ALABAMA TAX TRIBUNAL

HADI STORE, LLC, D/B/A HADI STORE,	§	
Taxpayer,	§	DOCKET NO. S. 20-1102-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

This appeal involves a final assessment of state sales tax for the periods of December 2017 through July 2019. A trial was held on March 6, 2023. Dwight Pridgen represented the Taxpayer. Fawaz Al-reyashi ("Al-reyashi"), the owner of the Taxpayer, appeared and testified. Sarah B. Harwell represented the Revenue Department. J.B. Dyer, the Revenue Department's auditor, appeared and testified. The Taxpayer filed a post-trial response in which it argued that the Revenue Department's audit approach of applying a standard 35-percent markup constituted an administrative rule and that the Revenue Department had not complied with the rulemaking procedures required by the Alabama Administrative Procedure Act (AAPA). Oral argument was held on the AAPA issue on April 4, 2024. The parties later submitted post-trial briefs.

Facts

Mr. Dyer testified at trial that the Taxpayer operates a convenience store in Tuscaloosa and that he audited the Taxpayer. According to Mr. Dyer, in response to his request for records, the Taxpayer provided only six months of vendor records,

which were incomplete, and provided no sales records. Mr. Dyer stated that he could not determine the Taxpayer's method of reporting sales tax, nor could he validate the reported amounts.

Mr. Dyer then subpoenaed the Taxpayer's bank statements and canceled checks. Upon examination, though, it was clear to Mr. Dyer that the Taxpayer had not deposited all the checks he had received. Specifically, Mr. Dyer testified that the bank deposits did not coincide with the reported sales, and the purchase records indicated that purchases for resale were paid for in cash. Therefore, the bank statements could not be used to determine the Taxpayer's correct amount of tax due for the audit period.

Because of the absence of sales records and the unreliability of the bank records, Mr. Dyer conducted an indirect purchase-markup audit. He testified that he used data from the state's Wholesale to Retail Accountability Program ("WRAP"), along with information from the Taxpayer's records, to obtain amounts the Taxpayer purchased from vendors during the audit period. Based on that information, he stated that the Taxpayer's inventory purchases exceeded its reported sales by $869,265.65. To estimate the Taxpayer's total sales, Mr. Dyer applied a 35% markup to the Taxpayer's total purchases, subtracted nontaxable electronic benefit transactions (EBT's), and determined that the Taxpayer had underreported its taxable sales by 288%. According to Mr. Dyer, the 35% markup accounts for theft and spoilage, and the Taxpayer provided no documentation of waste, spoilage, or theft. Mr. Dyer testified that, although he requested information regarding

beginning and ending inventory, no such records were provided. Mr. Dyer included a fraud penalty because of the Taxpayer's consistent pattern of underreporting, the absence of sales records, the lack of documentation to verify the sales tax returns, and the significant amount by which the Taxpayer's purchases exceeded its reported sales.

Mr. Al-reyashi testified that he purchased the Taxpayer from Mr. Hadi Fotaih and that Mr. Al-reyashi became a member of the Taxpayer in February 2019. Mr. Al-reyashi and Mr. Fotaih were both members of the limited liability company (the Taxpayer) for two months before Mr. Al-reyashi became the sole member. According to Mr. Al-reyashi, Mr. Fotaih had lost money operating the store. Mr. Al-reyashi also testified that none of the items he sold in the store, including sodas and snacks, were marked up by 35%. He stated that beer and wine were marked up between 7 and 16 percent, and the sodas were marked up between 20 and 25 percent. Upon direct examination, he testified that he had no prior experience owning a convenience store and that his prior experience was working as a cook in a restaurant. Upon cross-examination, however, he admitted that he had worked with his uncle, who owned a convenience store, prior to purchasing the Taxpayer. He also has owned Boaz Tobacco, LLC, for five or six years.

Mr. Al-reyashi stated that he had no documentation to show that the markup percentage used by the Revenue Department is wrong. And he had no documents showing the amounts of waste, spoilage, or theft.

Discussion

A.

The Taxpayer first argues that the Revenue Department's final assessment is void because the Department did not enter the assessment in the name of the correct taxpayer. Specifically, the Taxpayer contends that the Revenue Department should have entered an assessment against Mr. Fotaih for the periods in which Mr. Fotaih was the sole owner of the Taxpayer and entered a separate assessment against Mr. Al-reyashi for the periods in which Mr. Al-reyashi was the sole owner of the Taxpayer.

