WILLIAM EARLE SEALES P.O. BOX 56 MAPLESVILLE, AL 36750-0056,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 05-515
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed William Earle Seales ("Taxpayer") for State sales tax for June 2000 through May 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 October 26, 2005. The Taxpayer attended the hearing. Assistant Counsel Wade Hope represented the Department.

The Taxpayer owns and operates a gas station/grocery store in Maplesville, Alabama. The Department audited the Taxpayer for sales tax for the period in issue. The Taxpayer provided the Department examiner with his purchase invoices, and also some z-tapes and monthly sales reports. However, the z-tapes were incomplete, and the monthly sales indicated on the sales reports were substantially less than the Taxpayer's monthly cost of goods sold per his invoices.

Because the Taxpayer's records were insufficient, the examiner performed a modified purchase mark-up audit. He scheduled the Taxpayer's wholesale purchases for the period. He then determined the price charged for the various items sold by the Taxpayer, either by reviewing the items in the store or asking the Taxpayer what he sold the items for. By comparing the Taxpayer's wholesale cost of his merchandise to what he sold the items for, the examiner determined that the Taxpayer's average mark-up

was 30.79 percent. The examiner reduced the Taxpayer's total purchases by 5 percent for spoilage and theft, and also deleted nontaxable items such as food stamp and WIC sales. He multiplied the Taxpayer's net taxable purchases by the 30.79 percent mark-up to arrive at the Taxpayer's total sales. He then allowed a credit for tax previously paid to arrive at the additional tax due.

The Taxpayer's invoices showed that on average he purchased $29,179 in merchandise at wholesale in each month. His monthly retail sales as reported to the Department averaged only $13,953, or less than half of his monthly purchases. Because the Taxpayer consistently and substantially underreported his monthly sales tax during the audit period, the Department assessed the Taxpayer for the 50 percent fraud penalty levied at Code of Ala. 1975, §40-2A-11(d).

The Taxpayer argues that the 30.79 percent mark-up is too high because at least half of his sales were cigarettes, which were marked up less than 10 percent. He also disputes the fraud penalty.

The burden was on the Taxpayer to maintain accurate sales records from which his sales tax liability could be correctly determined. Code of Ala. 1975, §40-2A-7(a)(1). He claims that he maintained daily cash register z-tapes. He testified that at the end of each month, he totaled the daily z-tapes on a month ending z-tape. He then discarded the daily tapes because, according to the Taxpayer, the Department examiner told him it was not necessary to keep the daily tapes. However, the Department examiner never talked to the Taxpayer before he conducted the audit in issue. Consequently, the examiner could not have told the Taxpayer during the audit period that he was not required to keep his daily z-tapes. Such advice also would be contrary to Alabama law,

and the Department's consistent practice of requiring retailers to keep all cash register tapes.

If a retailer fails to keep adequate records, the Department may use any reasonable method to compute the retailer's liability. *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982). The purchase mark-up audit has been established as a proven method for reasonably estimating a retailer's liability in the absence of good records. See generally, *Arnold v. State of Alabama*, S. 03-1098 (Admin. Law Div. 7/27/04); *Moseley's One Stop, Inc. v. State of Alabama*, S. 03-316 (Admin. Law Div. 7/28/03); *Pelican Pub & Raw Bar, LLC v. State of Alabama*, S. 00-286 (Admin. Law Div. 12/15/00); *Joey C. Moore v. State of Alabama*, S. 99-126 (Admin. Law Div. 8/19/99); *Robert Earl Lee v. State of Alabama*, S. 98-179 (Admin. Law Div. 6/28/99); *Red Brahma Club, Inc. v. State of Alabama*, S. 92-171 (Admin. Law Div. 4/7/95); and *Wrangler Lounge v. State of Alabama*, S. 85-171 (Admin. Law Div. 7/16/86).

The Taxpayer complains that the 30.79 percent mark-up used by the Department is too high. The mark-up is, however, based on the actual prices charged by the Taxpayer in his store. Also, the standard IRS mark-up showed a 36 or 37 percent mark-up for the type of store operated by the Taxpayer. The Taxpayer's overall mark-up may have been less than the 30 percent used by the examiner because of the large volume of low profit margin cigarettes sold by the Taxpayer. But if the Taxpayer had maintained complete and accurate sales records, as required by Alabama law, a mark-up estimate would not have been necessary. Under the circumstances, the Department's audit is affirmed.

Code of Ala. 1975, §40-2A-11(d) levies a 50 percent penalty for any underpayment due to fraud. 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 Department is required to prove fraud by clear and convincing evidence. *Bradford v. C.I.R.*, 796 F.2d 303 (1986). "The burden is upon the commissioner to prove affirmatively by clear and convincing evidence actual and intentional wrongdoing on the part of the (taxpayer) with a specific intent to evade the tax." *Lee v. U.S.*, 466 F.2d 11, 14 (1972), citing *Eagle v. Commissioner of Internal Revenue*, 242 F.2d 635, 637 (5th Cir. 1957). The existence of fraud must be determined on a case-by-case basis, and 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), citing *Traficant v. Commissioner*, 884 F.2d 258, 263 (6th Cir. 1989). Consequently, fraud may be established from "any conduct, the likely effect of which would be to mislead or conceal." *Walton*, 909 F.2d at 926, quoting *Spies v. United States*, 63 S.Ct. 364, 368 (1943). The failure to keep adequate records and the consistent underreporting of tax is strong evidence of fraud. *Wade v. C.I.R.*, 185 F.3d 876 (1999) ("There is no dispute (taxpayer) kept inadequate books and records, further suggesting fraud.").

When asked to explain why he had grossly underreported his monthly sales, the Taxpayer explained that he had some employees, including his sister, that "weren't

quite up to snuff." T. at 14. He admitted that his sister intentionally rang up cigarette and other taxable sales as nontaxable gasoline sales on the cash register. He claims that he did not know she was improperly ringing up taxable sales as exempt until the underpayment was discovered during the Department audit. The sister no longer works for the Taxpayer.

The Taxpayer and his wife have personally operated their store for 22 years. Mrs. Seales has always done the store's taxes. The couple obviously knew how much merchandise they bought and sold in a given day, week, and month. It is thus hard to believe that the Taxpayer, as the hands-on operator of the business, did not realize that the monthly sales being reported to the Department during the audit period were on average less than half of what they paid for the merchandise. Even disregarding utilities, insurance, and the other operating expenses incurred in operating the business, the Taxpayer could not have stayed in business, much less made a profit, by consistently spending substantially more to stock his store than he had in gross receipts in each month.

Under the circumstances, I must conclude that the Taxpayer was aware that he was substantially underreporting his sales during the audit period. The fraud penalty is affirmed.

The final assessment is affirmed. Judgment is entered against the Taxpayer for tax, penalties, and interest of $46,929.21. Additional interest is also due from the date the final assessment was entered, March 11, 2005.

This Final Order 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 December 16, 2005.

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BILL THOMPSON
Chief Administrative Law Judge