

CRANBERRY MAGNETITE CORP. '
Post Office Box 188
Pounding Mills, Virginia 24637, '

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, '
v. '

DOCKET NOS. INC. 95-371
S. 95-372
WITH. 96-402

STATE OF ALABAMA '
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed Cranberry Magnetite, Inc. for withholding, sales, and use tax for all or part of the period June 1992 through March 1995. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, ' 40-2A-7(b)(5)a. The cases were consolidated, and hearings were conducted on May 14, June 14, and August 1, 1996. Thomas H. Brinkley and Daniel H. Markstein, III represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

This case involves taxes owed by a bingo business that operated in Piedmont, Alabama during the subject period. The primary issue is whether Cranberry Magnetite actually operated the bingo business, and thus is liable for the taxes in question. Cranberry Magnetite claims it only leased two buildings in Piedmont in which bingo was played. The Department counters that the various charities in whose name bingo was operated were "fronts" for Cranberry Magnetite, and that in substance Cranberry Magnetite conducted and controlled the bingo games.

If Cranberry Magnetite is liable for any of the above taxes, a second issue is

whether the Department properly computed Cranberry Magnetite's liability.

The record includes a 767-page transcript and over 100 exhibits. One exhibit is a 455-page transcript from a Calhoun County Circuit Court case between Cranberry Magnetite and one of the individuals involved in the bingo operation, M.F. "Mutt" Johnson. The testimony of Mutt Johnson, Victoria Johnson, Wanda McDill, Robert Weber, and Sam Whitlock discussed below is from the Calhoun County transcript.

A detailed summary of the evidence is necessary to understand the case.

Amendment 508 to the Alabama Constitution was ratified in 1990 and allows qualified charitable organizations to conduct bingo in Calhoun County, subject to certain restrictions. The City of Piedmont also enacted ordinances in 1990 through 1992 authorizing bingo in Piedmont. (TP Ex. 1 & 2).

In early 1992, Mike Graham ("Graham") and Mutt Johnson ("Johnson") discussed the possibility of operating a high-stakes bingo game in Piedmont. Graham and Johnson previously operated a bingo game in Natchez, Mississippi under the auspices of the Natchez Chapter of the Gospel Music Hall of Fame ("GMHF"). As discussed below, the GMHF is one of several § 501(c)(3) charities controlled by W.T. Lewis. The Natchez bingo operation was closed after several months by the sheriff in Natchez.

Graham asked Mike McGlothlin ("McGlothlin") if he would finance the bingo in Piedmont. McGlothlin was a Virginia businessman who owned Cranberry Magnetite, Limestone Dust Corporation, and several other corporations. Graham had worked closely with McGlothlin as his financial advisor and CPA since 1980. Graham handled

all of McGlothlin's personal and business records and taxes. The two were also one-third partners in a Florida partnership, Zackers Gas, that itself owned several corporations.

McGlothlin agreed to finance the bingo operation, and directed Graham to find a location in Piedmont where bingo could be conducted. The parties intended to initially operate a relatively small game, and if successful, build a much larger facility for bingo in Piedmont.

Graham found an old gym owned by the City of Piedmont that seated approximately 350 to 400 people. McGlothlin leased the gym from the City in the name of Cranberry Magnetite for \$1,500 a month. Cranberry Magnetite had been dormant since the early 1980s. McGlothlin also gave Graham \$15,000 to renovate and prepare the old gym for bingo.

McGlothlin and Graham claim that Cranberry Magnetite was not involved in the bingo, but rather only subleased the gym to Mutt Johnson, operating as "Bonanza Bingo." However, no lease was executed between Cranberry Magnetite and Bonanza Bingo. Rather, Mutt Johnson paid Cranberry Magnetite's \$1,500 rent directly to the City.

Mutt Johnson obtained a bingo application, and Graham used it to apply for a bingo permit with the City in June 1992 in the name Cranberry Magnetite. (TP Ex. 3). Graham signed the application as secretary-treasurer of the corporation.

