

ALABAMA TAX TRIBUNAL

MASRATH INTERNATIONAL, INC.,	§	
D/B/A HILLABEE QUICK STOP,		
	§	
Taxpayer,		
	§	DOCKET NO. S. 19-1335-JP
v.		
	§	
STATE OF ALABAMA		
DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

This appeal involves final assessments of state and local sales tax for February 1, 2016, through January 31, 2019. A trial was held on November 8, 2022. Taylor Meadows represented the Taxpayer. Abdul Wahid, the owner of the Taxpayer, and Elas Chaij, the Taxpayer’s accountant, appeared and testified. Margaret McNeill represented the Revenue Department, and Sylvester Williamson, a manager for the Revenue Department, appeared and testified. The parties filed post-trial briefs.

Facts

Mr. Williamson testified that he was the supervisor of the auditor who performed the audit in this case. According to Mr. Williamson, the auditor resigned in 2019, and Mr. Williamson had been in charge of the audit review since that time.

Mr. Williamson stated that the auditor obtained bank records and purchase records of the Taxpayer,¹ but that it was impossible to use the bank records to determine the sales tax measure because the business cashed checks for customers

¹ There was a dispute of fact whether the auditor had to subpoena the records or whether the Taxpayer’s accountant provided them.

which resulted in large deposits that did not constitute retail sales. And it was difficult to isolate the nontaxable check deposits. He also testified that there were deposits from nontaxable sales of gasoline. The only other records the auditor was able to obtain were records of the Taxpayer's purchases from vendors of items that the Taxpayer resold at retail.

According to Mr. Williamson, the Taxpayer's purchases of inventory from vendors during the audit period totaled \$2,395,697.38, whereas the taxable sales reported during that same period totaled \$2,311,857.44. The auditor then marked the purchases up 35%, which is the standard markup used by the Revenue Department for convenience stores when the Revenue Department considers a taxpayer's records to be inadequate. Using the markup, the amount of taxable sales for the audit period was determined to be \$3,234,191.46. Compared to the taxable sales of \$2,311,857.44 reported for the audit period, only 71% of the estimated taxable sales were actually reported. And, according to z-tapes, taxable sales exceeded purchases by 4-6%.

Mr. Williamson testified that the Taxpayer also had collected an abnormal amount of Electronic Benefits Transfers (EBTs) despite the fact that Williamson received information that the Taxpayer had forfeited the right to do so. He also testified that he received z-tapes from the Taxpayer for January through September 2018 after the audit was completed. Using those records, Mr. Williamson calculated profit from taxable items, check cashing, and gas to be approximately \$44,000 for that nine-month period. For those same months, however, the Taxpayer's bank

statements showed that the Taxpayer had \$171,000 in expenses not related to inventory; *i.e.*, rent, utilities, and payroll. In Mr. Williamson's opinion, such a disparity between profit and expenses is not sustainable. Also, Mr. Williamson stated that the Taxpayer's sales recorded on the z-tapes exceeded the Taxpayer's purchases from vendors for the nine-month period for which the Taxpayer provided z-tapes. However, as noted, in comparing the Taxpayer's vendor purchases to the Taxpayer's sales reported on its tax returns, the Taxpayer's purchases exceeded those reported sales. Therefore, Mr. Williamson considered the z-tapes provided by the Taxpayer to be inaccurate.

According to Mr. Williamson, the fraud penalty was assessed because the Taxpayer failed to keep and provide sales records, the Taxpayer underreported taxable sales by a large percentage, and the Taxpayer's vendor purchases exceeded reported sales.

Mr. Wahid testified that he is the sole owner of the Taxpayer, which consists of a convenience store and gas station that opened in 2012. The store had only one register during the audit period. According to Mr. Wahid, he is in charge of the day-to-day operations of the business, as well as collecting and reporting sales tax. He stated that he gave z-tapes from the store's register to his accountant to determine the monthly sales tax measure, and that his accountant then generated a monthly sales report for tax return purposes.