Ala. Code § 40-2A-7(b)(1)c states: "All preliminary and final assessments issued by the department shall be executed as provided by regulations promulgated by the department." And Ala. Admin. Code r. 810-14-1-.15(3) provides:

> "The final assessment must include, but may not be limited to, the following information:
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> (a) the name and tax identification number of the taxpayer, if known;
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> (b) the last known address of the taxpayer;
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> (c) character or type of tax/value of the liability assessed;
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> (d) the taxable period or periods;
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> (e) the amount of the final assessment, including applicable interest and penalty; and
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> (f) the date of entry of the final assessment.

In response to the Taxpayer's argument, the Revenue Department asserts that the assessment was entered in the name of the correct entity; *i.e.*, the Taxpayer, Hadi Store, LLC, and that there was no legal requirement for the assessment to include

the names of the individual owners of the Taxpayer. The Revenue Department explains that Mr. Fotaih was the sole member of the Taxpayer from May 16, 2017, through April 17, 2019; Mr. Al-reyashi served as the single member of the Taxpayer from April 17, 2019, through May 15, 2019; and Mr. Fotaih and Mr. Al-Reyashi were both members of the Taxpayer from May 15, 2019, through May 4, 2021. Mr. Al-reyashi thereafter became the sole owner of the Taxpayer again. The Revenue Department states that, if it prevails, it "will attempt to collect the liability associated with the final assessment at issue against the Taxpayer entity listed on the final assessment and may, if necessary, attempt to collect the liabilities of [Mr.] Fotaih and [Mr.] Al-Reyashi under Alabama's 100 percent penalty statutes, [Ala. Code 1975] §§40-29-72 and 40-29-73. [Mr.]Fotaih and [Mr.] Al-Reyashi will have the opportunity to dispute their individual liabilities under Alabama's 100 percent penalty statutes once notice and demand for 100% penalty has been made."

Although the Taxpayer focuses on the fact that Mr. Al-Reyashi was not the sole owner of the Taxpayer during all the periods assessed, it is self-evident that the Revenue Department did not enter the assessment in Mr. Al-reyashi's individual name. Instead, the Revenue Department chose to proceed first against the Taxpayer (Hadi Store, LLC). And the Revenue Department points out that the Alabama Court of Civil Appeals has held that an LLC and its sole member are not distinguishable from one another. *Alabama Dep't of Revenue v. Downing*, 272 So. 3d 184 (Ala. Civ. App. 2018).

In *Downing*, the appellate court stated that "[f]or state-tax purposes, single-

member LLCs are disregarded as entities separate from their sole owner . . . if the company is also disregarded for federal-income-tax purposes." *Downing*, 272 So. 3d at 188 (internal citations and quotations omitted). The Court of Civil Appeals cited 26 C.F.R. § 301.7701–2(a)[1] to further explain that, "[b]ecause the LLC meets the definition of a disregarded entity for federal-income-tax purposes, *the LLC is disregarded as a separate entity* and its sole member, Downing, is treated in the same manner as a sole proprietor for state-tax purposes. *Id.* at 188-89 (emphasis added). The Court of Civil Appeals then stated that, "[a]s a disregarded entity, the LLC is not distinguishable from Downing[,]" meaning that either the LLC or its sole member would have standing to appeal to the Tax Tribunal. *Id.* at 189.

Therefore, the Revenue Department asserts that it could have entered the assessment against the sole owner of the Taxpayer or the Taxpayer LLC itself. The Taxpayer has not cited any law to the contrary. Thus, the entry of the final assessment in the name of Hadi Store, LLC, was valid.

B.

Concerning the merits of the final assessment, the Taxpayer's first claim is that the assessment "is based on purchase information obtained from vendors who sold products to the Taxpayer for resale." The Taxpayer then argues that, although hearsay is admissible in the Tax Tribunal, it may not base its judgment entirely on hearsay evidence. However, Ala. Code § 40-2A-7(b)(5)c.3 states: "On appeal … to the

[1] 26 C.F.R. § 301.7701–2(a) states that "[a] business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner."

