

STATE OF ALABAMA, § STATE OF ALABAMA
V. § DEPARTMENT OF REVENUE
§ ADMINISTRATIVE LAW DIVISION
WRANGLER LOUNGE, INC. §
1004 North Street §
Talladega, AL 35160, § DOCKET NO. S.85-161
Taxpayer. §

ORDER

This case involves three disputed preliminary assessments of State sales tax (July 1, 1982 - January 31, 1985), Talladega County sales tax (October 1, 1984 - January 31, 1985) and City of Talladega sales tax (July 1, 1982 - January 31, 1985) entered by the Revenue Department against the Wrangler Lounge, Inc. (Taxpayer) on April 16, 1985. A hearing was conducted in the matter by the Administrative Law Division on April 16, 1986. The parties were represented at said hearing by attorney Stuart E. Smith, for the Taxpayer, and assistant counsel Eddie Crumbley, for the Department.

Based on the evidence taken at the hearing, and in consideration of the arguments and authorities presented by the parties through oral argument and post-hearing briefs, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The assessments in issue are a result of an audit of the Taxpayer's restaurant and lounge operations by the Revenue Department. The records initially provided by the Taxpayer to the Department's examiner were various purchase invoices and, as testified to by the examiner, a wirebound notebook containing

incomplete gross receipts entries. The Taxpayer did not provide a general journal, sales journal, purchase journal, or any other records which accurately and completely reflected the Taxpayer's sales, purchases and gross receipts during the audit period. The Taxpayer did produce at the administrative bearing a copy of several ledger sheets (Taxpayer's Exhibit 1) which Mrs. Gail Carter, the corporation's secretary-treasurer, testified were weekly gross receipts totals for the restaurant and lounge taken from the business' daily cash register tapes. The actual cash register tapes were not kept by the Taxpayer. The Department examiner determined that the records provided by the Taxpayer were incomplete and thus insufficient to support a direct audit. The examiner also questioned the Taxpayer's bookkeeping methods and monthly sales tax reports because, as discussed below, independently obtained information indicated that the Taxpayer's actual beer and liquor purchases were much greater than the sales reported on the monthly returns, with no corresponding increase in inventory, indicating an underreporting of taxable sales. A bank analysis audit was considered but rejected because numerous personal checks had been written on the business checking accounts and part of the Taxpayer's payouts involved cash which would not have been reflected in the checking account records. Also, checks for a number of the months involved in the audit were missing. In light of the above, the examiner did an indirect purchase markup

audit, as follows:

The audit involved four main items; beer purchases, liquor purchases, food purchases and admissions. Each is discussed separately below.

The total cases of beer purchased by the Taxpayer during the audit period was determined from Talladega County records based on information provided by the beer distributors in the area (State's Exhibit 1). An average price per case was computed by averaging the Taxpayer's beer invoices that were available to the examiner (State's Exhibit 2). The dollar amount of beer purchases was then determined by multiplying the number of cases by the average price per case. Beginning and ending inventory figures, as provided by the Taxpayer, were factored in to arrive at taxable beer purchases.

A markup of 80% was added to arrive at gross taxable sales. The initial beer markup was 100%, but was reduced after negotiations with the Taxpayer to allow for the numerous discount "specials" during the audit period. Beer tax was computed (State's Exhibit 4), and then deducted from gross sales to arrive at net taxable beer sales. For summary, see State's Exhibit 9, lines 1-7.

Liquor purchases were determined from information provided by the Alcoholic Beverage Control Board (State's Exhibit 5). Adjustments were made for beginning and ending inventory figures, again as provided by the Taxpayer, to arrive at taxable purchases (State's Exhibit 6). A markup factor of 125% was applied to arrive

at net taxable liquor sales. The initial liquor markup was 300%, but like the beer percentage, was reduced after negotiations to allow for the cost of various mixers, and also for the discounted drinks sold during happy hour and other discount occasions. For summary, see State's Exhibit 9, lines 10-14.

