

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petitions	:	
of	:	
<b>GUTLOVE &amp; SHIRVINT, INC.</b>	:	DECISION
for Review of a Denial, Suspension, Cancellation, Refusal	:	DTA NOS. 822533
or Revocation of a License, Permit, Appointment or	:	AND 822921
Registration under Article 20 of the Tax Law.	:	

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Petitioner, Gutlove & Shirvint, Inc., filed an exception to the amended determination issued by the Administrative Law Judge dated June 2, 2009 in the matter of the petitions<sup>1</sup> for review of a denial, suspension, cancellation, refusal or revocation of a license, permit, appointment or registration under Article 20 of the Tax Law. Petitioner appeared by Allen & Overy LLP (Michael S. Feldberg, Esq., and Brian de Haan, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Herbert M. Friedman, Jr., Esq., and Michelle M. Helm, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at the request of petitioner, was held on September 30, 2009 in Troy, New York.

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<sup>1</sup> Petitioner filed a petition dated September 25, 2008, which contested a notice of cancellation dated June 30, 2008. As detailed in the Findings of Fact, this notice of cancellation repeated word-for-word the grounds for cancellation noted in an earlier notice of *proposed* cancellation dated April 8, 2008, as well as asserting three additional grounds for cancellation of petitioner's licenses under Article 20 of the Tax Law. Petitioner also filed a petition dated March 10, 2009, which contested a Conciliation Order dated December 12, 2008 issued by the Division of Taxation's Bureau of Conciliation and Mediation Services (BCMS) denying its request for relief from the notice of *proposed* cancellation dated April 8, 2008. This later petition duplicated its petition dated September 25, 2008. The Division of Taxation then filed its answer dated March 31, 2009 in response, which duplicated its earlier answer filed in response to the petition dated September 25, 2008. These two related proceedings have now been consolidated for purposes of this determination.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Tully took no part in the consideration of this decision.

### ***ISSUES***

I. Whether the Division of Taxation is collaterally estopped from asserting that petitioner engaged in a scheme to deceive cigarette manufacturer Philip Morris in order to continue to sell Philip Morris cigarettes to a smoke shop that was a major source of bootlegged cigarettes sold in New York City despite petitioner's agreement with Philip Morris not to do so.

II. Whether the introduction of certain evidentiary material prejudiced petitioner's ability to obtain a fair hearing.

III. Whether the Division of Taxation may cancel petitioner's licenses as a New York State cigarette stamping agent, wholesale dealer and distributor.

### ***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge except for finding of fact "2" which has been modified. We have also deleted footnotes numbered 10, 11 and 14 contained in the Administrative Law Judge's findings of fact as irrelevant. The Administrative Law Judge's remaining findings of fact and the modified fact are set forth below.

1. The Division of Taxation (Division) licenses petitioner, Gutlove & Shirvint, Inc., (1) as a "stamping agent," so it may purchase and affix cigarette tax stamps on packages of cigarettes, (2) as a "wholesale dealer," with the authority to sell cigarettes or tobacco products to retail dealers or other persons for purposes of resale and to "an Indian nation or tribe or to a reservation cigarette seller on a qualified reservation," and (3) as a "distributor," who may import or cause to be imported into New York any tobacco product for sale with the authorization "to make returns and pay the tax on tobacco products sold, shipped or delivered" by it to any person in New York.

Started in 1939, petitioner was one of the first cigarette stamping agents in New York. It is now owned entirely by its corporate president, Joseph Ruda, who is a descendant of the original operators. Mr. Ruda controls all of petitioner's operations and is the sole signatory on all corporate checks. Of petitioner's approximately 50 employees, 10 to 12 are drivers, 10 to 15 perform warehouse duties, and the remainder are office staff, including a small accounting staff headed by Steven Sussner, petitioner's chief financial officer, who was hired by Mr. Ruda in late 2006. Petitioner also utilizes 10 to 15 nonemployee commission salespeople. In addition to cigarettes and tobacco, petitioner wholesales candy and confections. It maintains an inventory worth approximately \$6,000,000.00, which it turns over 30 to 40 times a year while filling more than 75,000 orders a year and doing approximately \$260,000,000.00 worth of business annually, although its actual profit margin is relatively narrow.

