GUESS ELECTRONICS CO., INC. 561 HOLCOMBE AVENUE MOBILE, AL 36606-1572,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 06-1252
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Guess Electronics Company, Inc. ("Taxpayer") for State sales tax for March 2003 through February 2006. 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 1, 2007. Will Sellers represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

The Taxpayer sells closed circuit television systems, access control systems, automatic gates, and other security equipment and related items at three retail locations in Alabama.

The Department audited the Taxpayer for sales tax beginning in the Fall of 2005. The initial audit period was September 2002 through August 2005. The Department examiner asked the Taxpayer during the audit to sign a waiver of the statute of limitations that would have allowed the Department until June 30, 2006 to assess the Taxpayer for the above period. The Taxpayer elected not to sign the waiver.

The audit continued, and the examiner later deleted September 2002 through February 2003 from the audit because those months were out-of-statute. He also added the months of September 2005 through February 2006.

The Department issued its initial audit report in February 2006. The report recommended that "the 5% negligence penalty should be waived as the liabilities established in this audit were not done so out of neglect or disregard." The above audit report was issued before the Taxpayer elected not to execute the above discussed waiver. The examiner issued two revised audit reports after the Taxpayer refused to sign the waiver. Those reports recommended that the 5 percent negligence penalty should be assessed. The Department examiner testified that he recommended the penalty at the insistence of his supervisor.

The Department examiner determined that the Taxpayer owed additional sales tax because: (1) it improperly made tax-free sales to customers that had expired or invalid sales tax numbers, (2) it improperly sold supplies, tools, and other items to contractors tax-free that were used and/or consumed by the contractors and not resold; and (3) it improperly made tax-free cash and credit card sales to government employees that were not properly documented as exempt sales to the governmental entities. The Department assessed the Taxpayer for the additional tax due on the above items, plus the 5 percent negligence penalty and interest.

The Taxpayer's owner, David Guess, explained at the May 1 hearing that when a new business customer first purchases items from his business, he requires the customer to provide evidence that it operates a valid, licensed business. If the customer claims that it should be allowed to purchase the items tax-free for resale, the Taxpayer requires the customer to provide a valid Alabama sales tax license. If the customer does so, the Taxpayer puts the number on file and thereafter sells tax-free to the customer.

Guess testified that on occasion he or one of his employees will call the Revenue Department to verify that a sales tax number provided by a customer is valid. He also conceded that once he has a customer's sales tax number on file, he thereafter sells items to the customer tax-free, and does not inquire if the customer intends to resell the item or use the item in its business.

This case involves a recurring issue that the Administrative Law Division has addressed on numerous occasions. That is, what is a retailer's duty when it sells tangible property to a customer tax-free. The issue was recently discussed in *Coca-Cola Company d/b/a Minute Maid Company v. State of Alabama*, S. 06-1261 (Admin. Law Div. 8/29/2007), as follows:

> This issue has been addressed by the Administrative Law Division on numerous occasions. In *Alabama Liquidation & Collection Agency, Inc. v. State of Alabama*, S. 03-345 (Admin. Law Div. 12/11/2003), the issue was whether the taxpayer should be held liable for sales tax on tax-free sales it made to customers that had provided the taxpayer with invalid or non-existent sales tax numbers that the taxpayer believed to be valid. The Final Order in the case reads in pertinent part as follows:
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> > The sale of tangible personal property to a licensed retailer for resale constitutes a nontaxable wholesale sale. Code of Ala. 1975, §40-23-1(a)(9); *State v. Advertiser Company*, 337 So.2d 942 (Ala. Civ. App. 1976). To be tax-free, however, the wholesale purchaser must provide the seller with a valid sales tax number. The burden is on the seller to know the general nature of the wholesale purchaser's business, and that the purchaser is in the business of reselling the type of property being purchased. Dept. Reg. 810-6-1-.184; see also, *Webster Enterprises*, *supra.*
> >
> > The Taxpayer's owner testified at the October 28 hearing that when a customer provided him with a sales tax number, he assumed the number was valid, and consequently allowed the customer to purchase items tax-free. He conceded that he did not inquire as to the customer's business, or whether the

> customer intended to resell the goods at retail. He claimed, however, that he should not be held liable if a customer gave him an invalid or wrong number, or otherwise did not purchase an item for resale. The owner's testimony was forthright and believable. Unfortunately, he failed to fully understand his duty as a retailer under Alabama's sales tax law.
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> A retailer cannot blindly accept a sales tax number from a customer. Rather, as stated in Reg. 810-6-1-.184, a retailer is under a duty to know the general nature of his customer's business. If it is not readily apparent that a customer using a sales tax number intends to resell the goods being purchased, the retailer must inquire concerning the type of business engaged in by the customer. The burden must be on the retailer to police the proper use of tax numbers. Otherwise, the improper use of such numbers to buy items tax-free would be rampant.
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> If, however, the retailer exercises due care and reasonably believes that the customer intends to resell the goods, then the retailer can sell the goods tax-free. In that case, the retailer is relieved of liability, even if it is later discovered that the customer improperly purchased the item tax-free, again assuming that the retailer used due diligence in determining that the customer was in the business of and intended to resell the goods at retail.