Alabama Tax Tribunal, the final assessment shall be prima facie correct, and the burden of proof shall be on the taxpayer to prove the assessment is incorrect." As stated, though, Mr. Al-reyashi provided the Revenue Department with no records at all. By contrast, the Revenue Department's calculations were based on its comparison of purchase information with amounts reported by the Taxpayer on its returns. Therefore, the Taxpayer's argument on this issue is unavailing.

C.

The Taxpayer also challenges the 35% markup used by the Revenue Department. As noted, the Revenue Department took the position, based in part on the Taxpayer's lack of sales records, that the amounts of tax reported by the Taxpayer during the audit period were not correct. In such a situation, "the department may calculate the correct tax … based on the most accurate and complete information reasonably obtainable by the department." Ala. Code 1975, § 40-2A-7(b)(1)a.; *see also Jai Shanidev, Inc., v. State Dep't of Revenue*, S. 16-449-CE (Ala. Tax Trib. Apr. 27, 2017). The Tax Tribunal has recognized the following:

> All retailers subject to Alabama sales tax are statutorily required to keep complete and accurate sales, purchase, and other records from which their correct sales tax liability can be computed. Code of Ala. 1975, §§ 40-2A-7(a)(1) and 40-23-9. A retailer's duty to keep sales records is straightforward and simple. It is commonly understood that such records must be maintained to allow the Department to verify that the correct amount of sales tax has been reported and paid.
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> The Taxpayer in this case admittedly failed to provide complete sales records. In such cases, the Department is authorized to compute a taxpayer's correct liability using the most accurate and complete information obtainable. Code of Ala. 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., supra, at 4 (emphasis added).

Because the Taxpayer in this appeal failed to maintain and produce 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% markup is based on Internal Revenue Service information regarding percentage markups of gas stations and grocery stores. *See, e.g., E&Z, Inc. v. State Dep't of Rev.*, S. 19-989-LP (Ala. Tax Tribunal Jan. 12, 2022). The percentages have been averaged to reach the 35% figure. *E&Z, Inc.*, 19-989-LP at 4. The IRS markup includes a markup on gas because many states tax gas; however, Alabama does not charge sales tax on gas, thus the IRS markup is skewed downward for Alabama as the markup on gas typically is very low. *Id.*

The Tribunal has ruled in other cases that the percentage is reasonable. *See, e.g., E&Z, Inc., supra. See also Masrath Int'l, Inc. v. State Dep't of Revenue*, S. 19-1335-JP (Ala. Tax Trib. Sept. 15, 2023) (upholding the application of the 35% markup

because the Taxpayer produced contradictory records that indicated its z-tapes were both incomplete and inaccurate); *Cresview Foods, LLC, v. State Dep't of Revenue*, S. 20-759-JP (Ala. Tax Trib. May 5, 2023) (upholding the application of the 35% markup because the Taxpayer failed to provide documentary proof that the estimated percentage was higher than the Taxpayer's actual markup); *Bessemer Exxon, Inc., v. State Dep't of Revenue*, S. 20-519-LP (Ala. Tax Trib. Dec. 7, 2022) (upholding the application of the 35% markup because of its inclusion of the markup on gas which skewed the markup downward for Alabama). "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*." *E&Z, Inc.*, 19-989-LP at 4 (emphasis added). In accordance with the Tax Tribunal's previous rulings, the Revenue Department's method of calculating taxable sales in this case was reasonable. Therefore, the tax component of the final assessment is not reversible based on the percentage markup used in this case.

Concerning the assessment of the fraud penalty, the Tax Tribunal has previously explained as follows:

> 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).
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> 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).
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> *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 should have reasonably known that its taxes were being grossly underreported. *Russo v. C.I.R., T.C. Memo* 1975-268; *Temple v. C.I.R.*, 67 T.C. 143 (1976).
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> *Any retailer should know with certainty that sales records must be maintained for audit purposes.* The Tax Tribunal, as well as its predecessor the Department of Revenue Administrative Law Division, has affirmed the fraud penalty numerous times in similar cases. *See Jai Kru, LLC v. State of Alabama*, S-18-387-LP (Tax Trib. 03/18/2019), *and Kwik Mart, LLC v. State of Alabama*, S-18-694-LP.