Mr. Wahid testified that, at the time of the audit in July 2019, he was in India, but that he had given his accountant authority to handle the audit. However, the

accountant no longer had access to z-tapes because Mr. Wahid had locked them in the store.

Mr. Wahid stated that z-tapes from 2018 (except for the month of October) were provided to the Revenue Department when he returned from India, but that he could not find z-tapes for other periods. He stated that he had kept the z-tapes in his locked office but has no idea what happened to them. Mr. Wahid denied throwing away any z-tapes, and he stated that the total taxable sales for 2018 according to the z-tapes were \$846,794.84. He also stated that the z-tapes more accurately reflected the Taxpayer's sales than did the audit results.

Mr. Wahid testified that he did not purposefully withhold z-tapes or underreport sales, and he stated that the discrepancy between vendor purchases and retail sales could be attributable to theft. He also testified that he borrowed money to run the business and that he used a business credit card to purchase inventory.

Mr. Chaij testified that he had been the Taxpayer's accountant since the business opened in 2012 and that he was in charge of filing sales tax returns based on the information Mr. Wahid gave him. According to Mr. Chaij, he provided the bank statements, deposit records, documentation regarding EBT, and purchase invoices that the auditor requested. Mr. Chaij testified that there had been a flood in the back room of the store and that the roof had been redone. He opined that the flood could have led to the lack of z-tapes. And Mr. Chaij stated that there had been no issues with sales tax reporting before the audit period. He also testified that the Taxpayer had filed its sales tax returns timely and paid sales tax timely for each one

of the months within the audit period.

Discussion

On appeal, the Taxpayer challenges the Revenue Department's determination of the sales tax measure as well as the assessment of the fraud penalty.

The Taxable Measure

It is undisputed that the Taxpayer in this case failed to provide complete sales records. In such a situation, the Revenue Department may compute the Taxpayer's liability "based on the most accurate and complete information reasonably obtainable..." Ala. Code 1975, § 40-2A-7(b)(1)a; *Jai Shanidev Inc. d/b/a Country Corner*, S. 16-449 (Ala. Tax Tribunal 04/27/17).

"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).

"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 in this appeal failed to maintain and produce complete sales records, the auditor applied a markup of 35% to the Taxpayer's wholesale purchases to estimate the Taxpayer's retail sales. As the Tax Tribunal has explained

in previous cases, the 35% 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. *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 that percentage is reasonable. *See, e.g., E&Z, Inc., supra.* “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.*

Here, the Taxpayer argues that the Revenue Department should have used the 2018 z-tapes to determine the sales tax measure, citing appellate case law for the proposition that a sampling of records, or incomplete records, can suffice to calculate a taxpayer's sales-tax measure. *See State v. Ludlam*, 384 So. 2d 1089 (Ala. Civ. App. 1980), and *State v. Levey*, 29 So. 2d 129 (Ala. 1946). In both of those cases, the courts agreed that the taxpayer's records, albeit incomplete, were sufficient to rebut a final assessment, at least partially, even where the taxpayer's records were kept “inartfully.” In this case, however, the Revenue Department does not argue that the records were kept inartfully, but that the z-tapes were incomplete *and* that other records of the Taxpayer showed the z-tapes to be inaccurate. Thus, the Revenue Department deemed the Taxpayer's z-tapes to be unreliable.

Specifically, Mr. Williamson noted that, according to the z-tapes that he examined, profits from taxable items, check cashing, and gas totaled approximately \$44,000, whereas, during that same period, the Taxpayer's bank statements showed

approximately \$171,000 in expenses not related to inventory. Further, Mr. Williamson noted the inconsistent results when comparing different combinations of the three sales and purchase records; *i.e.*, the Taxpayer's filed returns, vendor invoices of the Taxpayer's purchases, and the z-tapes provided by the Taxpayer. In comparing the z-tapes to the Taxpayer's purchase invoices, the sales recorded on the z-tapes were greater than the amounts purchased from vendors during the same period. However, when comparing the amounts purchased from vendors with sales reported on the Taxpayer's returns, the purchases from vendors (of items to be resold at retail) were greater than the sales reported by the Taxpayer. And according to Mr. Williamson, if the Taxpayer's z-tapes for those periods are accurate, the Taxpayer lost approximately \$130,000 during that time (\$171,000 in expenses minus \$44,000 in profit).

