

ALABAMA TAX TRIBUNAL

KAJAL, INC., §
§
Taxpayer, § DOCKET NO. S. 19-974-LP
v. §
STATE OF ALABAMA §
DEPARTMENT OF REVENUE. §

FINAL ORDER

This appeal involves a final assessment of State sales tax for October 1, 2015, through September 30, 2018. A hearing was conducted on January 9, 2020. The Taxpayer’s owner, Jayesh Patel, attended the hearing. Assistant Counsel Hilary Parks represented the Alabama Department of Revenue.

The Taxpayer operated convenience stores in Eufaula, Dothan, and Clayton, Alabama during the period at issue. The stores primarily sold the following: gasoline, tobacco products, groceries, wine, beer, soft drinks, and snack foods.

The Revenue Department’s examiner, Denise Mays, audited the stores to determine compliance with State sales tax laws during the subject periods. The examiner requested the stores’ sales tax-related records, including the following: all books and records used to prepare sales tax returns; daily/monthly z-tapes, purchase invoices, bank records with canceled checks, 1099-K statements, federal and state income tax returns, and depreciation schedules. The Taxpayer provided Store Sales Summary Reports, various purchase invoices and bank records for the Dothan and Eufaula locations. The Taxpayer did not provide any records for the Clayton location. The examiner determined that the records were incomplete.

Because the examiner was not provided complete information regarding the Taxpayer's purchases, she compared the reported sales from the Taxpayer's sales tax returns against the available records to determine if the records supported the reported sales figures. Those comparisons revealed that the sales were substantially underreported. The examiner next applied the standard IRS mark-up of 1.35 percent on purchases to arrive at the stores' estimated retail sales.

The audit revealed that the Taxpayer's purchases for the audit period were over \$827,000. Because the Taxpayer's wholesale purchases during the audit period substantially and consistently exceeded its reported retail sales, the examiner also applied the 50 percent fraud penalty levied at Ala. Code § 40-2A-11(d).

The Taxpayer was assessed for the additional sales tax due, interest, and a fraud penalty of \$136,859.34. The Taxpayer timely filed a notice of appeal. The Taxpayer does not contest that it owes the tax due but has requested that the fraud penalty be waived. Mr. Patel stated at the hearing that he was not in the stores because he was sick. He asked that he be allowed a credit for rebates and discounts.

The Revenue Department timely filed its Answer, asserting that the Taxpayer failed to maintain records and that it substantially and consistently underreported sales. This conduct, it argued, is strong evidence of fraud. For this and other reasons set forth below, I agree.

As discussed, the Department assessed the Taxpayer for the fraud penalty because it failed to maintain adequate records and because its wholesale purchases substantially and consistently exceeded its reported retail sales. 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 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).

The Tax Tribunal has affirmed the fraud penalty previously in similar cases, see *Saku, LLC v. State of Alabama*, Docket No. S. 19-420-LP (T.T. 10/4/2019), and *Jai Kru, LLC*, Docket No. S. 18-387-LP (T.T. 3/18/2019). The fact that the Taxpayer’s retail sales were more than 50 percent underreported, that the underreporting was consistent throughout the audit period, that the Taxpayer failed to provide complete records, and that the Taxpayer refused to offer a single, plausible

explanation for such significant and consistent underreporting supports a finding that the Department correctly applied the fraud penalty in this case. It is reasonable that the Taxpayer should have known the taxes were grossly underreported. The Department thus met its burden to prove fraud.

At the hearing, the Revenue Department agreed to review the Taxpayer's discounts and rebates. It later notified the Tax Tribunal that the final assessment should be reduced from \$132,525.53 to \$130,106.61, which includes interest through January 9, 2020. The Taxpayer was then directed to notify the Tax Tribunal no later than June 19, 2020, if it disagreed with the reduced amount due and, if so, why. The Taxpayer did not respond.

The final assessment, as reduced, is affirmed. Judgment is entered against the Taxpayer for \$130,106.61. Additional interest is also due from January 9, 2020.

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

Entered July 8, 2020.

/s/ Leslie H. Pitman

LESLIE H. PITMAN

Associate Tax Tribunal Judge

lhp:dr

cc: Jena R. Hart, CPA
Hilary Y. Parks, Esq.