Graham and Johnson attended a Piedmont City Council meeting in early June

1992. The minutes of the meeting indicate that Johnson and Graham attended as representatives of Cranberry Magnetite. (Dept. Ex. 10). The Council approved Cranberry Magnetite's bingo permit, and also the lease of the old gym to Cranberry Magnetite. The City subsequently issued a bingo permit in the name "Bonanza Bingo." Piedmont City Administrator Brent Morrison claims he issued the permit in the name Bonanza Bingo by mistake.

Bingo started at the old gym in June 1992. The games were managed primarily by Mutt Johnson, Mutt's cousin, Victoria Johnson, and sometimes Graham. McGlothlin was also present and helped out on occasion. The business employed between 25 and 30 individuals.

Wanda McDill was hired as bookkeeper in June 1992. McDill testified that she asked Graham about a federal tax identification number for the business, and Graham directed her to use Cranberry Magnetite's number. McDill subsequently used Cranberry Magnetite's tax number to file various 1992 federal withholding tax forms in the name "Cranberry Magnetite Bonanza Bingo." Several federal withholding tax deposits were also made in the name "Cranberry Magnetite Bonanza Bingo" using Cranberry Magnetite's tax number. (Dept. Ex. 29, 30 & 31).

McGlothlin and Graham both deny that McDill was authorized to use Cranberry Magnetite's tax number. They claim that either Mutt Johnson or McDill got the number from a filing cabinet kept by Cranberry Magnetite in a Gadsden apartment to

which Johnson had access.

In June or July 1992, McGlothlin opened a "Cranberry Magnetite Bonanza Bingo" account at the First National Bank of Keystone in Keystone, West Virginia (the "9113" account). McGlothlin maintained other personal and corporate accounts at the Bank, and Graham was an independent auditor for the Bank. McGlothlin claims he does not know how the name Bonanza Bingo got on the 9113 account, or on the checks printed for the account.

Also in June 1992, "Cranberry Magnetite d/b/a Bonanza Bingo" applied with a Piedmont insurance agent, Brian Jennings, for a workers' compensation insurance policy. Graham is listed as a corporate officer, and his signature is on the application dated June 19, 1992. A policy was issued, and later renewed for another year in June 1993. Claims were made against the policy by various employees at the bingo operation. (Dept. Ex. 35).

On September 13, 1992, Cranberry Magnetite contracted with the City of Piedmont to operate bingo in Piedmont for ten years. In return, Cranberry Magnetite agreed to pay the City a \$4 per person "head tax," and also guaranteed the City at least \$500,000 a year in head tax proceeds. (Dept. Ex. 38).

In October 1992, City Administrator Morrison notified Victoria Johnson at Bonanza Bingo that the bingo games were not being operated by a qualified ' 501(c)(3) charity, as required by Amendment 508 and Piedmont ordinances. Victoria Johnson

notified Graham and Mutt Johnson, who contacted W. T. Lewis, the president of the national chapter of GMHF. Graham and Johnson had worked with Lewis when they operated the Natchez Chapter of the GMHF. Lewis agreed to allow use of the GMHF name in Piedmont in return for monthly payments. Lewis accordingly established a Piedmont Chapter by transferring the old Natchez Chapter to Piedmont. Victoria Johnson was named president. (TP Ex. 7).

City Administrator Morrison approved GMHF's bingo application on November 3, 1992, without Council action. (TP Ex. 2). Morrison wrote on the application "Approved by City Council under name Cranberry Magnetite Corporation, June 8, 1992."

GMHF and the City contracted on October 30, 1992 for GMHF to operate bingo in Piedmont for ten years. (TP Ex. 5). Morrison wrote on the contract - "this contract replaces the original dated Sept. 1992. Contracts are the same except change from Cranberry Magnetite to Gospel Music Hall of Fame." The same individuals continued to operate the bingo business as before.