Food purchases were taken based entirely on the food purchase invoices provided by the Taxpayer (State's Exhibit 7). A markup factor of 50% was added to arrive at net taxable food sales. The food markup was based primarily on the Dunn and Bradstreet, Inc. average markup chart, which is ordinarily used by the Department to project profit markups for different types of businesses. The original food markup was greater than 50%, but was lowered to that figure to allow for free happy hour buffets and spoilage. For summary, see State's Exhibit 9, lines 17-21.

No admissions gross receipts records were provided by the Taxpayer. However, it was agreed between the parties that a reasonable estimate of admissions gross receipts for the audit period would be \$200.00 a night, three nights a week (State's Exhibit 8).

Having determined total taxable gross receipts, the applicable tax rates were applied to compute State (State's Exhibit 10), Talladega County (State's Exhibit 13), and City of Talladega (State's Exhibit 15) tax due, plus interest. A delinquent penalty

of one-half of one percent per month and a ten percent failure to file penalty were added where appropriate. The preliminary assessments in issue were entered based on the above computations.

The Taxpayer objects to the audit on several grounds. First, the Taxpayer argues that its records were sufficient and should have been used in conducting the audit. The records relied on by the Taxpayer were not provided to the examiner during the course of the audit, and were first produced at the administrative hearing on April 16, 1986. They consist of copies of several ledger sheets made by the Taxpayer's accountant showing weekly and/or monthly totals for restaurant, bar, liquor, beer and admissions gross receipts. The years 1982 and 1984 are broken into both weekly and monthly totals. The 1983 figures are divided into monthly totals only. The Taxpayer's secretary-treasurer, Mrs. Carter, testified that the ledgers were compiled based on weekly totals taken from the business' various cash register receipt tapes. As stated previously, none of the actual register tapes were produced, nor were any other records from which the weekly and monthly gross receipts ledger totals could be verified. While arguing that the above ledger sheets accurately reflect its liability, the Taxpayer admits that some of its merchandise was withdrawn for personal use or consumption, and that tax is due and unpaid on those withdrawals.

The Taxpayer also contends that even if its composite ledger

sheets were insufficient, the audit should have been done using the business' checking account records. As stated earlier, the examiner did attempt a bank analysis audit, but changed to a purchase markup method after discovering that the business had several different accounts during the audit period, that some of the monthly statements were missing, and that numerous personal checks had been written on the accounts.

The Taxpayer further argues that the 125% liquor markup is excessive because it fails to allow enough credit for the cost of mixers and the numerous discount drinks sold by the Taxpayer. The Taxpayer contends that a markup figure of 75% would be reasonable.

The Taxpayer disputes the 80% beer markup for the same reasons, arguing that the 80% figure is approximately double what it should be. The Taxpayer also contends that the average price per case projected in the audit (State's Exhibit 2) took into account only the most expensive beer, which, according to the Taxpayer, over-inflated the purchase price on which the beer markup was applied.

However, the evidence indicates that the average case price was taken from an average of all beer invoices available to the examiner. Finally, the Taxpayer disputes the 50% food markup, arguing that most of the food was either given away during the happy hour buffets or lost through spoilage.

CONCLUSIONS OF LAW

Code of Alabama 1975, §40-23-9 requires that all taxpayers

making retail sales shall maintain and preserve adequate records from which their proper liability can be ascertained.

it shall be the duty of every person engaging or continuing in this State in any business for which a privilege tax is imposed by this division, to keep and preserve suitable records of the gross sales, gross proceeds and gross receipts of sales of such business and such other books or accounts that may be necessary to determine the amount of tax for which he is liable, under the provisions of this division. It shall be the duty of every person to keep and preserve, for a period of three years, all invoices of goods, wares and merchandise purchased, for resale or otherwise, and all such books, invoices and other records shall be open for examination at any time, by the Department of Revenue or its duly authorized agent. Any person selling both at wholesale and retail shall keep his books so as to show separately the gross proceeds of wholesale sales and the gross proceeds of retail sales.