We modify finding of fact "2" of the determination to read as follows:

2. As a wholesale dealer, petitioner was a major supplier of cigarettes to "Indian nations or tribes or reservation cigarette sellers on qualified reservations." Its sales to such customers for the month of January 2008, as an example, which it reported on a Schedule E, Sale of Cigarettes to Dealers/Vendors on American Indian Reservations, totaled nearly 90 million cigarettes (4.5 million packs) to 16 dealers/vendors. Cigarettes are then sold tax free on tribal lands in New York.<sup>2</sup>

3. The Division's Registration, Bond and Cigarette Unit, within the Transaction and Transfer Tax Bureau/Fuel, Alcohol, Cigarette and Carrier Tax Section (TTTB/FACCTS) of the Audit Division, issued a "Notice of *Proposed* Cancellation of Your Licenses as a Cigarette Stamping Agent & Wholesale Dealer, Distributor and Wholesaler of Tobacco Products Under Article 20 of the New York State Tax Law" (emphasis added) dated April 8, 2008 to petitioner,

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<sup>2</sup>We modified this fact to delete extraneous commentary.

Gutlove and Shirvint, Inc. This notice provided the following explanation for the *proposed* cancellation of petitioner's licenses:

1. You violated Tax Law § 480.3 and 20 NYCRR §§ 71.6 and 72.3 by committing fraud or deceit in the operation of your cigarette agency or wholesale dealer business. On December 20, 2007 you signed an agreement with Philip Morris acknowledging that you would no longer supply Philip Morris products directly or indirectly to Peace Pipe Smoke Shop. On at least (5) five separate occasions after that date you conspired and participated in a scheme with AJ's Candy and Tobacco to circumvent the December 20, 2007 agreement and supply Philip Morris product directly or indirectly to Peace Pipe Smoke Shop.
2. You violated Tax Law § 474.4 and 20 NYCRR § 75.5 by providing false and/or inaccurate information on invoices for the sale of cigarettes during February and March 2008. Specifically, your invoices during this period falsely listed product being sold to Diane Anderson, Adlai's Smoke Shop, Spirit Smokes and Native Smokes.
3. You violated Tax Law § 475 and 20 NYCRR § 75.1 by providing false information on your CG-6, Resident Agent Cigarette Tax Report with respect [to] Schedule E- Sales of Cigarettes to Dealers/Vendors on American Indian Reservations and certified the information was true and correct.
4. A couple of months after its issuance of the notice of *proposed* cancellation detailed above, the Registration, Bond and Cigarette Unit within TTTB/FACCTS decided to *cancel* petitioner's licenses due to its belief that the assessment or collection of cigarette tax "will be jeopardized" unless the licenses were canceled immediately. Accordingly, it issued a "Notice of *Cancellation of Your Licenses as a Cigarette Stamping Agent & Wholesale Dealer, Distributor and Wholesaler of Tobacco Products Under Article 20 of the New York State Tax Law*" (emphasis added) dated June 30, 2008 to petitioner. This cancellation notice restated word-for-word the three grounds detailed above in the notice of *proposed* cancellation, as well as three additional grounds related to petitioner's involvement in shipments of cigarettes by Wholly Smokes of Kentucky, Inc.:

1. You violated Tax Law § 480.3 (a)(iii) by knowingly aiding and abetting Wholly Smokes of Kentucky, Inc. in the importation of at least 3750 cartons of unstamped cigarettes into New York State destined for 39-26 23<sup>rd</sup> St., Long Island City, NY 11101.

2. You violated Tax Law § 480.3 and 20 NYCRR §§ 71.6 and 72.3 by committing fraud or deceit in the operation of your cigarette agency and/or wholesale dealer business by failing to notify the Department pursuant to Regulation § 72.1(c)(1) that you were carrying on another business in conjunction with your warehouse facility as required in [Tax Law §] 480.1(d).

3. You violated Tax Law § 480.3(a)(ii) by failing to comply with [Tax Law] §§ 480.1(d) and 483(a)(2) with regard to maintaining a separate warehousing facility for the purpose of receiving and distributing cigarettes and conducting your wholesale business as product invoiced to Wholly Smokes of Kentucky, Inc. is being shipped to your warehouse located at 39-26 23<sup>rd</sup> Street, Long Island City, NY 11101.