In late 1992, McGlothlin incorporated at least four businesses in Alabama for the purpose of providing goods and services at the bingo operation. (TP Ex. 53). Those corporations included J & J Gifts, Inc., Bonanza Express Tours, Inc., Cranberry Bingo Supplies, Inc., and Bonanza Food and Snack Bar Services, Inc. McGlothlin owned 50 percent of the corporations. Graham and Mutt Johnson owned 25 percent each.

It is unclear which, if any, of the above corporations actually operated in

Alabama. However, the corporations opened checking accounts at AmSouth Bank in Gadsden in January 1993. A Cranberry Bingo Supplies account was also opened at the Keystone Bank in West Virginia. Bookkeeper McDill testified that Mutt Johnson gave her cash from the bingo games to deposit in the Gadsden accounts. She was also instructed to prepare checks on Cranberry Magnetite's 9113 account and deposit those in the various accounts.

Based on the success of bingo at the old gym, Graham projected that bingo in a larger facility with a capacity of 2,500 to 3,000 people would gross approximately \$29.6 million, and reap a net profit of approximately \$13.6 million. (Dept. Ex. 25). Based on those figures, McGlothlin decided to build a large bingo hall in Piedmont. He purchased land in March 1993 in the name of Cranberry Magnetite. Construction began in May 1993 on a large bingo hall to be called the Frontier Palace. A lease was prepared requiring GMHF to pay Cranberry Magnetite \$150,000 a month rent on the building. (TP Ex. 34) However, the lease was never executed and no rent was ever paid.

Cranberry Magnetite's 9113 account in Keystone was used to build the Frontier Palace. The Bank "swept" money into the 9113 account as necessary from McGlothlin's personal and other corporate accounts. McGlothlin testified that the money came primarily from retained earnings from his other businesses. At least \$6 to \$6.5 million passed through the account during the audit period.

Graham and McGlothlin had check signing authority on the 9113 account. Mutt

Johnson was not on the signature card, but was verbally authorized by McGlothlin to sign on the account. However, the Bank was instructed not to honor a check from Johnson unless it first got verbal approval from Graham or McGlothlin.

From mid-1993 through the end of 1993, Mutt Johnson wrote approximately \$650,000 in checks on the 9113 account, payable to Barnett Securities. The Bank honored the checks, and Johnson deposited the money with Barnett Securities in the name of his wife or son.

Graham and McGlothlin claim that Johnson took the money without their knowledge or permission. Graham claims he was busy on business in Florida and failed to properly monitor the 9113 account. McGlothlin thought Graham was reviewing the account. They also claim that unknown to them, someone instructed the Keystone Bank to send the 9113 account statements directly to Mutt Johnson in Gadsden. There is no evidence why the Bank mailed the statements to Mutt Johnson without the approval or knowledge of McGlothlin or Graham, or why the Bank approved the Johnson checks totaling approximately \$650,000 without the express approval of either McGlothlin or Graham. Neither Cranberry Magnetite nor McGlothlin have sued Johnson for return of the money.

On the other hand, Mutt Johnson testified that he regularly used the 9113 account beginning in mid-1992 to pay operating expenses at Bonanza Bingo. Concerning the Barnett Securities checks, Johnson testified that Graham and McGlothlin agreed that he would draw the money out of the 9113 account and create



a reserve account with Barnett Securities. The money was then invested in the stock of various Mississippi casinos in which the three had invested. Johnson claims the money was returned to the bingo operation through various accounts.

The City requested a \$25,000 letter of credit from GMHF in June 1993 to insure payment of the head tax. (TP Ex. 14). The First National Bank of Keystone confirmed to the City on September 15, 1993 that "Cranberry Magnetite, and/or Bonanza Bingo" had a \$25,000 letter of credit through Cranberry Magnetite's 9113 account at the Bank. (Dept. Ex. 6).

