

FARMERS FEED & SUPPLY CO. OF §
MONTGOMERY, INC. §
16 E. FLEMING ROAD §
MONTGOMERY, AL 36105-3206, §

Taxpayer,

v.

STATE OF ALABAMA §
DEPARTMENT OF REVENUE. §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 04-885

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Farmers Feed & Supply Company of Montgomery, Inc. ("Taxpayer") for State sales tax for July 2000 through June 2003. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on May 24, 2005. Bob Hendrick represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department.

The Taxpayer operates a retail business in Montgomery, Alabama at which it sells feed, fertilizer, agricultural supplies, and related items. The Department audited the Taxpayer for the subject period and assessed it for the additional sales tax, penalties, and interest in issue.

The Taxpayer raises three issues on appeal:

- (1) Is a portion of the assessment period time-barred by the statute of limitations for assessing tax at Code of Ala. 1975, §40-2A-7(b)(2);
- (2) Did the Department properly adjust the Taxpayer's gross receipts to account for cash register over-rings; and,
- (3) Did the Department improperly tax otherwise exempt sales because the Taxpayer failed to maintain exemption certificates for the sales, as required by Code of Ala.

1975, §40-23-4.3?

Issue (1) The statute of limitations.

Section 40-2A-7(b)(2) requires that the Department must enter a preliminary assessment for any tax due within three years from the due date of the return. The Taxpayer argues that the tax for November 2000 and prior months is time-barred because the Department failed to either enter a preliminary assessment or obtain a waiver of the statute within three years from the due dates of the returns for those months.

The Department contends that the tax was timely assessed because the Taxpayer signed waivers extending the assessment deadline. It submitted two waivers into evidence at the May 24 hearing. Dept. Ex. 1 was executed on November 7, 2003, and extended the statute of limitations for assessing the tax due until April 30, 2004. Dept. Ex. 2 was executed on April 27, 2004, and extended the statute until July 31, 2004. The Department entered the preliminary assessment against the Taxpayer on July 26, 2004.

The returns for July, August, and September 2000 were due on August 20, September 20, and October 20, 2000, respectively. As indicated, the first waiver, Dept. Ex. 1, was executed on November 7, 2003, or more than three years after the due dates of the above returns. The three year statute thus expired concerning those months. The subsequent execution of a waiver cannot reopen a period for which the statute of limitations for assessing tax has already expired. *Johnson v. State of Alabama, Inc.* 89-181 (Admin. Law Div. 1/23/90). Consequently, the tax, penalty, and interest due for July, August, and September 2000 is time-barred, and should be deleted from the final assessment.¹ The

¹ The Taxpayer's representative indicated at the May 24 hearing that the Taxpayer had
(continued)

October 2000 return was due on November 20, 2000, or after the first waiver was executed on November 7, 2000. Consequently, the tax, penalty, and interest due for October 2000 and subsequent months was timely assessed.

Issue (2) The cash register over-rings.

The Department examiner reviewed the Taxpayer's cash register z-tapes and found that the Taxpayer's taxable sales as reflected on the tapes exceeded the amounts reported by the Taxpayer in 12 of the 36 months of the audit period. The Taxpayer's accountant explained that the discrepancy was due to cash register over-rings. She testified concerning the over-rings, as follows:

Administrative Law Judge: Just a minute. Explain to me what an over-ring is, if you don't mind.

Ms. Northington: That's when Dale starts to punch in a sale on the cash register, and Steve comes behind him and he goes to punch one in; and lo and behold, a \$65 sale becomes a \$65,000 sale. Do you follow me? In other words, he keys something in and then someone behind him keys something in, and they never total the sale out. They – they – they run – they are so busy down there. I mean there are times when you walk in that store, there may be fifty people walking in the store, and you've got three people running it. During seed season especially, you've got people buying little amounts of seed. You've got feed, you've got plants. It's a very busy environment. And it's not like Wal-Mart where you've got 50 employees walking around.