5. On July 1, 2008, in conjunction with its issuance of the cancellation notice, the Division shut down all of petitioner's cigarette related business operations, which petitioner immediately challenged by seeking a temporary restraining order in a court action in the New York State Supreme Court, Queens County, which was denied. On July 7, 2008, Justice John M. Leventhal, Associate Justice of the Appellate Division, Second Judicial Department, reversed the earlier order by the Queens County trial court and issued a temporary restraining order staying the Division's cancellation of petitioner's licenses and thereby ordering the Division to refrain from further interference with petitioner's cigarette related business operations pending an administrative hearing in the Division of Tax Appeals.

6. On September 8, 2008, petitioner and the Division entered into a stipulation staying the cancellation of petitioner's licenses pending a hearing on the merits in the Division of Tax Appeals of the six grounds asserted for the cancellation of petitioner's licenses. Pursuant to this stipulation, the parties agreed that a request would be made of the Division of Tax Appeals (1) to provide an "expedited hearing," and (2) to have the Administrative Law Judge "render a

determination within 30 days from the date of . . . [the last brief filed] *as is practicable*,” and (3) if petitioner takes an exception to the Administrative Law Judge’s determination to the Tax Appeals Tribunal that “the Tribunal shall be requested to issue its determination within three months from the date of the filing of the exception to the ALJ’s determination [emphasis added].”<sup>3</sup>

*Petitioner and Peace Pipe Smoke Shop*

7. As a wholesale distributor of cigarettes and tobacco, as noted in finding of fact 2, petitioner is one of the principal suppliers of non-tax paid (unstamped) cigarettes<sup>4</sup> to cigarette wholesalers and vendors located on Native American reservations in New York. Its sales to such customers are among the hundreds of thousands of orders petitioner receives each year.<sup>5</sup> Peace Pipe Smoke Shop, a cigarette wholesaler and vendor located on the Poospatuck Reservation in Mastic on Long Island, was one of petitioner’s largest customers, and petitioner has had a long-term business relationship with this smoke shop. In fact, petitioner received orders from Peace Pipe Smoke Shop every day. Peace Pipe Smoke Shop, in addition to being a brick and mortar retailer on a Native American reservation, had a large internet cigarette business and also accepted orders over the telephone. Although petitioner sold cigarettes produced by a variety of

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<sup>3</sup>Although there is no explicit language in the Tax Law requiring the expedited issuance of a determination after a hearing with reference to a notice of cancellation of a license under Article 20, the Administrative Law Judge agreed to treat this proceeding as a “quasi-expedited” matter in conformance with the parties’ stipulation (*cf.*, Tax Law § 480[b] [which, in contrast, *specifies* an expedited time frame with reference to a notice of proposed refusal to license]). The Tax Appeals Tribunal declined to follow this expedited schedule.

<sup>4</sup> As a stamping agent, petitioner is permitted to possess and otherwise deal in cigarettes on which taxes have not been paid and which do not bear the New York tax stamps that evidence such payments. Such cigarettes are commonly referred to as “non-tax paid cigarettes.”

<sup>5</sup> According to petitioner’s chief financial officer, petitioner maintains a money room with currency and coin counters because “hundreds of thousands of dollars a day” are processed and deposited daily because “at least 50 percent or a little bit more of the money that we collect is in the form of cash” (tr., pp 624-625).

manufacturers, a large share of its total sales were of Philip Morris, USA, Inc. (Philip Morris) products, which include the most popular of all cigarette brands, Marlboro cigarettes.

Approximately 40% of petitioner's sales to Peace Pipe Smoke Shop were of Philip Morris cigarettes. This smoke shop and major customer of petitioner had been the subject of law enforcement activity related to its cigarette sales, notably sales of large amounts of non-tax paid cigarettes to bootleggers that were regularly shipped into the New York City market.

