VINA KHANTHAVONGSA D/B/A OLD SHELL CONVENIENCE STORE 6567 OLD SHELL ROAD MOBILE, AL 36608-3933,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 07-728
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Vina Khanthavongsa ("Taxpayer"), d/b/a Old Shell Convenience Store, for State sales tax for December 2001 through December 2005. 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 June 10, 2008. The Taxpayer's representative was notified of the hearing by certified mail, but failed to appear. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer operates a gas station/convenience store in Mobile, Alabama. The Taxpayer sells gasoline, groceries, tobacco products, beer, wine, soft drinks, snacks, and sundries. The Department audited the Taxpayer for sales tax for December 2001 through December 2005. The Taxpayer provided the Department examiner with purchase invoices, cigarette manufacturer check stubs, purchase summaries, and bank statements. The Taxpayer failed, however, to provide any cash register z-tapes or any other complete sales records.

The examiner determined that the Taxpayer's monthly purchases were consistently greater than her reported monthly sales. Specifically, the examiner discovered that the Taxpayer's purchases during the audit period per her own records were $1,012,790. The

Taxpayer had reported sales of only $441,792. The examiner thus concluded that the Taxpayer's returns were not correct. He consequently computed the Taxpayer's liability using a purchase mark-up audit.

The examiner determined the Taxpayer's wholesale purchases using purchase invoices provided by the Taxpayer. He then computed the Taxpayer's liability by applying the standard 124.865 percent IRS mark-up for gas station/convenience stores. He also assessed the Taxpayer for the 50 percent fraud penalty.

All taxpayers subject to sales tax are required to keep complete and accurate records from which the Department can accurately determine the taxpayer's correct liability. Code of Ala. 1975, §§40-2A-7(a)(1) and 40-23-9; *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982). If a taxpayer fails to keep adequate records, the Department can use any reasonable method to compute the taxpayer's liability. The taxpayer cannot later complain that the liability so computed by the Department is inexact. *Jones v. C.I.R.*, 903 F.3d 1301 (10th Cir. 1990).

The Department's use of a purchase mark-up audit is a commonly used and accepted method of computing a taxpayer's liability in the absence of adequate records. See generally, *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04); *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).

In this case, the Department examiner determined that the Taxpayer had not correctly reported her monthly sales because her monthly purchases, without mark-up, greatly exceeded her reported monthly sales. The examiner thus correctly computed the Taxpayer's liability using the purchase mark-up audit.

The Taxpayer's representative asserts that the examiner did not consider that the Taxpayer had an ending inventory of merchandise that she purchased during the audit period, but did not sell. She also claims that some merchandise was discarded.

An ending inventory should generally be considered in a purchase mark-up audit. However, a beginning inventory must also be considered if the taxpayer had been in business before the audit period or had purchased an on-going business, as in this case. Consequently, because the Taxpayer failed to provide records showing a beginning inventory, she cannot be allowed a reduction in purchases for her ending inventory.

Concerning the discarded items, the Taxpayer failed to provide evidence of the amounts discarded, if any. In any case, the IRS mark-up percentage generally takes into account that a business that sells perishables will discard some damaged or out-dated items.

The Taxpayer has failed to present any evidence that the *prima facie* correct final assessment based on the purchase mark-up audit is incorrect. Consequently, the final assessment must be 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 by the examiner to explain why she had grossly underreported her monthly sales, the Taxpayer explained that she could not afford to pay all of the sales tax due. Sales tax is a trust fund tax collected by the retailer from the customer. The Taxpayer had thus collected the sales tax in issue from her customers. She opted, however, to use the tax money for her own purposes instead of remitting it to the Department, as required by Alabama law.

Under the circumstances, I must conclude that the Taxpayer was aware that she

was substantially underreporting her sales during the audit period, and thus knowingly underpaid her sales tax for the period. The fraud penalty is affirmed.

The *prima facie* correct final assessment is affirmed. Judgment is entered against the Taxpayer for State sales tax, fraud penalty, and interest of $54,819.94. Additional interest is also due from the date the final assessment was entered, July 19, 2007.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered June 16, 2008.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Duncan R. Crow, Esq.
Kay Tse
Joe Cowen
Mike Emfinger