E&Z, Inc., v. State Dep't of Revenue, 19-989-LP at 5-7 (Ala. Tax Trib. Jan. 12, 2022) (emphasis added). In *E&Z*, the taxpayer's purchases consistently exceeded its reported sales, and the *E&Z* taxpayer provided only incomplete records on audit, causing the Revenue Department to apply a fraud penalty. *Id.* at 2-3. The Tax Tribunal ultimately ruled in *E&Z* that the fraud penalty was warranted given the taxpayer's consistent underreporting of retail sales by more than 50 percent, failure to provide complete sales records, and failure to disclose a second bank account. *Id.* at 6-7.

Here, the Revenue Department's auditor testified that he assessed a fraud

penalty because of the Taxpayer's consistent pattern of underreporting by 288%, the absence of sales records, the lack of documentation to verify the sales tax returns, and the fact that the Taxpayer's purchases consistently exceeded its reported sales. The evidence indicated that, for the 20-month audit period, the Taxpayer provided only six months of vendor records, which were incomplete, and provided no sales records. The Revenue Department's auditor testified that he could not determine the Taxpayer's method of reporting or validate the reported amounts. Thus, there was non-hearsay evidence presented to support the assessment of the fraud penalty. The Revenue Department, therefore, met its burden of proving fraud.

D.

Finally, the Taxpayer argues that the 35% markup approach used by the Revenue Department constitutes an administrative rule that was used in violation of the Alabama Administrative Procedure Act ("AAPA"). The AAPA, codified as Ala. Code § 41-22-1, *et seq*., "is intended to provide a minimum procedural code for the operation of all state agencies when they take action affecting the rights and duties of the public." Ala. Code § 41-22-2(a). And the AAPA "shall be construed broadly to effectuate its purposes." *See* Ala. Code § 41-22-25(a). Those purposes are to "[i]ncrease public accountability of administrative agencies" (§ 41-22-2(b)(1)b); [s]implify government by assuring a uniform minimum procedure to which all agencies will be held in the conduct of their most important functions" (§ 41-22-2(b)(1)c); "[i]ncrease public access to governmental information" (§ 41-22-2(b)(1)d); "[i]ncrease public participation in the formulation of administrative rules" (§ 41-22-

2(b)(1)e); and "[s]implify the process of judicial review of agency action as well as increase its ease and availability" (§ 41-22-2(b)(1)g), among others. *See Montgomery Rehabilitation Hosp., Inc. v. State Health Planning Agency*, 610 So. 2d 403, 406 (Ala. Civ. App. 1992).

However, not all agency actions constitute a rule for purposes of the Act. Instead, the AAPA defines "rule" as follows:

> Each agency rule, regulation, standard, or statement of general applicability that implements, interprets, or prescribes law or policy, or that describes the organization, procedure, or practice requirements of any agency and includes any form which imposes any requirement or solicits any information not specifically required by statute or by an existing rule or by federal statute or by federal rule or regulation; provided, however, all forms shall be filed with the secretary of the agency and with the Legislative Services Agency, Legal Division, and all forms, except intergovernmental, interagency, and intra-agency forms which do not affect the rights of the public and emergency forms adopted pursuant to Section 41-22-5, shall be published in the Agency Administrative Code. The term includes the amendment or repeal of all existing rules, but does not include any of the following:
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> a. Statements concerning only the internal management of an agency and not affecting private rights or procedures available to the public.
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> b. Declaratory rulings issued pursuant to Section 41-22-11.
>
> c. Intergovernmental, interagency, and intra-agency memoranda, directives, manuals, or other communications which do not substantially affect the legal rights of, or procedures available to, the public or any segment thereof.
>
> d. Determinations, decisions, orders, statements of policy, and interpretations that are made in contested cases.
>
> …..

Ala. Code § 41-22-3(9).

"The term 'rule' is intended to have a broad definition in regard to the procedural requirements of the AAPA." *Hartford Healthcare, Inc. v. Williams*, 751 So.2d 16, 20 (Ala. Civ. App. 1999).

> A rule . . . can be a regulation, standard, or statement that prescribes policy or describes procedures or practice requirements. . . . Another aspect of . . . a rule is that it must be a statement of "general applicability" rather than a determination, decision, order, statement of policy, or interpretation in a contested case.

