

## ALABAMA TAX TRIBUNAL

THE GRIDIRON 3, LLC,	§	
GRIDIRON OF CENTRE, LLC,	§	
Taxpayers,	§	DOCKET NOS. S. 18-967-LP
	§	S. 18-968-LP
v.	§	
	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.	§	

### FINAL ORDER

These appeals involve final assessments of State sales tax and consumer’s use tax for March 1, 2015, through March 31, 2017, (S. 18-967) for The Gridiron 3, LLC, and October 1, 2011, through March 31, 2017, (S. 18-968) for Gridiron of Centre, LLC. The cases were consolidated, and a hearing was conducted on April 4, 2019. Attorney Josh Sullivan and the Taxpayers’ owner, Jeremy Reeves, attended the hearing. Assistant Counsel Margaret Johnson McNeill represented the Alabama Department of Revenue (the “Department”). Warren Watson and Ronnie Adcock also appeared for the Department.

### FACTS

The Gridiron 3, LLC, is a restaurant located in Boaz, Alabama. Gridiron of Centre, LLC, is a restaurant in Centre, Alabama. The Revenue Department audited the restaurants to determine compliance with State sales tax and use tax laws during the subject periods. The examiner requested each restaurant’s sales-tax-related records, including the following: a copy of any electronic records or backup from Point of Sale (“POS”) system, all books and records used to prepare sales tax returns, sales invoices and sales journals, customer tax exempt file, purchase invoices, income tax returns, Form 1099-K Statement of Payment Card and Third-Party Network transactions, and cancelled

checks and bank statements. The Taxpayer provided some POS data, bank records, purchase invoices and cost of goods sold, and Form 1099-K. The Taxpayer did not provide any POS records for the periods prior to February 2017. The Taxpayer claimed an update in the POS software unexpectedly deleted prior records.

The examiner reviewed the above records and determined that the records were incomplete and insufficient to directly compute the Taxpayer's liability. Consequently, the examiner conducted an indirect audit. The examiner determined that the best method for computing the audit liability was to use total sales from the POS system for February 2017 and March 2017 and estimate the value of "zero-sales," transactions recorded as having no dollar value. The additional taxable measure was calculated and divided by the reported measure to determine an error rate which was then applied to all months.

The audit revealed that the Taxpayer's sales were over 50 percent underreported. Consequently, the examiner applied the 50 percent fraud penalty levied at Ala. Code § 40-2A-11(d). The Revenue Department subsequently changed the fraud penalty to a negligence penalty. Billing progressed to entry of a final assessment for Gridiron 3 on August 31, 2018, in the amounts of State sales tax of \$24,917.56, interest of \$2,442.32, and negligence penalty of \$1,245.91, for a total of \$28,605.79, and consumer use tax of \$2,861.54, interest of \$369.74, and late-filing penalty of \$286.16, for a total of \$3,517.44. For Gridiron of Centre, the State sales tax final assessment was entered on August 28, 2018, for tax of \$72,496.66, interest of \$10,672.45, and negligence penalty of \$3,624.90, for a total of \$86,794.01.

## LAW & ANALYSIS

### Extension of Assessed Period

The Taxpayers contest the extension of the assessed period to six years for Gridiron of Centre because it was not notified by the Department that the assessment was extended back six years due to underpayment in excess of 25 percent rather than due to fraud. Section 40-2A-4(a) of the Alabama Code requires the Department to notify the Taxpayer of the basis for the assessment in simple and non-technical terms.

While the Department did tell the Taxpayer that the audit was being extended under Ala. Code § 40-2A-4(b)(2), which includes both fraud and underpayment, that explanation was not in simple and non-technical terms: “The examination period of your sales tax account is being extended back to April 1, 2011 as allowed under Ala. Code 1975 § 40-2A-7(b)(2) TIME LIMITATION FOR ENTERING PRELIMINARY ASSESSMENT. A copy of this code section is included with this letter.”<sup>1</sup> (ADOR Letter to Gridiron of Centre, LLC, May 23, 2017).

When the Department subsequently issued the confidential audit report, which was the basis of the preliminary assessment, it stated therein: “The report and attached working papers serve as notification and explanation of the basis for any assessment and penalties in accordance with Section 40-2A-4(a)(3)a., Code of Alabama 1975, as amended.”

Within the confidential audit report, the Department stated “[t]he audit period was extended to April 1, 2011 because of fraud based on Section 40-2A-7(b)(2)(a).”

Additionally, the report states: “The following Sections of Law and Rules were given to the

---

<sup>1</sup> The copy of this letter furnished by the Department included the attached code section 40-2A-7 but only through subsection (b)(1). Subsection (b)(2), the pertinent language, was not included.

taxpayer as backup for any adjustments made in this examination.” And among those listed is Ala. Code § 40-2A-7. However, the supplementation of Code sections does not comport with the requirement that “the department shall provide to the taxpayer in simple and non-technical terms . . . the basis for the assessment.” Ala. Code § 40-2A-4(a)(3)(a) (emphasis added).

Therefore, the basis for the extended assessment was not properly conveyed to the Taxpayer, Gridiron of Centre, in the letter, the confidential audit report, or the addendum thereto.

As the Taxpayer points out in its Post-Hearing Brief, the remedy for the Department’s failure to properly follow the procedure at hand is the abatement of penalties rather than the voiding of the assessment. Ala. Code § 40-2A-4(c). Thus, the penalties imposed on Gridiron of Centre, LLC, for periods for which returns were filed before October 26, 2014, shall be abated for reasonable cause.<sup>2</sup> Ala. Code § 40-2A-11(h).