The Frontier Palace opened in November 1993. Cranberry Magnetite advanced \$100,000 to conduct the opening day games. McGlothlin and Graham claim the \$100,000 was a loan. However, a loan document was never executed, and no money was ever repaid.

In February 1994, Graham and McGlothlin asked W. T. Lewis to help them remove Mutt and Victoria Johnson from the Frontier Palace. Lewis testified that McGlothlin and Graham told him that Mutt Johnson was stealing from them, and they wanted to take over the local GMHF chapter and run the bingo operation. Lewis agreed to help, and notified the City that Victoria Johnson was no longer president of the Piedmont Chapter of GMHF. Lewis also appointed Graham as the new president of the local chapter. (TP Ex. 15 & 16).

Victoria Johnson responded to the attempted removal by notifying City Administrator Morrison that she had not received any such notice from W.T. Lewis.

She also claimed that there were no GMHF by-laws authorizing the national office to change local officers. (Dept. Ex. 8). Lewis testified that the national chapter had no by-laws at the time, but at the insistence of Graham and McGlothlin, he drew up some by-laws allowing the national office to remove local officers.

McGlothlin, Graham, and Lewis wrote a letter dated March 25, 1994 terminating Mutt Johnson from his employment or alleged employment with Cranberry Magnetite, GMHF, Limestone Dust, and the various other bingo related corporations in Piedmont. Johnson was directed to turn over all assets of the corporations to Graham. (Dept. Ex. 26). A memorandum was also issued directing all creditors of Cranberry Magnetite, GMHF, and the other corporations to send all bills to "Mike McGlothlin c/o Cranberry-Magnetite Corporation" in Virginia. (Dept. Ex. 27).

Mutt Johnson left the Frontier Palace and started another bingo operation in Piedmont in the Spring of 1994. He apparently also removed some chairs, tables, and other items from the Frontier Palace. Cranberry Magnetite sued Mutt Johnson in Calhoun County Circuit Court in 1994 for conversion of that property.

Bingo was not conducted at the Frontier Palace from late February or early March until April 1994. During that period, Graham and McGlothlin contacted W. T. Lewis about using another one of his charities at the Frontier Palace. Lewis testified that Graham and McGlothlin wanted another charity because GMHF was having problems with the IRS.

Lewis subsequently authorized bingo at the Frontier Palace under the auspices of the Southern Congress of Racial Equality ("SCORE"), another one of Lewis' ' 501(c)(3) charities. Lewis, as national president, appointed Graham as president of the Piedmont chapter.

SCORE applied for a bingo permit on April 11, 1994. Graham was listed as one of the operators. The City issued a permit to SCORE on April 16, 1994. (Dept. Ex. 7).

SCORE rented the Frontier Palace from Cranberry Magnetite for \$150,000 per month. (TP Ex. 37). McGlothlin signed for Cranberry Magnetite. Graham signed as president of SCORE. No rent was ever paid. SCORE ceased operating at the Frontier Palace on July 1, 1994.

Elkhorn Valley Development Corporation ("Elkhorn") applied for a bingo permit with the City on June 24, 1994. (TP Ex. 19). Elkhorn was a ' 501(c)(3) charity located in Keystone, West Virginia. Graham was listed as one of the operators, and was appointed president of the Piedmont Chapter. (TP Ex. 20). The City approved the application and issued a permit to Elkhorn on July 5, 1994. (Dept. Ex. 9).

Elkhorn also rented the Frontier Palace from Cranberry Magnetite for \$150,000 a month. (TP Ex. 45). McGlothlin signed for Cranberry Magnetite. Graham signed as president of Elkhorn. Again, no rent was ever paid.

Cranberry Magnetite sold the Frontier Palace building to SBI Communications, Inc. in late 1994 for 1.5 million shares of SBI preferred stock valued at approximately \$.60 to \$.70 per share. SBI had been formed to make satellite broadcasts of bingo

from the Frontier Palace. SBI later sold the building to Horizon Gas Corporation, which is owned by the Florida partnership, Zackers Gas, in which McGlothlin and Graham each have a one-third interest.