Administrative Law Judge: It's my understanding when somebody makes a sale, a clerk will go to the cash register and total – put in the amount of the sale price and punch it up, and that's the end of it.

Ms. Northington: That's correct. And generally that's the way that it works,

received a letter from the Department indicating that three waivers had been signed. However, the Department attorney stated at the hearing that only two waivers were executed. (T. 9). Those two waivers were submitted into evidence as Dept. Exs. 1 and 2. If a third waiver was executed that pre-dated the one signed in November 2003, the Department may apply for a rehearing and offer the missing waiver into evidence. Appropriate action would then be taken.

but you have to understand these guys, first off, they're not sometimes as well versed in running the cash register as I'd like for them to be. They're getting a lot better. But when they're so busy and this one keys something in, he's waiting on somebody to write a check, and then there's five customers at the counter and someone else starts to ring up, sometime there would be an over-ring where it would not be voided out. I don't think they knew how to void one out.

T. 24 – 26.

The Department examiner inquired with the accountant as to how the over-rings were accounted for. The accountant conceded that the Taxpayer's sales personnel failed to document the over-rings. The examiner nonetheless recognized that some over-rings had occurred. She discussed the matter with her supervisor, who agreed that if the Taxpayer's bank deposits for a given day were less than total sales as reflected on the cash register tapes, the examiner should accept the lesser bank deposit amount as the Taxpayer's sales for the day.²

The Taxpayer appreciates that the Department agreed to use its bank deposits in lieu of its cash register tapes when the tape amounts exceeded the deposits. It contends, however, that the bank deposits should be further adjusted because (1) the examiner used the bank deposits for the day in question, not the subsequent day when the prior day's receipts were actually deposited; (2) the examiner failed to reduce the deposits by the sales receipts that were nontaxable or exempt; and (3) the examiner failed to consider that the deposits may have included payments on accounts receivable from prior credit sales that had already been reported by the Taxpayer.

Concerning the Taxpayer's first argument, the examiner initially used the bank

² By using the Taxpayer's bank deposits in lieu of the cash register tapes, the Taxpayer's
(continued)

deposits in a given day to determine the sales for the day. However, the Taxpayer's accountant and the examiner apparently discussed the problem, and the examiner subsequently used the next day's deposits to determine a given day's sales (T. 30). Consequently, this issue is no longer disputed.

The Taxpayer next argues that some of the deposits were derived from exempt sales, and thus should be deleted in determining taxable receipts. The Taxpayer claims that its cash register tapes should be used to identify the exempt sales.

If the Taxpayer's bank deposits included proceeds from exempt sales, those proceeds should not be taxed. However, the Taxpayer concedes that just as taxable sales may have been over-rung, exempt sales may also have been over-rung. Consequently, if the exempt sales shown on the cash register tapes are deleted, the Taxpayer may be improperly allowed credit for some over-rung exempt sales.

Finally, the Taxpayer reports sales tax on the accrual basis, and thus reports and pays tax on credit sales when the sales are made. It argues that the deposits included payments on prior credit sales on which tax was previously paid, and that those payments should not be taxed again. However, while the deposits may have included payments on previously reported credit sales, the deposit amounts would not include the taxable credit sales that occurred during the period. As indicated, those sales would be reportable under the accrual method. Without records, there is no way of knowing if the nontaxable account receivable collections in a given period were more or less than the taxable credit sales during the period.

taxable gross receipts were reduced by approximately \$169,000 over the audit period.

