

**ALABAMA TAX TRIBUNAL**

AZ INTERNATIONAL, LLC, AND ITS SOLE MEMBER, ALI MOHAMED MUFLEHI,	§	DOCKET NOs	S. 20-453-JP S. 21-1148-JP S. 22-415-JP
Taxpayer,	§		
and	§		
ALI MUFLEHI & NAJAT AHMED,	§		
Taxpayers,	§		INC. 21-809-JP
v.	§		
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§		

**OPINION AND FINAL ORDER**

Docket No. S. 20-453-JP involves a final assessment of sales tax against AZ International, LLC, and its sole member, Ali Mohamed Muflehi, for tax periods May 2016 through April 2019. That final assessment includes tax, interest, and a fraud penalty. Docket No. INC. 21-809-JP involves final assessments of individual income tax against Ali Muflehi and Najat Ahmed for tax years 2016 through 2018. Those final assessments include tax, interest, and various penalties, but not the fraud penalty. Docket No. S. 21-1148-JP involves a final assessment of sales tax against AZ International, LLC, and its sole member Ali Muflehi, for tax periods April 2020 through June 2020. That final assessment includes tax, interest, and a negligence penalty. Docket No. S. 22-415-JP involves a final assessment of sales tax against AZ International, LLC, and its sole member, Ali Muflehi, for tax periods July 2020

through September 2020. That final assessment includes tax, interest, and a negligence penalty only.

These consolidated cases came before the Tax Tribunal for trial on December 12, 2022. The Taxpayer was represented by Josh Sullivan. The Revenue Department was represented by Meredith Blackburn and Hilary Parks. Ali Muflehi appeared and testified. Zahoor Maqrouf, who had assisted Mr. Muflehi with his business, also appeared and testified. Warren Watson, a Revenue Department auditor in its Sales and Use Tax Division who reviewed the original audit, and Michael Eugene Adams, a Revenue Department income tax auditor, appeared and testified. The parties filed post-trial briefs.

### Facts

During the assessment periods, the Taxpayer operated a convenience store in Gadsden, Alabama, called Corner Food Mart. Mr. Watson testified that, during the audit by the Revenue Department, the Taxpayer presented incomplete records which included z-tapes, journals, bank statements, and Forms 1099. However, those records were insufficient to arrive at the sales tax measure reported by the Taxpayer on its returns.

Although the Taxpayer's records were incomplete, Mr. Watson testified that there were six months of z-tapes that were sufficient for calculating taxable sales during each of those months. Therefore, the Revenue Department's auditor scheduled those sales in detail by category and then subtracted amounts for electronic benefits transfers (EBTs) and for tax to arrive at taxable sales. For those six months,

the Taxpayer's taxable sales based on its own z-tapes totaled \$229,000, but its reported taxable sales for those same periods totaled only \$75,087.80. And the Taxpayer's purchases from vendors for those periods totaled \$111,000. The auditor used an average of the z-tapes, and applied the average to months for which z-tapes were missing. Based on the six sample months, however, the Taxpayer had a 206% error rate in reporting, which was determined by subtracting the Taxpayer's reported taxable sales during the period – \$75,000 – from the taxable sales per the z-tapes – \$229,000 – and then dividing that difference – \$154,000 – by the reported sales of \$75,000. That error rate was applied to the other months under audit (for which there were no complete z-tapes) to arrive at the remaining taxable measure.

With respect to income tax, Mr. Adams testified that the Revenue Department increased the amount of tax due based on the result of the sales tax audit. Specifically, the Revenue Department increased the amount of sales reported on Schedule C of the income tax return by the amount of sales increased pursuant to the sales tax audit. He also stated that a small amount of income was added from a Form K-1 from Jamal Ministop, a store which Mr. Mufflehi apparently owned.

Mr. Watson testified that the Revenue Department assessed the fraud penalty in Docket No. S. 20-453-JP for three reasons: First, during the six-month period for which the Taxpayer kept nearly-complete z-tapes, those tapes recorded taxable sales of approximately \$229,000. However, the Taxpayer reported only \$75,000 in taxable sales for that same six-month period on its sales tax returns filed with the Revenue Department. Second, for the same six-month period, the Taxpayer purchased

\$111,000 from vendors for resale, which amount exceeded its reported sales of \$75,000 during the six-month period by nearly 50 percent. Third, the Taxpayer's error rate in reporting its taxable sales during the six-month period was 206 percent, which is \$154,000 in underreported sales (\$229,000 minus \$75,000) divided by \$75,000 in reported sales.