8. With reference to *retail* sales of cigarettes on Native American reservations, the Division has had a policy of "forbearance."<sup>6</sup> However, with reference to *wholesale* sales of cigarettes on Native American reservations, the Division did not apply its "forbearance" policy, but rather sought to limit such wholesale sales so as to impede the bootlegging of non-tax paid cigarettes. Philip Morris, aware of the law enforcement activity<sup>7</sup> related to Peace Pipe Smoke Shop and fearful that it might be accused of aiding and abetting the bootlegging of non-taxed cigarettes into New York City, advised petitioner by a letter dated December 7, 2007 that it would no longer sell its products to wholesalers that supply its cigarettes "directly or indirectly"

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<sup>6</sup> This policy of forbearance by the Division in its enforcement of Article 20 with respect to on-reservation retail sales of cigarettes to non-Native American consumers was upheld based upon the conclusion that it did not violate the equal protection rights of off-reservation retailers (*New York Assoc. of Convenience Stores v. Urbach*, 275 AD2d 520, 712 NYS2d 220 [3<sup>rd</sup> Dept 2000], *appeal dismissed* 95 NY2d 931, 721 NYS2d 606 [2000], *lv denied* 96 NY2d 717, 730 NYS2d 790 [2000], *cert denied* 534 US 1056 [2001]). Nonetheless, it is observed, as noted in finding of fact 2, that smoke shops on Native American reservations in New York sold nearly 304 million packs of cigarettes in 2007- nearly a third of New York's total. The Poospatuck reservation where the Peace Pipe Smoke shop was located, with a population of about 270, accepted shipment of about 100 million packs of cigarettes in 2007. New York put its losses at more than \$576 million in a study released in 2006, which is prior to the latest substantial increase in the level of cigarette tax. Nonetheless, despite such forbearance, Chief Investigator Patrick Simet of the Division's Petroleum, Alcohol and Tobacco Bureau stated clearly and forcefully at the hearing: "If they're being sold at a wholesale level to non-Indians, it violates [the] law. If they're being sold over the internet, it violates [the] law. The only sales that are allowed by law would be a Native American to another Native American for their [sic] own personal use on the reservation where the sale took place" (Tr., p. 900).

<sup>7</sup> Persons associated with Peace Pipe Smoke Shop, defendants in two actions filed in federal court by the United States, were charged with sales of large amounts of non-tax paid cigarettes that were regularly shipped into New York City in violation of the Contraband Cigarette Trafficking Act (18 USC § 2341 *et seq.*), among other crimes (including orchestrating the 2003 murder of an associate who opened a competing store). As of the hearing dates for this proceeding, these actions were ongoing.

to Peace Pipe Smoke Shop. In order to continue its purchases of Philip Morris product, petitioner provided Philip Morris with a written acknowledgment, dated December 20, 2007, executed by its president, Joseph Ruda, stating that it would no longer supply “directly or indirectly” Philip Morris product to Peace Pipe Smoke Shop, given the ongoing criminal prosecution of this Long Island Native American smoke shop. This embargo on the sale of Philip Morris products to Peace Pipe Smoke Shop represented a major loss of business for petitioner and prompted petitioner to devise a plan to circumvent the restriction. Further pressure was placed upon petitioner’s operations by demands made by Philip Morris that it “must bring up our ratio from 40% to a minimum of 60% or lose direct account status,” which permits it to purchase non-tax paid cigarettes directly from Philip Morris. The use of the term “ratio” refers to the ratio of sales to buyers who are viewed as “qualified” by Philip Morris as a percentage of petitioner’s total sales, which would include its sales to buyers who are viewed as “non-qualified” by Philip Morris. “Non-qualified” sales would be sales by petitioner to (1) internet sellers, (2) nondirect and nonreporting distributors (distributors who do not report their sales of cigarettes to Management Science Associates,<sup>8</sup> who “do the data mining and send all the demographics for each store that we sold back to all the vendors or manufacturers [including Philip Morris],” and (3) retail outlets that are in excess of a 10,400 carton per quarter cap. This concern on the part of Philip Morris to control sales to “non-qualified” buyers reflects a desire to operate with some responsibility in its manufacture and sale of cigarettes to its wholesalers so as to exert some control over the potential bootlegging of its product and to limit sales of its cigarettes to consumers without the required imposition and collection of taxes.

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<sup>8</sup> Management Science Associates is a reporting agency used by manufacturers of cigarettes so they can track the sales and purchases of cigarettes.