Ex parte Traylor Nursing Home, Inc., 543 So. 2d 1179, 1183-84 (Ala. 1988). "Although it is not determinative, an agency's characterization of its own standard as nonbinding is persuasive and deserves some weight." *Families Concerned About Nerve Gas Incineration v. Ala. Dep't of Envtl. Mgmt.*, 826 So.2d 857, 863 (Ala. Civ. App. 2002) (citing *Alliance for Bio-Integrity v. Shalala*, 116 F. Supp.2d 166, 171-72 (D.D.C. 2000). "'The ultimate issue is the agency's intent to be bound by its announced standard.'" *Families Concerned About Nerve Gas Incineration*, 826 So.2d at 863-64 (citing *Public Citizen v. United States Nuclear Regulatory Comm'n*, 940 F.2d 679, 682 (D.C. Cir. 1991).

Alabama Code Section 40-2A-7(b)(1)(a) states: "If the department determines that the amount of any tax as reported on a return is incorrect, or if no return is filed, or if the department is required to determine value, the department may calculate the correct tax or value *based on the most accurate and complete information reasonably obtainable by the department*." (emphasis added). In this case, the Revenue Department extrapolated the Taxpayer's total sales from its total vendor purchases by applying to the Taxpayer's purchases a percentage derived from

Internal Revenue Service information regarding percentage markups of gas stations and grocery stores. Specifically, the Revenue Department multiplied the Taxpayer's monthly vendor purchases by 1.35 (a 35 percent increase) and used the result as the estimate of the Taxpayer's sales for each corresponding month. The Taxpayer argues that the auditor was instructed by his supervisor to use the Revenue Department's standard markup of 35 percent. And the Taxpayer attached an exhibit featuring a flowchart that represented the Revenue Department's "WRAP and C-Store Audit Procedure," which included steps allowing the assigned auditor to either use a taxpayer's sales records or the 35% markup if sales were not reasonably more than purchases, or if records were not provided. Based on that information, the Taxpayer asserts that the 35% purchase markup procedure is an administrative rule that is invalid because it was not subjected to the notice and comment procedure of the AAPA.

The Revenue Department, on the other hand, asserts that the 35% markup is not a rule because it does not have "general applicability" and is not a binding norm upon which all audits are conducted. The Revenue Department relies, in part, on *Families Concerned about Nerve Gas Incineration v. Alabama Department of Environmental Management, et al.*, 826 So. 2d 857 (Ala. Civ. App. 2002). In *Families*, the Alabama Court of Civil Appeals explained: "[T]o be a § 41-22-3(9) 'rule,' a requirement must be couched in binding, mandatory terms ('must' and 'require') and must concern a matter of 'general applicability.'" 826 So. 2d at 863 (internal quotations and citations omitted).

The courts of Alabama, as well as the United States Court of Appeals for the Eleventh Circuit and the United States District Court for the Middle District of Alabama, have recognized "that the mere fact that something resembles a 'rule' as defined by the AAPA does not require the state to follow the AAPA's notice-and-comment requirements to promulgate or revoke it." *Smith v. Ivey*, No. 20-14765, slip op. at 6 (11th Cir. Jul. 21, 2021) (affirming the decision of the District Court in *Smith v. Ivey*, 501 F.Supp.3d 1248 (M.D. Ala. 2020)). "The touchstone of a legislative rule is that it establishes a binding norm. However, if the agency remains free to consider the individual facts in the various cases that arise, then the agency action in question has not established a binding norm." *Families Concerned About Nerve Gas Incineration*, 826 So.2d at 869 (internal quotations omitted); *see also Ala. Dep't of Envtl. Mgmt. v. Coosa River Basin Initiative, Inc.*, 826 So.2d 111, 116 (Ala. 2002).

In *Families*, the Court of Civil Appeals was presented with a challenge by two interest groups of the cancer-risk factor considered by the Alabama Department of Environmental Management ("ADEM") when issuing hazardous-waste incineration permits. The interest groups argued that the cancer-risk factor was a legislative rule that was not adopted according to formal rulemaking procedures because ADEM "had previously used the same cancer-risk factor in other hazardous-waste permit cases." *Families Concerned About Nerve Gas Incineration*, 826 So.2d at 864. The appellate court disagreed because the cancer-risk factor did not establish a binding norm and was subject to change. *Id.* at 869-70. In fact, the record before the court established that ADEM had retained the freedom to consider facts on a case-by-case basis and

that ADEM "[did] not intend to rigidly enforce the risk-assessment methodology set out in the EPA Guidance" from which the cancer-risk factor originated. *Id.* Not long after the *Families* decision was issued, the Alabama Supreme Court adopted the reasoning applied by the Court of Civil Appeals in *Families* "in its entirety" when reviewing the propriety of ADEM's issuance of a permit to the United States Department of the Army and to a private corporation for the incineration of chemical weapons. *Coosa River Basin Initiative*, 826 So.2d at 116.