Alabama Liquidation at 4 – 6.

The Administrative Law Division held in the above case that although the taxpayer's owner was unaware that the items were not being resold, he was nonetheless liable because he did not exercise due diligence by inquiring about the nature of the customers' businesses and whether they intended to resell the items.

In this case, Ricketts provided the Taxpayer with an apparently valid multi-jurisdictional sales and use tax certificate. That alone, however, is not sufficient to relieve the Taxpayer from liability. Rather, as indicated, the burden was also on the Taxpayer to inquire whether Ricketts was in the business of reselling the repair parts.

Unlike the customers in *Alabama Liquidation*, who were not in the business of reselling the items purchased from the taxpayer, Ricketts was in the business of reselling the repair parts to its service customers. The Taxpayer

> knew that Ricketts was in the business of reselling the parts. The Taxpayer thus exercised due care and reasonably believed that Ricketts was reselling the parts (which presumably it did). That fact, combined with the apparently valid sales tax certificate provided by Ricketts, is sufficient to relieve the Taxpayer from liability for tax on the Ricketts sales.

Coca-Cola at 2 – 4.

In this case, the customers in question at one time had a valid sales tax account with the Department. The first question is whether the Taxpayer should be held liable for selling tax-free to those customers because, for whatever reason, the customers' numbers had been canceled before the sales occurred.

The Taxpayer's owner testified that he generally knows the type of business his customers engage in, and that he sold tax-free to the customers in question because they were in the business of reselling goods and he had their Alabama sales tax numbers on file. He argues that he should not be required to inquire with the Department each time he sells to a "licensed" customer, and that doing so during the period in issue would have been time-consuming and impractical.

The issue presented in this case is oft-times difficult to decide. On the one hand, the burden is "on the retailer to police the proper use of tax numbers. Otherwise, the improper use of such numbers to buy items tax-free would be rampant." *Alabama Liquidators* at 6. Conversely, if a retailer obtains a sales tax number from a customer, and knows that the customer is in the business of reselling the items being purchased, the retailer should be allowed to sell to the customer tax-free. The retailer should not later be held liable if the customer's license had been previously canceled and the retailer was unaware of that fact.

In this case, the Taxpayer knew the general nature of its customers' businesses, and

also had what it believed were valid sales tax numbers on file for the customers. Given those facts, the Taxpayer should not be held liable only because, unbeknown to the Taxpayer, the customers' sales tax numbers had been canceled.[1]

The above finding is supported by the Department's own Reg. 810-6-4-.10. That regulation requires that if a retailer sells to another licensed retailer for resale, the retailer must put the customer's sales tax number on the sales invoice. However, in lieu of putting the number on each invoice, the retailer may instead simply maintain the retailer's sales tax number on file in its books and records. That is what the Taxpayer did in this case.

But even if a customer provides a retailer with a sales tax number, the customer can only purchase tax-free those items that it is in the business of reselling. If a licensed customer purchases supplies or other items that are used and/or consumed by the customer in its business, or otherwise not resold, those items are taxable.

In this case, the Department examiner reviewed the Taxpayer's invoices and determined that some tax-free sales that the Taxpayer made to validly licensed customers should have been taxed because the customers used or consumed the items in their businesses. The examiner cited drill bits, glow rods, and canned smoke sold to contractors as some of the items that were used and consumed by the contractors, and not resold.

The Taxpayer does not argue that the above items were purchased for resale, and thus nontaxable. Rather, it contends only that the examiner had no evidence supporting his conclusion that the items were not being resold.

The examiner in question is a seasoned, accomplished auditor that has conducted

[1] The Department can, of course, assess the customers for use tax on the property that the customers improperly purchased tax-free.

numerous sales tax audits. He has a general knowledge of the tools, materials, etc. that contractors use in performing their work, and he is not prohibited from using that knowledge in performing his audits. If the Taxpayer contends that the contractors had purchased the drill bits, etc. for resale, it could have presented evidence to that effect. It failed to do so. The examiner thus correctly included those items as taxable.

