

**ALABAMA TAX TRIBUNAL**

E&Z, INC., §  
§  
Taxpayer, § DOCKET NO. S. 19-989-LP  
v. §  
§  
STATE OF ALABAMA §  
DEPARTMENT OF REVENUE. §

**AMENDED FINAL ORDER**

A Final Order was entered in this case on December 28, 2021, affirming the final assessment.

The Revenue Department timely applied for a rehearing. On Page 4 of the Final Order, the Tax Tribunal stated:

The Taxpayer argued that a confidential audit should have been performed. Testimony proved that such an audit would have been onerous and extremely time-consuming since it requires the auditor to determine the actual cost and sales price of every item sold in the store. Additionally, the cost of every item was not made available to the auditor. The Revenue Department is required to use a reasonable method to determine a taxpayer’s liability. Performing a confidential audit in this case is not reasonable.

The Revenue Department requested that the word “confidential,” used twice in the above paragraph, be replaced by the word “classified.” The Taxpayer agrees with the change. The Final Order is amended accordingly, and is as follows:

This appeal involves final assessments of State and local sales tax for December 1, 2016, through October 31, 2018. The hearing was conducted on March 11, 2020. Deputy Counsel David Avery represented the Revenue Department. Dwight Pridgen and one of the Taxpayer’s owners, Mohammed Kassin, attended the hearing. The parties filed post-hearing briefs.

**Facts**

The Taxpayer operates a convenience store in Gordo, Alabama. The store sells gasoline, tobacco, snacks, drinks, electronic phone cards, and miscellaneous non-food items. The Taxpayer also operates a deli inside the store that sells hot foods.

The Revenue Department's examiner, Dorothy Poe, audited the store to determine compliance with State sales tax laws during the subject periods. The examiner requested the store's sales tax-related records, including the following: all books and records used to prepare sales tax returns; sales invoices and sale journals; cash register z-tapes; customer tax exempt file; purchase invoices; income tax returns; and cancelled checks and bank statements. The Taxpayer provided handwritten monthly sales reports, handwritten daily sales reports (several days of reports for each month were absent), incomplete purchase invoices, bank statements and cancelled checks for March 2017 through October 2018. The Taxpayer did not submit any income tax returns because it did not file state or federal income tax returns. According to the auditor's testimony, the reports provided did not appear contemporaneous but prepared from the amounts reported on the sales tax return.

Because the examiner was not provided complete information regarding the Taxpayer's purchases and because she determined that considerable purchases were made with cash, she estimated the Taxpayer's liability using a purchase mark-up audit. The examiner obtained the Taxpayer's purchase information for the audit period from documentation received from the Taxpayer's vendors. She compared the purchases per the vendors' records with the purchase information provided by the Taxpayer and determined that the records provided by the Taxpayer were incomplete. The examiner compared the Taxpayer's total purchases, calculated by invoices supplied by the Taxpayer's vendors and canceled checks, to the Taxpayer's reported sales and

determined that the Taxpayer's purchases exceeded its reported sales for the audit period by \$635,000.

Upon examining the Taxpayer's bank statements, the examiner discovered that the Taxpayer had used another checking account to pay its sales tax liabilities. A subpoena was issued to West Alabama Bank to provide copies of statements, deposit tickets, and cancelled checks. The owner of that checking account was the previous owner of the store who sold it in December 2016. The Taxpayer continued to use the West Alabama Bank account as an operating account from December 2016 through August 2017. From September 2017 through December 2017, the previous owner transferred the balance into the Taxpayer's checking account before closing the West Alabama Bank account in December 2017. After examining the deposits, it was determined that the deposits were not a reliable source for calculating the Taxpayer's taxable sales.

The examiner next applied the standard IRS mark-up of 1.35 percent on purchases to arrive at the store's estimated retail sales. 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).

