribunal has previously explained: "Many states tax gas and so the markup on gas is included in

the gas station average. Alabama does not charge sales tax on gas, thus the IRS gas station markup is skewed downward for Alabama as the markup on gas is typically very low." E&Z, supra. The grocery store category is averaged with the "gas stations with convenience stores" category to reach the 35% figure See, e.g., E&Z, Inc. v. State of Ala. Dep't of Rev., S. 19-989-LP (Ala. Tax Tribunal 1/12/2022). The Tribunal has previously held that the 35% figure is reasonable. See, e.g., E&Z, Inc., supra. Although the Taxpayer argued that most of its sales were beer, wine, and tobacco, with a lower markup, the Taxpayer did not have sales records from which an exact markup could be determined.

The Taxpayer also argues that the 199% markup for the prepared food sold by the Taxpayer was unreasonable. However, the Taxpayer did not present evidence to contradict that percentage markup. Mr. Williamson testified that the 199% figure was taken from Internal Revenue Service information regarding percentage markups for restaurants and that the markup was applied only to the Taxpayer's prepared food sales. "The tax due as computed by the audit is by its nature an estimate, but the examiner of necessity estimated the Taxpayer's liability because the Taxpayer failed to maintain adequate records." Id.

In the absence of records to contradict the Revenue Department's use of the 199% markup on prepared foods and 35% markup on other items, the Taxpayer has not shown that the estimates were erroneous.

The Taxpayer also argues that the purchase markup audit was not adjusted for theft and spoilage. However, the Taxpayer failed to provide records of the amount

of theft and spoilage, and "the IRS markup accounts for spoilage and theft." E&Z, supra.

Therefore, the Taxpayer's challenge to the Revenue Department's markup percentages is unsuccessful. Thus, the Revenue Department properly applied the six-year statute of limitations (which is based on underreporting of 25% or more) to the periods of May 6, 2013, forward, with the exception of two months in 2015 as noted. The Taxpayer's other challenges are rejected.

Conclusion

The Revenue Department is directed to recalculate the sales tax final assessment in accordance with this Opinion and Preliminary Order by reducing the tax portion of the assessment to eliminate periods that are outside of the statute of limitations and by removing the fraud penalty. (The assessment contained both a late-payment penalty and a fraud penalty, which is prohibited by § 40-2A-11(g)). The Revenue Department is directed to inform the Tax Tribunal of its recalculation by **September 29, 2023**. The final assessment of prepaid wireless charges is upheld, and judgment will be entered as to that final assessment when an Opinion and Final Order is issued.

Entered September 1, 2023.

/s/ *Jeff Patterson*
JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:ac
cc: Blake A. Madison, Esq.
David E. Avery, III, Esq.