9. The scheme devised by petitioner in order to continue its sale of Philip Morris brand cigarettes to Peace Pipe Smoke Shop involved the utilization of a cigarette wholesaler/vendor located on a Seneca Native American reservation<sup>9</sup> in the Buffalo area: AJ's Candies and Tobacco [AJ's Candies] operated by Alyse Pierce.<sup>10</sup> AJ's Candies is a wholesale business that does not have an actual storefront, but rather wholesales cigarettes mostly to other smoke shops on the Cattaraugus reservation. Cigarette sales were documented to appear as sales to this Buffalo area cigarette wholesaler located on a Native American reservation, when in fact the cigarettes were merely shipped first to the Buffalo area and then reshipped to Peace Pipe Smoke Shop on Long Island. AJ's Candies, in Chief Investigator Patrick Simet's words, would "place a small markup, I think 50 cents a carton, on the order to pay for AJ's cost to deliver it, handle it and a small profit margin . . ." (Tr., pp 396-397). Petitioner arranged these transactions and knew that Peace Pipe Smoke Shop was the ultimate purchaser. Money was wired from a bank account of AJ's Candies to petitioner for the product and then money was wired from a Peace Pipe Smoke Shop bank account to an account of AJ's Candies to pay for the product again. Care was taken to vary slightly the exact amount of the product in order to deceive anyone who might audit the trail of deceptive sales documents. In addition, Peace Pipe Smoke Shop, to make the deal more appealing to Ms. Pierce's enterprise, would order native brand cigarettes such as cigarettes called

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<sup>9</sup> The Seneca Nation of Indians has three reservations in Western New York: (1) a very small reservation known as Oil Spring Reservation; (2) the Allegany Reservation in the Saranac, New York, area where there are approximately a hundred or more smoke shops and/or cigarette retailers; and (3) the Cattaraugus Reservation in the Irving and Silver Creek, New York, area where there are also another hundred or so smoke shops and/or cigarette retailers. AJ's Candies was located on the Cattaraugus Reservation in the area of Irving, New York.

<sup>10</sup> Alyse Pierce is also referred to in the administrative record as Alyse Pierce Eggleston and Alyse Eggleston Pierce. Pierce is her given name, and Eggleston was a married name given up after a divorce. In this determination, she has been referred to as Alyse Pierce.

Native and Seneca, which are made by Native Americans and carried by AJ's Candies in its own inventory.

10. Petitioner would fill the orders of the Buffalo area cigarette vendor at its Long Island City warehouse and use its own trucks to ship the cigarettes north to the Buffalo area, in carrying out an arrangement that constituted a sham. Upon arrival of the cigarettes, they would be unloaded from petitioner's trucks and reloaded onto other trucks under the control of the Buffalo area vendor for transport, generally on the same day, to Peace Pipe Smoke Shop on Long Island. The cigarettes for Peace Pipe Smoke Shop were separately wrapped and palletized by petitioner before shipment north to the Buffalo area. There were at least eight of these sham shipments of cigarettes as follows:

Shipment Number	Number of Cartons of Non-Tax Paid Cigarettes Shipped by Petitioner	Date of Shipment
1	2760	01/15/08
2	6510	01/22/08
3	1860	02/05/08
4	9900	02/12/08
5	8730	02/19/08
6	8010	02/26/08
7	8385	03/04/08
8	6450	03/11/08 <sup>11</sup>

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<sup>11</sup> Shipments 4 through 8 were reshipped to Peace Pipe Smoke Shop via undercover state investigators in a truck rented by them. On March 12, 2008, when the shipment was reshipped from AJ's Candies to Peace Pipe Smoke Shop in a truck that was driven by Tax Department employees acting as undercover agents, a seizure was staged in order to obtain damaging evidence against petitioner by recording the conversation where Joseph Ruda learns of the seizure from Alyse Pierce. As noted in finding of fact 11, the state obtained the damaging evidence it was seeking in order to establish its case.

11. It was only after the third shipment noted above that federal and New York State authorities became aware of the scheme, as the result of the decision by Gary Sanden, Commissioner of the Seneca Nation of Indians Import-Export Commission, to inform the authorities. On February 8, 2008, Investigator Patrick Simet and Special Agent Steve Dickey of the Federal Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) interviewed Alyse Pierce and Diane Anderson, in the presence of Seneca Nation Commissioner Sanden, and uncovered the scheme. Some very damaging information was obtained concerning the careful and misleading steps taken by petitioner to deceive Philip Morris and law enforcement, as well as the fact that petitioner's principal, Joseph Ruda, was the mastermind behind the scheme, including the following:

1. Petitioner's sales agent, Rodney Flores, instructed Alyse Pierce "to start adding some non Philip Morris product such as Newports and Rogers to the Peace Pipe orders" since Flores "was concerned that Philip Morris would be suspicious of orders for just Marlboro products;"
2. Alyse Pierce was instructed that she should not visit petitioner's premises "because [Joe] Ruda felt the facility was being watched by Law Enforcement;"
3. Rodney Flores noted to Alyse Pierce that "everything has to be approved by Joe [Ruda]."