The conversion action filed by Cranberry Magnetite against Mutt Johnson was tried before Calhoun Circuit Court Judge Laird on August 11 and October 4, 1994. Those hearings resulted in the transcript introduced in this case as Dept. Ex. 17 and 17-A.

Judge Laird issued an Order in the case on April 13, 1995. (Dept. Ex. 11). Judge Laird concluded that Cranberry Magnetite had operated the bingo game in Piedmont beginning in May or June 1992, and continued to operate the game through at least October 4, 1994 (the date of the last hearing before Judge Laird). Judge Laird further concluded that GMHF, SCORE, and Elkhorn were "fronts" for Cranberry Magnetite, and that Cranberry Magnetite was the party liable for the unpaid taxes resulting from the bingo. Judge Laird directed the Revenue Department to audit Cranberry Magnetite "to determine the amount of taxes due and payable from Plaintiff (Cranberry Magnetite) to the State of Alabama Department of Revenue pursuant to Section 40-23-2(2), Code of Alabama (1975), or any other provision of law, along with any penalties and interest allowed."

The Department accordingly formed an audit task force and audited Cranberry Magnetite for withholding, sales and use taxes. The audit resulted in the final assessments in issue.

Other relevant facts are:

(1) Victoria Johnson opened a Bonanza Bingo checking account in mid-1992 in Jacksonville, Alabama. Graham wired her the money to open the account from the Keystone Bank in West Virginia. She also applied with a bingo supply business in Iowa for a line of credit for Cranberry Bingo Supplies in October 1992. Graham arranged for a \$400,000 line of credit with the bingo supplier through Cranberry Magnetite's 9113 account in Keystone.

(2) Victoria Johnson, Wanda McDill, and several other employees were paid in cash. Other employees were paid by payroll check. Mutt Johnson was an unpaid "consultant." McGlothlin and Graham claim they never received any money from the business.

(3) The bingo operation rented several apartments in Gadsden during the audit period. Mutt Johnson lived in one, and several were used as offices. A receptionist was hired, and computers were installed. Graham and McGlothlin visited the apartments on occasion, and kept records in a filing cabinet in one of the apartments.

(4) Sam Whitlock was a bingo supply dealer in Arizona. Whitlock testified that Mutt Johnson contacted him in mid-1992 about obtaining bingo supplies for Cranberry Magnetite. Whitlock was later instructed to change the customer name to Bonanza Bingo. Whitlock was owed approximately \$32,000 when Mutt Johnson left

the Frontier Palace in early 1994. Whitlock discussed the debt with McGlothlin, and McGlothlin finally settled the debt by paying Whitlock \$16,500. McGlothlin continued buying bingo supplies for the Frontier Palace from Whitlock. On one occasion, McGlothlin wired Whitlock \$5,000 in advance for supplies.

(5) Limestone Dust Corporation, one of McGlothlin's corporations, leased a car which Mutt Johnson used while in Piedmont. Limestone Dust also purchased two cars, one for Mutt Johnson's wife, another for his son.

(6) Robert Weber was employed by the bingo operation. Weber testified that he received a car from Mutt Johnson and Graham as compensation for overseeing construction of the Frontier Palace in 1993. Weber also observed Mutt Johnson regularly take money out of the bingo hall at night in a briefcase. McGlothlin and Graham also left with Johnson on occasion.

(7) Wanda McDill testified that in July 1993, Mutt Johnson instructed her to write a \$9,000 check on each of the five bingo-related corporations, Bonanza Express Tours, J and J Gifts, etc., that had accounts in Alabama. The checks were deposited into Cranberry Magnetite's 9113 account in West Virginia. When one of the checks bounced, Mutt Johnson deposited \$9,000 cash in the account to cover the check.