Mr. Muflehi testified that he received a high school education in Yemen and that he moved to the United States in 2006. He also testified that he owns the Taxpayer, which has operated a convenience store known as Corner Food Mart since 2018, but that he has operated a convenience store since 2016. According to Mr. Muflehi, his wife has been sick since 2016 and her sickness distracted him from dealing with his business. He also stated that he had no employees but relied on his family, including his young adult children, to aid him.

According to Mr. Muflehi, he had no training on the store's sole cash register that he had purchased in a used condition. He stated that he rang up every transaction on the register, but that he did not know that some keys rang up transactions without sales tax being added. The Taxpayer's representative admitted that Mr. Muflehi had rung up a significant amount of sales as nontaxable and, therefore, had not collected the tax due on those sales. Mr. Muflehi stated that he did not sell gas and that he had few sales of motor oil, neither of which is subject to retail sales tax. He testified that he had not intentionally underreported his taxes, but that he did not know why his purchases from vendors exceeded his reported sales.

The Revenue Department introduced evidence that Mr. Muflehi owned a

Decatur convenience store and that he had been indicted for food stamp fraud in connection with that store. He testified, however, that the Decatur store was operated by his brother and that Mr. Muflehi's only involvement was that the store had been opened using his name at the insistence of family members.

Zahoor Maqrouf, who began assisting Mr. Muflehi with his business in 2020 at the time of the audit, testified that Mr. Muflehi had used a specific key (number 1) on the cash register whenever he did not know what category to use. That particular key recorded the sale of items as nontaxable which, according to Ms. Maqrouf, accounts for much of the discrepancy at issue in the audit. She also testified that Mr. Muflehi did not know how to void transactions on the register. According to her, key 1 still rings up items as nontaxable; however, she stated that Mr. Muflehi overpaid his taxes for 2022.

### Discussion

In its Notices of Appeal, the Taxpayer objected to the Revenue Department's audit method of marking up the Taxpayer's purchases by 35 percent and using those amounts as the Taxpayer's sales tax measure. However, the Taxpayer presented no proof at trial as to what it claims the correct measure is, and it did not argue in its post-trial brief that the measure determined by the Revenue Department was too high. Instead, in its brief, the Taxpayer argues only that the fraud penalty should be reduced to a negligence penalty. There was no fraud penalty assessed in connection with the income tax audit of years 2016 through 2018 (Docket No. Inc. 21-809-JP) or the sales tax audit for periods July 2020 through September 2020 (Docket No. S. 22-

415-JP) and periods April 2020 through June 2020 (Docket No. S. 21-1148-JP). Therefore, those final assessments are upheld. The tax and interest components of the final assessment for periods May 2016 through April 2019 (S. 20-453-JP) also are upheld.

Concerning the fraud penalty, the Taxpayer argues that Mr. Muflehi did not intend to record the sales of taxable items as nontaxable, but that his lack of understanding and experience with the business side of a convenience store and with the cash register in this store caused him to underreport taxable sales. Additionally, he stated that he was preoccupied with his wife's illness and that the store experienced a high amount of theft.

The Tax Tribunal has previously explained:

“Ala. Code § 40-2A-11(d) levies a 50 percent fraud penalty for any underpayment of tax due to fraud. The burden of proof in an assessment of a fraud penalty falls on the Department. Ala. Code § 40-2B-2(k)(7). 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 existence of fraud must be determined on a case-by-case basis 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). Consequently, fraud may be established from ‘any conduct, the likely effect of which would be to mislead or conceal.’ Id. The mere underreporting of gross receipts is itself insufficient to establish a finding of fraud, unless there is evidence of repeated understatements in successive periods when coupled with other circumstances showing an intent to conceal or misstate sales. Barrigan v. C.I.R., 69 F. 3d 543 (1995).