After informing law enforcement, Alyse Pierce, beginning with the fourth shipment noted above, began working with state and federal law enforcement as an unpaid informant to establish a case against petitioner. ATF decided to allow what it termed a "conspiracy" to continue so "they could learn more about the conspiracy and have the opportunity to gain further evidence against the people committing this conspiracy" (Tr., p. 409). In fact, ATF would take responsibility for delivering the cigarettes down to Peace Pipe Smoke Shop using undercover New York State personnel employed by the Division's Petroleum, Alcohol and Tobacco Bureau. Alyse Pierce

assisted the authorities in making recordings of her conversations with petitioner's principal, Joseph Ruda, and others related to petitioner, including Rodney Flores, a long-term sales agent for petitioner as well as individuals involved with the operation of Peace Pipe Smoke Shop. Initially, the Division resisted the disclosure of these recordings to petitioner since they were part of a criminal investigation being conducted by federal authorities. Ultimately, the Division offered the recordings and transcripts of the conversations into evidence over the objection of petitioner. The recordings are damaging to petitioner and establish that Joseph Ruda was the mastermind of the scheme to continue to supply Philip Morris cigarettes to Peace Pipe Smoke Shop despite petitioner's signed agreement to cooperate with the cutting off of such product to this smoke shop. Mr. Ruda, in several conversations, showed his intense concern to conceal his personal involvement in the scheme, noting that if the truth of his involvement became known, "This would be a disaster for me" (Conversation # 28 on March 12, 2008). When the eighth shipment of cigarettes noted in finding of fact 10 was seized in Nassau County on March 12, 2008 by the state investigators upon the reshipment to Peace Pipe Smoke Shop, Mr. Ruda was recorded telling Ms. Pierce not to worry because he would make good on the more than \$100,000.00 worth of cigarettes that had been seized. Petitioner would replace the load at no cost to Ms. Pierce.<sup>12</sup> Further, these recorded conversations establish that petitioner, by this scheme, was "the only source of Philip Morris" for Peace Pipe Smoke Shop, in the words of Peace Pipe Smoke Shop's employee identified as Jennifer (Conversation # 29 on March 12, 2008). These recordings also clearly show that Mr. Ruda was extremely calculating, valuing his

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<sup>12</sup> However, petitioner by Joseph Ruda never made good on this promise after Mr. Ruda received legal counsel to not make a move because something more was going on. In the taped conversations, Mr. Ruda "explained that his attorneys talked to Alyse's attorney and red flags – red lights . . . went off and he was advised by his attorneys don't make a move. There's something more to it" (Tr., pp. 893-894).

lawyer's relationship with former Governor Spitzer as a way to prepare for changes in the state's policy of forbearance. He had been advised by legal counsel that there was nothing illegal about sales between one sovereign nation (Seneca Nation vendors in the Buffalo area) to another sovereign nation (smoke shop located on the Poospatuck Nation's Long Island reservation), which provided a "legal" patina for his scheme: Non-tax paid (unstamped) cigarettes could flow freely between the two sovereign Native American nations so long as there was paperwork to support such flow. As noted above, care was taken so that additional cigarettes (nonpremium tiers of cigarettes) were added out of AJ's Candies' own stock to the cigarettes supplied by petitioner before reshipment to Peace Pipe Smoke Shop in order to make the paper trail of sales transactions more difficult to follow, since they would not be "mirror images." However, the Seneca Nation was not willing to be used in this way, resulting in the undercover operation as noted above.