A few months after the issuance of the *Families* and *Coosa River Basin* opinions, the Alabama Supreme Court held that procedures promulgated by ADEM governing the discharge of pollutants into Alabama waterways did constitute rules under the AAPA. *Ex parte Legal Env't Assistance Found., Inc.*, 832 So. 2d 61 (2002) ("*LEAF*"). In *LEAF*, the Federal Antidegradation Policy concerning water quality, codified at 40 C.F.R. § 131.12, required the individual states to "develop and adopt [] statewide antidegradation polic[ies] and identify the methods for implementing such polic[ies][;]" however, the Federal Antidegradation Policy specified only *minimum* standards for the water-quality policies of the individual states. *Id.* at 63. In response to the Federal Antidegradation Policy, ADEM eventually adopted implementation procedures but did not provide public notice or an opportunity for the public to be heard concerning those procedures. *Id.* at 64. The Alabama Supreme Court explained that ADEM's revised policy constituted a rule as it "implemente[d] the state antidegradation policy, prescribe[d] pollution policy . . . , and describe[d] the

procedure and practice requirements of ADEM for applications for discharge permits," and because ADEM's policy was not required by statute. *Id.* at 66.

The Eleventh Circuit Court of Appeals applied Alabama case law in deciding a similar question concerning the AAPA definition of "rule." *See Smith v. Ivey*, *Id.* In *Smith*, the plaintiff challenged a provision in an Annex to the state's Emergency Operations Plan that prohibited patients who were experiencing end-stage organ failure from receiving mechanical ventilator support; *i.e.*, "ventilator triage protocol." Among other claims, Smith asserted that the Annex constituted an administrative rule that was subject to Alabama's AAPA. In 2019, the Annex was removed from Alabama's Crisis Standards of Care, but the Annex remained accessible online. In 2020 apparently, the state agreed to remove the triage protocol from the internet and declared that the criteria were no longer effective. In holding that the Annex was not a rule, the court stated that the provision constituted non-binding guidelines. *Id.* at 7. *See also, Smith v. Ivey*, 501 F.Supp.3d 1248, 1262-63 (M.D. Ala. 2020), *aff'd*, No. 20-14765, slip op. at 6 (11th Cir. Jul. 21, 2021).

More recently, in *Keith v. LeFleur*, No. 2200821, ___ So. 3d ___ (Ala. Civ. App. Sept. 8, 2023), the Alabama Court of Civil Appeals held that an informal memorandum setting forth a grievance procedure that "appl[ied] generally to all discrimination complaints received by ADEM ... [and] describes step-by-step exactly how ADEM will process each and every discrimination complaint" fit within the definition of a rule. The Court of Civil Appeals further held that the memorandum did not fall into the exception for "[i]ntergovernmental, interagency, and intra-agency

memoranda, directives, manuals, or other communications which do not substantially affect the legal rights of, or procedures available to, the public or any segment thereof" because the memorandum did "not deal with internal personnel management, regulate the employment practices of an administrative agency, or concern the private rights of agency employees." *Id.* at 24. Instead, the memorandum "legislate[d] the procedures available to the public at large for resolving any discrimination grievance filed with ADEM," and thus constituted a rule for purposes of the AAPA. *Id.* The Court noted that "[t]he grievance procedures [did] not arise from any specific controversy [but, instead,] establish[ed] a uniform procedure to be followed to resolve each and every discrimination complaint submitted to ADEM." *Id.*

Here, the Taxpayer's case is more akin to *Families*, *Coosa River Basin*, and *Smith* than it is to *Keith*. The flowchart representing the Revenue Department's WRAP and C-Store Audit Procedure submitted by the Taxpayer shows that the Revenue Department has reserved some freedom to consider the individual facts before it when conducting such an audit. The flowchart explicitly displays that, before applying the 35% mark-up, the Revenue Department's auditor must (1) attempt to obtain the taxpayer's sales records and, if successful, (2) review the taxpayer's sales to determine if the sales are "reasonably more than purchases." If the taxpayer's reported sales records are reasonable, the auditor is to use the sales records rather than apply the 35% mark-up. Therefore, the flowchart illustrates the

Revenue Department's discretion to review the individual facts of each case before deciding whether to apply the 35% mark-up.