(8) SCORE opened a checking account with SouthTrust Bank in Calhoun County in 1994. Graham, McGlothlin, and two other individuals had check signing authority on the account. (Dept. Ex. 21). McGlothlin wrote a \$25,000 check on April 12, 1994 on the account of Cranberry Bingo Supply in Keystone. \$24,900 of that

money was deposited in the SCORE account in Alabama. (Dept. Ex. 22).

(9) Lewis testified that SCORE received checks or was wired money from the Cranberry Bingo Supply account from April through June 1994. The checks were signed, or the wire authorized, by McGlothlin.

(10) GMHF and SCORE were not active anywhere else during the subject period, except in Piedmont. W.T. Lewis was also associated with three other charities - Non-profit Servant Mutual Churches, South Carolina Gospel Music Workshop, and Spartanburg Gospel Music Workshop. Those three organizations had previously been involved in bingo in various states.

(11) Bingo was usually conducted everyday except Sundays and Wednesdays. The number of players fluctuated each day, but usually averaged 300 - 400 per session. (Dept. Ex. 25).

(12) The Frontier Palace conducted a bingo game in November 1994 in which a \$1 million payout was guaranteed. Over \$1 million was taken in at that game. Graham testified that the profit from the game was deposited in a local bank, although he could not remember under which account or in which bank. The bank account or accounts, if any, into which any bingo proceeds were deposited during the audit period have never been specifically identified.

(13) Frontier Palace, Inc., a non-existent entity, issued 1994 W-2 statements, filed Alabama Quarterly Employer Withholding tax returns for the last two quarters of 1994, and also filed a 1994 Federal Unemployment Tax return. (Dept. Ex. 31 & 34 and

TP Ex. 48). Graham responded on February 8, 1995 to an IRS inquiry concerning Frontier Palace, Inc.'s federal withholding liability. (TP Ex. 48). Graham and McGlothlin also signed checks on the Bonanza Express Tours checking account to pay the Alabama withholding tax liability of Frontier Palace, Inc. for the third quarter of 1994. (Dept. Ex. 34). The Department deposited those payments in a suspense account because Frontier Palace, Inc. did not have a withholding account with the Department.

(14) In early 1995, Robert Weber, an employee at the bingo operation, sued Cranberry Magnetite in Calhoun County Circuit Court on a workers' compensation claim arising from a work related injury.

Weber and Cranberry Magnetite settled the suit pursuant to a "Settlement and Petition" on June 27, 1996. (Dept. Ex. 47). The settlement required "employer, Cranberry Magnetite, Inc." to pay Weber \$82,683.11 in full release of all claims. The workers' compensation carrier is the same carrier through which agent Brian Jennings issued a policy to Cranberry Magnetite in 1992. The Circuit Court issued an "Order Approving Settlement and Petition" on June 27, 1996. (Dept. Ex. 46).

(15) McGlothlin claims that of the approximately \$6.5 million that Cranberry Magnetite invested in Piedmont, it received only \$145,000 in return. When and from what account that money was paid to Cranberry Magnetite is not in evidence.

(16) The City of Piedmont received in excess of \$500,000 in head tax from the bingo operation from June 1992 through March 1995. The bingo operation also



donated some money to local charities.

(17) The national chapters of GMHF, SCORE, and Elkhorn were qualified as '501(c)(3) charitable organizations pursuant to the Internal Revenue Code. The local Piedmont chapters of those organizations were not. Nor were the local chapters in existence for two years before being used for bingo, as required by Piedmont ordinance.

(18) Elkhorn, through Graham as president, continued conducting bingo at the Frontier Palace at least through June 28, 1995. (Dept. Ex. 40). Bingo was still being conducted at the Frontier Palace in mid-1996 by the Piedmont Jaycees.

Substance over form must govern in tax matters. Newman v. C.I.R., 902 F.2d 159 (2nd Cir. 1990); Boswell v. Paramount Television Sales, Inc., 282 So.2d 892 (1973).