### **Audit Method**

The Department is authorized to compute a taxpayer’s correct liability using the most accurate and complete information obtainable. Ala. Code § 40-2A-7(b)(1)a. The Department can also use any reasonable method to compute the liability, and the taxpayer, having failed in the duty to keep good records, cannot later complain that the records and/or method used by the Department is improper or does not reach a correct result. *Jones v. CIR*, 903 F.3d 1301 (10th Cir. 1990); *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980) (holding that a taxpayer must keep records showing the business transacted, and if the taxpayer fails to keep such records, the taxpayer must suffer the penalty for noncompliance).

A taxpayer must keep an “accurate and complete set of records, books, and other information sufficient to allow the [D]epartment to determine the correct [tax due].” Ala. Code § 40-2A-7(a)(1). In this case, the Taxpayer clearly failed to keep complete or adequate records from which its sales tax liability could be properly computed. Consequently, the Department examiner computed the Taxpayer's liability using the best information available. The audits were reasonable and must be affirmed.

The auditors at both locations were not provided complete records of sales. Only records from February and March of 2017 were available as the Taxpayer had upgraded his POS system, which caused all prior months’ records to be erased. The Taxpayers’ owner testified at the hearing that he should have backed up the records prior to the update.

The auditor of Gridiron 3 had dined in the restaurant twice during February and March 2017, and she compared her receipts to the POS records. Both of her purchases were made in cash. One purchase was correctly recorded. The other purchase was listed as a zero-sale, showing no purchase was made. Thus, both auditors concluded that zero-sales were non-recorded actual sales and used an average of all recorded sales to assign a value to each zero-sale. However, these zero-sale transactions were contested during the audit.

The Taxpayer argued that some occurred when the bartender made change or put a credit card slip in the cash drawer. Those zero-sales were removed from the audit. The Taxpayer argued that “fast transactions” should not be included because they were automatically-generated transactions that were closed before any purchase was made. The auditor removed these fast transactions.

---

<sup>2</sup> The preliminary assessment for Gridiron of Centre was entered on October 26, 2017.

The Taxpayer argued that some of the zero-sale type 1 transactions occurred in too short of a time-frame to be actual sales. The auditors determined from the POS system that uncontested sales did occur in as few as three or four seconds. Nevertheless, the auditors removed all zero-sale type 1 transactions that occurred in 20 seconds or less.

The Taxpayer argued that the auditor should have compared the zero-sales to the recorded data on what food was ordered to determine which were actual sales. The auditor of Gridiron 3 admitted that such information was available but she did not examine it other than to verify her own purchase. The auditor of Gridiron of Centre was not aware that such information was available. The Taxpayer did not present that information to the Tribunal. Additionally, the Taxpayers' owner testified that there was potential for a bartender to prepare a drink order without having to enter the order in the POS.

The Taxpayer also argued that the audit should be based on the Taxpayer's financial statements, which were computed from bank records, as the Taxpayer had used the financial statements to prepare federal income tax returns. The Department found that method unreliable as it questioned whether there were other unknown bank accounts of the Taxpayer and because the Department was unable to account for all of the cash transactions. Additionally, financial statements and bank records were not made available for 2017.

The Taxpayer's owner testified that he did underreport the sales but claims not to the extent assessed. For the two restaurants, he relied on the managers to report sales to the Taxpayer's CPA. The managers reported sales as equal to bank deposits in each month. Since the audit, the Taxpayer's owner has changed the practice to reporting sales from the POS system. He believes the sales are now being reported accurately.

The auditor of Gridiron of Centre used several methods to verify the reasonableness of the audit. POS data showed the total number of sales since the restaurant opened in January 2011, which average about 5,000 sales per month. For February and March 2017, the POS data confirmed about 5,000 sales per month. The auditor averaged the amount of each sale and applied it to 5,000 sales per month. This resulted in the highest tax liability.

The auditor also took purchases from the Taxpayer's income tax return and added cash payouts recorded on the POS system. He then applied the IRS mark-up of 2.97 percent. That method resulted in the next-highest liability.

The auditor testified that often if a taxpayer is underreporting, in the month following the audit commencement the taxpayer will correct it and report a higher figure. That occurred in this case. The average sales reported for the audit period were \$65,000 per month. The month after the audit began, the Taxpayer reported \$102,000 in sales. The auditor estimated monthly sales of \$92,000. This reporting, along with the other methods presented above, confirmed in the auditor's mind that his assessment was reasonable. I agree.

The Department has shown that it used a reasonable method to determine the Taxpayers' liabilities. Without the proper records, the Department was forced to estimate sales. The Department removed many zero-sales contested by the Taxpayers despite a showing that some of those were likely actual sales.

The final assessments are affirmed. Judgment is entered against the The Gridiron 3, LLC, for State sales tax, negligence penalty, and interest of \$28,605.79, and consumer's use tax, interest, and the late-filing penalty in the amount of \$3,517.44, and against Gridiron of Centre, LLC, for State sales tax, interest, and penalties in the amount of \$86,794.01, less penalties imposed on periods for

which returns were filed prior to October 26, 2014. Additional interest is also due from the date the final assessments were entered, August 31, 2018, and August 28, 2019, respectively.

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

Entered October 22, 2019.

*/s/ Leslie H. Pitman*

\_\_\_\_\_  
LESLIE H. PITMAN

Associate Tax Tribunal Judge

lhp:dr

cc: Joshua B. Sullivan, Esq.  
Margaret Johnson McNeill, Esq.