This retained freedom is increasingly evident when reviewing the numerous sales tax cases that have come before the Tax Tribunal and its predecessor, the Administrative Law Division of the Revenue Department. *See*, *e.g.*, *Saku, LLC v. State Dep't of Revenue*, S. 19-420-LP (Ala. Tax. Trib. Oct. 4, 2019) (identifying the Department's reduction of the applicable mark-up from 35% to 27%); *Alwan, Inc. v. State Dep't of Revenue*, S. 16-1315-CE (Ala. Tax Trib. May 15, 2018) (explaining that the comparison of the taxpayer's records necessitated a reduction of the applicable IRS standard mark-up of 41% to 33%); *Dunning v. State Dep't of Revenue*, S. 14-962 (Ala. Tax Trib. May 6, 2015) (explaining that the comparison of the taxpayer's records necessitated a reduction of the applicable IRS standard mark-up of 41% to 33%); *Freedom Ventures, Inc. v. Dep't of Revenue*, S. 14-480 (Ala. Tax Trib. Oct. 17, 2014) (Op. and Preliminary Order); *Moghis Ghauri Speedy Shop 2676 Highway 77 Attalla, AL v. State Dep't of Revenue*, Op. of Dep't of Revenue, Admin. Law Div., Docket No. S. 06-526 (Dec. 13, 2007) (identifying the Revenue Department's reduction of the standard IRS mark-up from 26.79% to 20% to take into account cigarette buy-downs). These cases demonstrate both the Revenue Department's use of the 35% mark-up and that the 35% mark-up is not applied generally, or indiscriminately, to all sales tax cases.

Therefore, the ruling in this appeal concerning the AAPA claim is the same as the decision in *Families*, and for the same reason. Here, it is clear that the Revenue

Department does not intend to be bound by the 35% mark-up. Instead, the record establishes that the 35% mark-up is merely an option available to the Revenue Department when conducting a sales tax audit, but it is not a requirement in each and every audit. And the mere fact that the 35% mark-up was used in multiple prior cases does not mean that it is a legislative rule subject to the requirements of the AAPA. *See Families*.

In short, the 35% markup is a method utilized by the Revenue Department to estimate a taxpayer's sales tax liability when that taxpayer has failed to uphold its statutory duty to maintain and produce accurate sales records. However, as represented by the Revenue Department's "WRAP and C-Store Audit Procedure" flowchart, the production of records by a taxpayer will preclude the application of the 35% mark-up unless those records are unreasonable or incomplete.

In this appeal, it is undisputed that the Taxpayer's records were incomplete and that the Taxpayer produced no sales records to the Revenue Department on audit. *See State v. T.R. Miller Mill Co.,* 130 So. 2d 185, 190 (Ala. 1961), which stated the following: "Under Alabama sales tax law, taxpayers are required to keep such records and accounts as may be necessary to determine the amount of tax due. Tit. 51, § 759, Code 1940. The purpose of such a requirement is to enable a proper determination of tax due. The State is not required to rely on verbal assertions of the taxpayer in determining the correctness of the tax return, but records should be available disclosing the business transacted. Where there are no proper entries on the records to show the business done, the taxpayer must suffer the penalty of

noncompliance and pay on the sales not so accurately recorded as exempt. *State v. Levey*, 29 So.2d 129." *See also* Ala. Code § 40-2A-7(a)(1), requiring taxpayers to "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 value or correct amount of any tax … administered by the department …"

Conclusion

The Revenue Department's final assessment of state sales tax for December 2017 through July 2019 is upheld. Judgment is entered against the Taxpayer in the amount of $83,366.66, consisting of $52,930.71 of outstanding tax, a $26,465.37 fraud penalty, and interest of $3,970.58, plus additional interest that continues to accrue from the date of the entry of the final assessment until the liability is paid in full.

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

Entered April 15, 2025.

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

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