The evidence confirms Judge Laird's finding that GMHF, SCORE, and Elkhorn were "fronts" at the bingo operation. Those entities were involved in name only, and had nothing to do with operating the bingo. Rather, the individuals that actually controlled the bingo were McGlothlin, Graham, and Mutt Johnson. After Johnson left in early 1994, Graham and McGlothlin controlled and ran the business through at least mid-1995.

Cranberry Magnetite was also directly and substantially involved in operating the bingo. Cranberry Magnetite initially applied for a bingo permit with the City. It leased the old gym where bingo was played. It contracted with the City to operate bingo for ten years. It purchased a workers' compensation insurance policy for the

business. Tax returns were filed in Cranberry Magnetite's name using Cranberry Magnetite's tax number. Cranberry Magnetite's 9113 account was used to operate the bingo, and also to build the Frontier Palace. Money from the 9113 account was deposited in the accounts of the various bingo related corporations in Alabama, and vice versa. The 9113 account was also used to pay or guarantee payment of various bingo related debts. Cranberry Magnetite provided a \$25,000 letter of credit to guarantee payment of the head tax to the City. Cranberry Magnetite provided \$100,000 to operate the opening night bingo at the Frontier Palace.

The evidence is clear and overwhelming. Cranberry Magnetite initially operated the bingo in its own name, and in substance continued to operate the business after the "front" charities became involved in October 1992. Having elected to use Cranberry Magnetite to operate the bingo in Piedmont, McGlothlin cannot now deny his corporation's liability for the unpaid taxes in issue.

The next issue is whether the Department properly computed the final assessments.

The Department assessed sales tax pursuant to Code of Ala. 1975, ' 40-23-2(2), which levies a tax on the gross receipts from public places of amusement. However, Code of Ala. 1975, ' 40-23-4(a)(43) exempts certain bingo receipts from the tax, as follows:

. . . gross receipts derived from all bingo games and operations which are conducted in compliance with validly enacted legislation . . . and which comply with the distribution requirements of the applicable local laws; . . . the exemption provided for in this section shall be limited to those

games and operations by organizations which have qualified for exemption under the provisions 26 U.S.C. ' 501(c)(3) . . . ."

The gross receipts in issue are not exempt under ' 40-23-4(a)(43) because (1) Cranberry Magnetite was not a qualified ' 501(c)(3) organization as required by the exemption (nor were any of the Piedmont chapters of the "front" charities), and (2) there is no evidence that the entire proceeds of the bingo operation were distributed to a qualified charitable organization as required by ' XI of Piedmont Ordinance 373.

The burden is on a taxpayer to prove an exemption from tax. Brundidge Milling Co. v. State, 228 So.2d 475 (1969). Clearly, the receipts in issue were not exempt pursuant to ' 40-23-4(a)(43).

If no return is filed, the Department can assess tax due based on the best available information. Code of Ala. 1975, ' 40-2A-7(b)(1)a. The Department computed the sales tax liability in issue using daily or weekly reports and head tax recap sheets filed by the bingo operation with the City of Piedmont. That information includes admissions by door and bus, receipts from the various types of bingo games played, total attendance, and average spent per player. The Department also used three quarterly reports filed by Elkhorn for July 1994 through March 1995. The examiner used average figures for the periods for which no records were available. The Department allowed a credit of \$3,232 paid by Victoria Johnson under her sales tax account number, apparently relating to a snack bar at either the old gym or the Frontier Palace.

The Department properly computed Cranberry Magnetite's sales tax liability

using the above information. Having failed to keep any records, Cranberry Magnetite cannot now complain generally that the indirect audit used by the Department is incorrect. State v. Ludlum, 384 So.2d 1089 (1980); Jones v. CIR, 903 F.2d 1301 (10th Cir. 1990). I agree with the Department examiner that the Department probably underestimated the taxable gross receipts of the bingo operation during the audit period.

