

SAIGON RESTAURANT, INC., d/b/a §  
SAIGON VIETNAMESE RESTAURANT §  
360 OLD OVERTON DRIVE §  
MADISON, AL 35756, §

Taxpayer, §

v. §

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE. §

STATE OF ALABAMA  
ALABAMA TAX TRIBUNAL

DOCKET NO. S. 13-1116

### OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Saigon Restaurant, Inc. (“Taxpayer”), d/b/a Saigon Vietnamese Restaurant, for State sales tax for August 2009 through July 2012. The Taxpayer appealed to the Administrative Law Division, now the Tax Tribunal, pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 19, 2014. The Taxpayer’s representative was notified of the hearing, but failed to attend. Assistant Counsel Christy Edwards represented the Department.

A Final Order affirming the final assessment was entered on June 25, 2014. That Order reads in substantive part as follows:

The Taxpayer operated a restaurant in Madison, Alabama during the period in issue. It also made retail beer sales during that time.

The Department audited the Taxpayer for sales tax for the period in issue and requested records from which the Taxpayer’s sales tax liability could be computed/verified. The Taxpayer provided some bank records, purchase invoices, and credit card receipts. It did not submit any cash register z-tapes, guest checks, or other sales records.

The Department examiner reviewed the records and discovered that the credit card receipts showed that the Taxpayer had underreported its credit card sales. A review of the Taxpayer’s bank records also showed that no cash had been deposited, despite the Taxpayer’s policy that all sales under \$10 must be paid in cash only. The Taxpayer conceded that money from its cash sales were not deposited. Because the bank records did not accurately reflect cash deposits or sales, the examiner determined that those records

were unreliable, and thus insufficient to accurately compute the Taxpayer's liability for the period. She consequently computed the Taxpayer's liability using a purchase mark-up audit.

Simply stated, a retailer's sales tax liability is computed through a purchase mark-up audit by determining the retailer's wholesale purchases, and then applying a reasonable retail mark-up percentage to determine the retailer's estimated retail sales. The sales tax due is computed on those estimated sales. A credit for sales tax previously reported and paid is then allowed to arrive at the additional sales tax due.

In this case, the Department examiner followed the above procedures by first obtaining the Taxpayer's purchase information from the Taxpayer's vendors. She then applied the standard IRS retail mark-up of 2.9 percent applicable to restaurants to arrive at the Taxpayer's estimated retail sales. She then applied the four percent State sales tax rate to determine the total tax due. She then allowed a credit for sales tax previously paid to determine the additional tax due. The fraud penalty was also applied because the Taxpayer had failed to keep adequate records during the period.

The Taxpayer petitioned for a review of the audit, and the Department conducted an informal conference in March 2013 concerning the audit and resulting preliminary assessment. The Taxpayer submitted additional documents at the conference. The Department reduced the mark-up from 2.9 percent to 2.5 percent, reduced the fraud penalty to the negligence penalty, made various other adjustments requested by the Taxpayer, and entered the final assessment in issue. The Taxpayer appealed.

The Taxpayer's owner claims in his notice of appeal that the Department examiner (1) incorrectly estimated the amount of purchases during the audit period; (2) failed to correct duplicate entries, and (3) incorrectly assessed the fraud penalty.

The Department responded that it used estimates only 11 times out of 970 purchases, that it removed the duplicate invoices, and that it reduced the fraud penalty to the negligence penalty.

All retailers subject to Alabama sales tax are statutorily required to keep complete 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. The retailer must record all sales on a cash register z-tape and/or on customer invoices or receipts, which may then be compiled onto a monthly sales journal. 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.

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).

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).

Because the Taxpayer in this case failed to maintain adequate records from which its sales could be accurately computed or verified, the Department examiner correctly conducted a purchase mark-up audit to reasonably compute the Taxpayer's liability for the audit period. 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. As discussed, because the Taxpayer failed to maintain good records, as required by Alabama law, it cannot now complain that the Department's computations must be rejected as inexact estimates.

The Department audit was properly conducted using the best information available. The Department also made all necessary adjustments to the initial audit. The final assessment based on the audit, as adjusted, is accordingly affirmed. Judgment is entered against the Taxpayer for tax, penalty, and interest of \$10,980.82. Additional interest is also due from the date the final assessment was entered, September 24, 2013.

The Taxpayer timely applied for a rehearing. A second hearing was conducted on August 28, 2014. The Taxpayer's owner, Robert Pham, attended the hearing. Assistant Counsel Christy Edwards again represented the Department.

The Taxpayer argues on rehearing that the examiners erroneously included non-food items in computing the total tax due, that the items consumed for personal use should not be marked-up, that the examiners failed to consider the Taxpayer's ending inventory, that credit should be given for losses due to an earthquake, and finally, that the negligence penalty should be removed.

The Department responded that the non-food items were removed from the audit, and that the mark-up had been removed from the food personally consumed by the owner and his family. That food was instead correctly taxed at cost as a withdrawal from inventory.

Concerning the ending inventory, the Taxpayer claimed that he always maintained a 30 – 40 percent inventory that the examiners failed to consider. The Department responded that if the Taxpayer always maintained a 30 – 40 percent inventory, then the beginning and ending inventories would have been the same, and consequently that no adjustment is due.

Concerning the earthquake loss, the Department agrees that the loss should be allowed, which reduces the tax due by \$67.48. Finally, the Department argues that because the Taxpayer failed to keep any cash register tapes or other sales records, the 5 percent negligence penalty is warranted.

I agree that the Department has made or agreed to make all adjustments warranted in this case, except one. It removed the duplicate invoices and the mark-up on the food the Taxpayer identified as having been used for personal consumption. It also accepted the Taxpayer's claim that he used a 2.5 percent mark-up, and reduced the mark-up factor accordingly. Finally, it also removed the fraud penalty. I agree with the Department that

the negligence penalty is appropriate because the Taxpayer failed to provide any sales records.

The one exception concerns the examiners' estimate of the Taxpayer's purchases during eleven weeks in the audit period. The Taxpayer generally purchased inventory on a weekly basis. The examiners reviewed the 970 weekly purchase transactions and determined that there were no purchase invoices for eleven weeks in the audit period. They assumed that the Taxpayer had purchased goods during those weeks, and that the purchase invoices were missing. They accordingly estimated the Taxpayer's purchases in those eleven weeks using the average weekly purchases for the remaining weeks in the audit period.

The Taxpayer's owner testified at the August 28 rehearing that while he generally purchased inventory weekly, there were some weeks when he had sufficient inventory and consequently did not purchase additional inventory. He argued that there were no purchase invoices for the eleven weeks in issue because he did not purchase goods during those weeks.<sup>1</sup> Under the circumstances, the estimated purchase amounts for those eleven weeks should be removed from the audit. The Department should recompute the Taxpayer's liability accordingly, and notify the Tribunal of the adjusted amount due. A Final Order will then be entered.

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<sup>1</sup> The Department's confidential audit report, at 2, also states that there were no missing invoices – "Upon examining the taxpayer's purchase invoices, it was determined that the taxpayer's invoices were complete. The taxpayer provided all purchase invoices for the audit periods."

This Opinion and Preliminary Order is not appealable. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered December 19, 2014.

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BILL THOMPSON  
Chief Tax Tribunal Judge

bt:dr

cc: Christy O. Edwards, Esq.  
Robert Pham