The above discussion illustrates the problems inherent in using bank deposits to determine a retailer's sales tax liability in lieu of good sales records, especially if the retailer reports on the accrual basis.³ The Taxpayer in this case was required to keep adequate records reflecting its correct liability. Code of Ala. 1975, §40-2A-7(a)(1). If the Taxpayer had contemporaneously documented its over-rings, use of its bank deposits would not have been necessary. Alabama's courts have also held that if a retailer fails to keep records identifying taxable and nontaxable sales, the retailer must suffer the consequences and pay tax on the sales not properly documented as exempt or nontaxable. *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1986), citing *State v. Levey*, 29 So. 129 (1946). By the Department accepting the bank deposits instead of the cash register tapes, the Taxpayer's taxable receipts were reduced by approximately \$169,000.⁴ Under the circumstances, the Department's use of the Taxpayer's bank deposits, without adjustments, in lieu of adequate records is reasonable, and is affirmed.

³ Code of Ala. 1975, §40-23-8 provides that a retailer may report all cash sales and credit collections made in a given month, and that "in no event shall the gross proceeds of credit sales be included in the measure of the tax to be paid until collections of such credit sales shall have been made." However, retailers may also report and pay on the accrual basis.

⁴ The Department is not required to use a retailer's bank records to determine the retailer's sales tax liability. Such records may not accurately reflect the retailer's sales because some cash proceeds may be diverted for personal use or to pay vendors, and thus never deposited. The fact that the Department used the Taxpayer's bank deposits indicates that the Taxpayer otherwise kept good records and was attempting in good faith to report and pay the correct tax due. In other cases, however, the Department has justifiably rejected the use of a taxpayer's bank records as unreliable. See, *Hesser v. State of Alabama*, S. 05-225 (Admin. Law Div. 8/17/05).

Issue (3) The exemption certificates.

Code of Ala. 1975, §§40-23-4(a)(2), (4), and (22) provide exemptions from sales tax for the sale of fertilizer, insecticides, fungicides, seedlings, and other items; provided, the items must be used by the purchaser for agricultural or other specified purposes. Because the exemptions apply only if the items are used for certain purposes, §40-23-4.3 requires that the purchaser must submit to the seller a certificate certifying that the items will be used for an exempt purpose. The filing of the certificate relieves the seller of liability for any sales tax due. The seller must “retain the original (certificate) for examination by the Department of Revenue for a period of not less than one year. . .”

The Department examiner exempted the products listed in subparagraphs (2), (4), and (22) of §40-23-4(a) if the Taxpayer provided her with a copy of the certificate required by §40-23-4.3. She taxed those sales for which certificates were not provided.

The Taxpayer argues that the otherwise exempt sales should not be taxed only because it failed to obtain the exemption certificates from its customers. The Taxpayer further argues “that if there is no requirement to maintain these forms for more than one year from the date of the sale, how can the auditor use the lack of availability of these forms as a basis for denying these amounts that are properly exempt. . .” Taxpayer’s Brief at 4.

I do not understand why the Legislature specified in §40-23-4.3 that retailers should keep the exemption certificates for only one year. The Department is authorized to audit and assess a retailer for at least three years, and in some cases for longer periods. See generally, Code of Ala. 1975, §40-2A-7(b)(2). In any case, even though §40-23-4.3 requires retailers to retain the exemption certificates for only one year, the burden is

otherwise on retailers to maintain records verifying that a sale is exempt from tax.⁵ As discussed above, if a retailer fails to properly document exempt sales, the sales must be taxed. See, *Ludlum, supra*; *Levey, supra*. The Taxpayer in this case failed to present evidence that the products listed in §§40-23-4(a)(2), (4), and (22) that it sold during the audit period were sold for an exempt purpose. Consequently, the exemptions were properly disallowed.

The Department is directed to recompute the Taxpayer's liability by deleting the tax, penalty, and interest assessed for July, August, and September 2000 from the final assessment. A Final Order will then be entered for the adjusted amount due.

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

Entered August 19, 2005.

BILL THOMPSON
Chief Administrative Law Judge

⁵ Although §40-23-4.3 requires the seller to maintain the exemption certificates "for a period not less than one year," a retailer may retain the certificates for a longer period. As a practical matter, retailers should retain the exemption certificates and other records for at least six years.