Thus, the Revenue Department asserts that the incomplete z-tapes are *not* the most accurate and complete information available. Moreover, the Revenue Department asserted that, because the Taxpayer's purchases (\$2,395,697.38) for the audit period exceeded the taxable sales reported (\$2,311,857.44), the Taxpayer clearly was underreporting. Finally, the Taxpayer did not have a clear explanation as to why he was missing z-tapes for a large percentage of the audit period.

Given the discrepancies noted, and considering the totality of the records, the Taxpayer has not overcome the final assessments' presumption of correctness as to the tax calculation. Therefore, the tax component of the final assessments entered by the Revenue Department is upheld.

The Fraud Penalty

The Revenue Department also included a fraud-penalty calculation in the final assessments.² The Revenue Department asserts the following in support of the penalty: the Taxpayer failed to keep and provide sales records, the Taxpayer underreported taxable sales by a large percentage, and the Taxpayer's purchases exceeded sales. The Tax Tribunal has previously explained:

“Ala. Code § 40-2A-11(d) levies a 50 percent fraud penalty for any underpayment of tax due to fraud. The burden of proof in an assessment of a fraud penalty falls on the Department. Ala. Code § 40-2B-2(k)(7). 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 existence of fraud must be determined on a case-by-case basis 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). Consequently, fraud may be established from ‘any conduct, the likely effect of which would be to mislead or conceal.’ *Id.* The mere under-reporting of gross receipts is itself insufficient to establish a finding of fraud, unless there is evidence of repeated understatements in successive periods when coupled with other circumstances showing an intent to conceal or misstate sales. *Barrigan v. C.I.R.*, 69 F. 3d 543 (1995).

“A taxpayer’s failure to keep adequate books and records, a taxpayer’s failure to furnish auditors with records or access to records, the consistent underreporting of tax, and implausible or inconsistent explanations regarding the underreporting are strong indicia of fraud. *See Solomon v. C.I.R.*, 732 F. 2d 1459 (1984); *Wade v. C.I.R.*, 185 F. 3d 876 (1999).... Ignorance is not a defense to fraud where the taxpayer

² In the final assessment of state sales tax, the penalty is identified as the negligence penalty by name, but the calculation appears to be the 50% fraud-penalty calculation authorized in Ala. Code 1975 § 40-2A-11(d). The Taxpayer did not raise the misnaming of the penalty as an issue, and both parties referred to the assessed penalty as the fraud penalty. In the local-tax final assessment, the penalty was identified by name and calculation as the fraud penalty.

should have reasonably known that its taxes were being grossly underreported. *Russo v. C.I.OOR.*, T.C. Memo 1975-268; *Temple v. C.I.R.*, 67 T.C. 143 (1976).”

“Any retailer should know with certainty that sales records must be maintained for audit purposes....”

E&Z, Inc., v. State of Alabama Department of Revenue, 19-989-LP (Ala. Tax Tribunal 1/12/22).

Here, the Taxpayer’s failure to keep and provide sales records, the Taxpayer’s underreporting of taxable sales by a large percentage, and the fact that the Taxpayer’s purchases of inventory exceeded reported sales, as discussed, support the Revenue Department’s application of the fraud penalty. Thus, the Revenue Department met its burden of proving fraud, and the fraud penalty is upheld.

The final assessments of state and local sales tax are affirmed. Judgment is entered in favor of the Revenue Department and against the Taxpayer for local tax in the amount of \$59,111.00 and state sales tax in the amount of \$59,111.00, plus additional interest that continues to accrue from the date of entry of the final assessments until the liabilities are paid in full.

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

Entered September 15, 2023.

/s/ Jeff Patterson

JEFF PATTERSON

Chief Judge

Alabama Tax Tribunal

jp:ac

cc: Taylor S. Meadows, Esq.
Margaret Johnson McNeill, Esq.