“A taxpayer’s failure to keep adequate books and records, a taxpayer’s

failure to furnish auditors with records or access to records, the consistent underreporting of tax, and implausible or inconsistent explanations regarding the underreporting are strong indicia of fraud. See Solomon v. C.I.R., 732 F. 2d 1459 (1984); Wade v. C.I.R., 185 F. 3d 876 (1999).... Ignorance is not a defense to fraud where the taxpayer should have reasonably known that its taxes were being grossly underreported. Russo v. C.I.OOR., T.C. Memo 1975-268; Temple v. C.I.R., 67 T.C. 143 (1976).”

“Any retailer should know with certainty that sales records must be maintained for audit purposes....”

E&Z, Inc., v. State of Alabama Department of Revenue, 19-989-LP (Ala. Tax Tribunal 1/12/22).

Here, the Taxpayer’s claims are unavailing. Mr. Muflehi began operating a convenience store in 2016, and then began operating the Corner Food Mart in 2018. He had experience in ordering merchandise from vendors for resale, and he arranged for sales tax returns to be filed with the Revenue Department on a monthly basis. In fact, the information used by the bookkeeper to prepare the returns came from Mr. Muflehi, and he signed the returns that were filed. It also was stipulated that Mr. Muflehi was involved in a 2020 circuit court case in Etowah County, Alabama, involving an audit and assessment of sales tax for the periods of July 2019 through September 2019. The case was civil in nature, not criminal, and it involved an assessment of sales tax and a negligence penalty, but not a fraud penalty. The Taxpayer paid an undisclosed amount regarding that assessment.

In this appeal before the Tax Tribunal, the Taxpayer’s own records showed that it was underreporting its sales. Specifically, the taxable sales for a six-month period based on the Taxpayer’s z-tapes totaled \$229,000, but the reported taxable sales on the Taxpayer’s sales tax returns totaled only \$75,087.80 for those same six

months. Additionally, the Taxpayer's purchases from vendors, which totaled \$111,000, were nearly 150 percent more than the taxable sales reported by the Taxpayer for those same months. Based on the six-month period, the Taxpayer had a 206% error rate in reporting. Moreover, the Taxpayer failed to keep records for the entire audit period. There also was evidence that Mr. Muflehi was an owner of a Decatur convenience store and that he had been indicted for food stamp fraud in connection with that store.

Mr. Muflehi explained his errors in reporting by stating that he did not know how to properly use his cash register and that he had limited training and experience. However, Mr. Watson testified that most grocery store owners have only a high school education. Mr. Muflehi also stated that he had been distracted from the business because of his wife's illness. It was clear, though, that Mr. Muflehi knew that he was keying in multiple taxable items using a nontaxable key. And Mr. Watson testified that the Taxpayer's reporting of taxable sales for periods after these periods under appeal has increased substantially, from an average of approximately \$13,000 per month to \$20,000 or \$21,000 per month.

The totality of the evidence supports a finding that the Revenue Department met its burden of proving fraud. Therefore, the assessment of the fraud penalty in Docket No. S. 20-453-JP is affirmed.

Based on the foregoing, the final assessments in all four appeals are upheld. Judgment is entered in favor of the Revenue Department and against the respective Taxpayers in the following amounts:

- In Docket No. S. 20-453-JP: \$66,492.10, plus additional interest that continues to accrue from the date of entry of the final assessment until the liability is paid in full;
- In Docket No. 21-809-JP: for 2016, \$16,636.62; for 2017, \$16,121.12; and for 2018, \$8,817.99; plus additional interest that continues to accrue from the date of entry of the final assessments until the liabilities are paid in full;
- In Docket No. S. 21-1148-JP: \$819.65, plus additional interest that continues to accrue from the date of entry of the final assessment until the liability is paid in full; and
- In Docket No. S. 22-415-JP: \$944.74, plus additional interest that continues to accrue from the date of entry of the final assessment until the liability is paid in full.

This Opinion and Final Order may be appealed to circuit court within 30 days, pursuant to Ala. Code 1975 § 40-2B-2(m).

Entered October 23, 2023.

*/s/ Jeff Patterson* \_\_\_\_\_

JEFF PATTERSON

Chief Judge

Alabama Tax Tribunal

jp:ac

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