### **Law and Analysis**

It is undisputed that the Taxpayer in this case failed to provide complete sales records. In such cases, the Revenue Department is authorized to compute a taxpayer's actual tax liability using the most accurate and complete information obtainable. Ala. Code § 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.2d 1301 (10th Cir.

1990); *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/2004); *Lofton v. State of Alabama*, S.19-629-LP (Tax Trib. 03/13/2020). The purchase mark-up audit is a simple, oft-used Revenue 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*, supra. Because the Taxpayer in this case failed to maintain adequate records from which his sales could be accurately computed or verified for sales tax purposes, the Department examiner correctly conducted a purchase mark-up audit to reasonably compute the Taxpayer's liability. 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. Although the Taxpayer claims the markup was lower than 35%, no records were provided to support that argument.

The IRS markup is an average of gas stations and food stores (i.e., grocery stores). Many states tax gas and so the markup on gas is included in the gas station average. Alabama does not charge sales tax on gas, thus the IRS gas station markup is skewed downward for Alabama as the markup on gas is typically very low.

The Taxpayer argued that the percentage markup is inaccurate, in part, because the Taxpayer does not sell beer. Randall Winkler, Director of sales and use tax at the Revenue Department, testified that the markup on beer is typically 22 percent. The Revenue Department submitted National Park Service Technical Bulletins for 2018 and 2019 (Exhibits 6 and 7), which support Mr. Winkler's testimony. The Bulletins presented markup percentages from the National Association of Convenience Stores. The inclusion of beer in the markup lowers the average, giving an advantage to

the Taxpayer.

The Taxpayer also argued that the markup used by the Department was skewed because the store lost money on its hot food bar. Additionally, he speculated that people were using his Sam's Club card to make non-store purchases and that employee theft was a problem. However, the Taxpayer provided no records to verify these contentions. Furthermore, the IRS markup accounts for spoilage and theft.

The Taxpayer argued that a classified audit should have been performed. Testimony proved that such an audit would have been onerous and extremely time-consuming since it requires the auditor to determine the actual cost and sales price of every item sold in the store. Additionally, the cost of every item was not made available to the auditor. The Revenue Department is required to use a reasonable method to determine a taxpayer's liability. Performing a classified audit in this case is not reasonable.

The Taxpayer argued that the population of Gordo was not considered when the markup was determined. The IRS markup is an average and includes data from communities of all sizes across the country.

The use of a 35% markup was reasonable. The sales tax assessed is affirmed.

As discussed, the Department also 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 (6<sup>th</sup> 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). “A taxpayer’s concealment of bank accounts from Internal Revenue agents is yet another sign indicating fraudulent intent. *Henry v. Commissioner*, 362 F.2d 640, 643 (5th Cir.1966).” *Solomon*, 732 F.2d at 1462. 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.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. 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. See also *GHF, supra*, and *Alsedeh, supra*. 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 failed to disclose a second bank account supports a finding that the Revenue Department correctly applied the fraud penalty in this case. It is reasonable that the Taxpayer should have known the taxes were grossly underreported. The Revenue Department thus met its burden to prove fraud.

The Taxpayer owner who attended the hearing testified that he was not involved in the daily operation of the store. Nor were the other owners. He was unaware of the recordkeeping requirements. He stated that he had no intent to defraud the State. The Tribunal has found that fraud existed where the owner did not perform the daily operations of the store or report the monthly sales to his accountant. *Saku, LLC v. State of Alabama*, S. 19-420-LP (Tax Trib. 10/04/2019). As stated above, ignorance is not a defense where the owner should have known of the underreporting.

The fraud penalty is affirmed.

The State and local sales tax final assessments are affirmed. Judgment is entered against the Taxpayer for \$94,934.28 and \$\$45,440.21, respectively. Additional interest is also due from the date the final assessments were entered.

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

Entered January 12, 2022.

/s/ Leslie H. Pitman  
LESLIE H. PITMAN  
Associate Tax Tribunal Judge

cc: Dwight W. Pridgen, Esq.  
David E. Avery, III, Esq.