Concerning the sales that the Taxpayer claims were nontaxable sales to exempt entities, the burden was on the Taxpayer to obtain and maintain sufficient records substantiating that the sales were exempt. Otherwise, the sales must be deemed to be taxable. *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied 384 So.2d 1094 (Ala. 1980).

The sales in issue were to individual government employees, who are not per se exempt. The Taxpayer failed to obtain government purchase orders or other documents showing that the exempt entities had purchased the items. The individuals also paid cash or used their own credit cards to pay for the items. Because there was no documentation showing that the exempt governments or governmental agencies purchased the items, they were correctly taxed by the examiner.

The Taxpayer argues that it was denied due process when the examiner deleted the first six months of the original audit period and added six months to the end of the period. It also objects that the Department vindictively added the 5 percent negligence penalty because the Taxpayer elected not to sign the waiver.

Changing the audit/assessment period during the audit did not violate the Taxpayer's

due process rights. The Department is authorized to audit and assess a taxpayer for any period or periods not barred by the statute of limitations. Code of Ala. 1975, §40-2A-7(b). It is not barred from changing an audit period anytime before a preliminary assessment is entered.

The examiner asked the Taxpayer to sign the waiver while the audit was ongoing. When the Taxpayer elected not to sign, the examiner could have estimated the Taxpayer's liability, and the Department could have then stopped the statute for the original audit period by entering a preliminary assessment for the estimated tax due. The examiner could have thereafter completed his audit, and the Department could have adjusted the preliminary assessment to reflect the correct amount due per the audit. The examiner elected not to estimate the Taxpayer's liability, and instead deleted six months from the beginning of the audit period and added six months at the end. That is routinely done and entirely permissible. Just as the Taxpayer was within its rights in not signing the waiver, the Department was within its authority in changing the audit/assessment period before the preliminary assessment was entered.

Concerning the Taxpayer's claim that the Department assessed the negligence penalty only because the Taxpayer refused to sign the waiver, it must be remembered that an examiner's recommendation in an audit report that a penalty should be applied or waived is only that, a recommendation. The final decision is made either by the examiner's field supervisor or at the Department's main office in Montgomery.

In this case, the examiner's supervisor advised the examiner to add the negligence

penalty in the examiner's second and third audit reports. There is no evidence that the supervisor did so either because the Taxpayer refused to sign the waiver or because the supervisor thought the Taxpayer was in fact negligent in reporting and paying its sales tax during the period. In any case, the pertinent question is whether the negligence penalty is applicable. That is addressed below.

The negligence penalty applies if a taxpayer fails to make a reasonable attempt to comply with Title 40, Code of Ala. 1975, and does so with careless, reckless, or intentional disregard. Code of Ala. 1975, §40-2A-11(c). The Taxpayer in this case has been in business for many years. Its personnel knew or should have known that while it can sell tax-free to other licensed retailers, it can only sell tax-free those items that the customer is in the business of reselling. The Taxpayer thus knew or should have know that it could not sell drill bits and other tools and equipment tax-free to contractors that they use in their business and do not resell. It was negligent when it did so.

The Taxpayer also knew or should have known that all exempt sales to governments and governmental agencies must be properly documented. It is improper for a retailer to sell tax-free to a government employee (or anybody) without documentation that the sale is to the exempt government or governmental agency, and that the goods were paid for by the exempt entity. The Taxpayer was negligent in doing so in this case.

Finally, as discussed, the Taxpayer argued that it would have been impractical and unreasonable for it to have been required to contact the Department concerning each sale to confirm that the customer had a valid sales tax license. Beginning in the Spring of 2006, however, retailers can now go to the Department's website and easily and promptly

determine if a customer has a valid sales tax license. The website is also coded to allow the retailer to determine the type of business the customer is in. Consequently, the Taxpayer and all other retailers in Alabama can now easily verify if they should sell to a customer tax-free, and if so, what items can be sold tax-free.

It is assumed that the Department has notified all existing (and all new) sales tax license holders of the availability of the above information on the Department website. In that case, all retailers should know that they can use the website to easily verify whether a customer has a valid sales tax number, and what items the customer is in the business of reselling. Their failure to use due diligence in doing so will, absent extraordinary circumstances, cause them to be liable on any improper tax-free sales.

The Department is directed to recompute the Taxpayer's liability for the subject period as indicated herein. A Final Order will then be entered for the adjusted tax, penalty, and interest 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 pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered December 10, 2007.

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BILL THOMPSON
Chief Administrative Law Judge

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