Cranberry Magnetite argues that the Department failed to present evidence supporting the use tax assessment. I disagree. The Department examiner testified that he viewed invoices indicating that Cranberry Magnetite purchased materials, supplies, etc. from out-of-state vendors. Those items were used to build and equip the Frontier Palace. The invoices are listed in the examiner's audit report, which was introduced as Dept. Ex. 24. That evidence supports the final assessment, and Cranberry Magnetite failed to rebut the prima facie correct assessment. The assessment is reasonable, considering that Cranberry Magnetite admits it built and equipped the Frontier Palace. The use tax assessment is affirmed.

The Department entered two withholding tax final assessments. One for wage withholding for 1994, docketed as With. 96-402, and a second for withholding on wager winnings for 1992 through 1994, docketed as Inc. 95-371.

The wage withholding assessment is based on 1994 W-2 wage statements issued by Frontier Palace, Inc. As discussed, Frontier Palace, Inc. is a non-existent entity. McGlothlin and Graham both wrote checks on the Bonanza Bus Tours account to pay

Frontier Palace, Inc.'s third quarter 1994 Alabama withholding liability. (See, paragraph (13) above). The Department allowed a credit for those payments in the audit.

Cranberry Magnetite offered no evidence rebutting the assessment, except to claim that it is not the taxpayer. The prima facie correct 1994 assessment on wage withholding is reasonable, and is affirmed. There is no evidence explaining why the Department failed to project the 1994 liability over the entire audit period.

Lottery and certain other wager winnings over \$5,000 are subject to withholding pursuant to Code of Ala. 1975, ' 40-18-90, which adopts by reference 26 U.S.C. ' 3402. However, bingo winnings are not subject to withholding. Section 3402(5).

The Department determined that Cranberry Magnetite had conducted an illegal lottery during the audit period. The Department accordingly assessed withholding tax using W-2G statements issued by Elkhorn for the last six months of 1994. (Dept. Ex. 32). The Department used only the W-2Gs over \$5,000, and then projected those winnings subject to withholding over the entire audit period, except 1995.

The Department concluded that an illegal lottery was being conducted based solely on Judge Laird's April 13, 1995 Order. However, Judge Laird did not find that a lottery was being conducted, or that bingo was not being conducted. Rather, he ruled, and I agree, that legal bingo was not being conducted. Although not in

compliance with Amendment 508 or Piedmont ordinances, Cranberry Magnetite was still conducting bingo in Piedmont. The bingo exemption, ' 3402(5), does not distinguish between legal and illegal bingo.

While the Department is authorized to compute the amount of tax due using the best information available, it must first present reasonable evidence that some tax is due. An assessment must have some rational evidentiary basis, and must be reasonable under the circumstances. Denison v. C.I.R., 689 F.2d 771, 773 (1982).

Where the record reflects no reasonable basis for the Commissioner's assessment, where the assessment cannot be deemed reasonable on its face, and where no finding is made in that regard, we cannot afford a presumption of correctness to attach automatically to the assessment.

Denison, 689 F.2d at 777.

While there is some reference to illegal "pull tabs," there is no substantial evidence that a lottery was being played during the audit period. Importantly, there is no evidence that any of the \$5,000 plus payouts qualified as "winnings which are subject to withholding" as defined at ' 3402(3). Without some evidence that the \$5,000 plus payouts were subject to withholding, the wager withholding final assessment cannot be affirmed.

Judgment is entered against Cranberry Magnetite for State sales tax for June 1, 1992 through March 31, 1995 of \$574,977.25, plus applicable interest; consumers use tax for June 1, 1992 through March 31, 1995 of \$22,093.68, plus applicable interest;

and 1994 withholding tax of \$5,084.24, plus applicable interest. The wager winnings withholding tax assessment for 1992 through 1994 is dismissed.

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

Entered April 14, 1997.

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BILL THOMPSON  
Chief Administrative Law Judge