Case law is clear that a taxpayer has the burden of keeping proper records, and that in the absence of such records the Department may obtain whatever relevant evidence or information necessary to accurately compute the tax due. Further, without adequate records, the Department is not obliged to rely on the unsupported State v. Ludlum assertions of the taxpayer. State v. Levey, 29 So.2d 129 (1946); State v. Mims, 30 So.2d 673 (1947); State v. T.R. Miller Mill Company, 130 So.2d 185 (1961); State v. Ludlum, 384 So.2d 1089 (1980); State v. Mack, 411 So.2d 799 (1982).

However, §40-23-9 does not prescribe a particular form or method of record keeping that must be followed, nor have the courts so designated such a method, State v. Mims, supra, State v. Ludlam,

supra, State v. Mack, supra, although clearly the statute envisions the keeping of sufficient records from which a taxpayer's complete liability can be computed, without the necessity of relying on third party records or the verbal assertions and explanations of the taxpayer. Thus, the determinative issue in the present case is whether the Taxpayer's records were sufficient to compute its liability, and if not, was the Department's indirect purchase markup audit reasonably and properly done so as to support the assessments in issue.

From a review of the testimony and exhibits presented by both parties, it must be determined that the records provided by the Taxpayer, both during and subsequent to the audit, are insufficient and should not be substituted for the Department examiner's audit findings.

While §40-23-9 does not dictate a particular record keeping method, it is reasonable to conclude that the statute envisions a contemporaneously recorded account of every purchase and sale made by a taxpayer. Although a weekly or monthly summary of gross receipts, as presented by the Taxpayer in the present case, may in some instances accurately reflect a taxpayer's gross receipts, just as easily a taxpayer could create an incorrect summary after the fact so as to verify its claimed liability. With no individual purchase or sales records, such as cash register tapes or individual sales receipts and purchase invoices, there is no way

that the accuracy of such a summary could be verified. In short, a written summary of gross receipts compiled by a taxpayer, with no substantiating records, is, in substance, equivalent to the unsupported verbal assertions of a taxpayer. The courts are clear in their holding that the Revenue Department is not required to rely on such evidence in computing a taxpayer's liability. Mack, supra.

The rejection of the Taxpayer's records in the instant case is further warranted by the fact that the Taxpayer had consistently underreported the beer and liquor sales on its monthly sales tax reports. The incorrect returns were based on the Taxpayer's weekly gross receipts totals, the same as the summary ledger sheets. Reliable information obtained from the Talladega County Courthouse (beer) and the Alcoholic Beverage Control Board (liquor) indicated a much greater volume of purchases by the Taxpayer than reported sales, with no increase in inventory. The only explanation is that numerous sales, or taxable withdrawals for use, were not reported by the Taxpayer.

Concerning the accuracy of the Department's purchase markup audit, by its nature an indirect audit must be based on third party records, estimates and projections. However, such an audit is necessary and warranted where a taxpayer does not maintain records from which its liability can be determined. In the present case, the examiner used the best available information, and reasonable

estimates based thereon, in computing the Taxpayer's liability. The beer and liquor purchase amounts were taken from Talladega County and ABC Board records. The admissions gross receipts figures were agreed to by the Taxpayer, and the food purchases were based entirely on the Taxpayer's purchase invoices, even though not all of the invoices were available.

The Taxpayer's primary objection is that the markups applied to the purchase figures were excessive and unreasonable. The Department examiner testified that the liquor, beer and food markups were initially much higher than the final figures used in the audit, but that each was reduced substantially to allow for the cost of liquor mixers, discount drinks and beer, and food giveaways and spoilage. The liquor was reduced from 300% to 125%, the beer from 100% to 80%, and the food an unspecified amount down to 50%.

Thus, clearly the examiner took into consideration the reduced price drinks and beer, the food giveaways and spoilage, and other miscellaneous expenses in computing the markups. Whether sufficient credit was allowed is open to speculation. However, under the circumstances the examiner's figures are reasonable and should be accepted.

Based on the above, it is hereby determined that the Department's audit was performed as fairly and accurately as possible, considering the Taxpayer's failure to keep proper records, and that the assessments based thereon should be upheld.

Accordingly, the Income Tax Division of the Revenue Department is hereby directed to make the preliminary assessments final as entered, plus interest.

Done this 17th day of July, 1986.

BILL THOMPSON
Chief Administrative Law Judge