12. A difficulty faced by petitioner with respect to its scheme to continue supplying Philip Morris product to Peace Pipe Smoke Shop related to the fact that Philip Morris restricts the number of cartons that a wholesale distributor, like petitioner, can sell to a *single* vendor like AJ's Candies. Preferred wholesale prices, which provide a wholesaler with a significantly larger profit, are available only for sales by the wholesaler to a single retail account that do not exceed 10,000 cartons per quarter or 40,000 cartons per year. This restriction was the result of the desire of Philip Morris to place an allotment on all Native American smoke shops of 10,000 cartons per quarter "because [Philip Morris] knew that the amount of product going to the Native American reservations wasn't being consumed by Native Americans. They knew there was a problem with bootlegging" (Tr., p. 410). As a result, petitioner sought to utilize additional cigarette vendors on Native American reservations in the Buffalo area in order to preserve the favorable prices from

Philip Morris: shipment 4 noted in finding of fact 8 was shown on petitioner's invoice as a shipment to Diane Anderson, d/b/a Heron's Landing; shipment 6 was shown on petitioner's invoice as a shipment to Adlai's Smoke Shop; shipment 7 was shown on petitioner's invoice as a shipment to Spirit Smokes; and shipment 8 was shown on petitioner's invoice as a shipment to Native Smokes. The cigarettes shipped by petitioner to the Buffalo area were never paid for by the other named entities. Rather, Alyse Pierce of AJ's Candies paid for the product.

13. When Philip Morris became aware of petitioner's scheme to continue supplying its product to Peace Pipe Smoke Shop, it terminated all direct sales of its Philip Morris brand cigarettes to petitioner by a notice issued on April 7, 2008 by Ross Webster, Philip Morris Vice President, Customer Service and Merchandising. According to this notice:

We have learned of the complaint filed by the City of New York against Gutlove & Shirvint, alleging that Gutlove & Shirvint made sales to Peace Pipe Smoke Shop that are in violation of the Contraband Cigarette Trafficking Act . . . . Such sales also contradict your representation to us on December 20, 2007 that Gutlove & Shirvint would not, directly or indirectly, supply Philip Morris USA products to Peace Pipe Smoke Shop.

*Petitioner and Wholly Smokes of Kentucky, Inc.*

14. With the termination of all direct sales by Philip Morris to petitioner, petitioner's principal devised a creative plan to continue to obtain at least some Philip Morris product. By an application dated July 1, 2008, petitioner's principal, Joseph Ruda, in his capacity as president of Wholly Smokes of Kentucky, Inc., applied for a State of Kentucky cigarette license as an "unclassified acquirer" and "transporter." On this Kentucky application, Mr. Ruda provided the Long Island City address of petitioner as the "location of business" for Wholly Smokes of Kentucky, Inc., as well as petitioner's telephone number as the Kentucky entity's telephone number. For "area of distribution," which required Mr. Ruda to "list states other than Kentucky

in which cigarettes will be distributed,” he noted “NY.” For the “cigarette supplier” to be utilized by the applicant, Mr. Ruda named AA of Tupelo, Mississippi, doing business as Globe Distributing. Petitioner then utilized Wholly Smokes of Kentucky, Inc., to purchase Philip Morris brand cigarettes from Globe Distributing.

15. In the opinion of Emanuel Urzi, who has been an employee of the Division for 46 years and who has served as the director of the Cigarette Tax Bureau and currently serves as the Special Assistant to William Comiskey, the Deputy Commissioner for Enforcement, there were “no business reasons” for petitioner’s principal to form Wholly Smokes of Kentucky, Inc., and five or six other similar entities.<sup>13</sup> According to Mr. Urzi, given the substantial New York taxes on cigarettes and heavy regulation of cigarettes in the state, New York must be able to monitor and control all cigarettes brought into New York, which was undermined by petitioner’s principal creating “a source of cigarettes outside the control of New York State taxing authorities” (Tr., p. 90). Further, according to Mr. Urzi, two cigarette businesses cannot be operated under one roof because “it becomes impossible for [the State] to affix responsibility as to ownership of the product” (Tr., p. 87). Mr. Urzi noted that the Division proceeded with an immediate Notice of Cancellation dated June 30, 2008, instead of merely a *proposed* cancellation, because with the establishment of the Wholly Smokes entities in other states by petitioner’s principal and the use of Wholly Smokes of Kentucky, Inc., to bring cigarettes into New York, the Division feared that

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<sup>13</sup> Other similar sister corporations were formed as Wholly Smokes of Florida, Inc., Wholly Smokes of Kansas, Inc., Wholly Smokes of No. Carolina, Inc., and Wholly Smokes of Oklahoma, Inc. According to the testimony of Steven Sussner, petitioner’s chief financial officer, Joseph Ruda asked “me to work on setting up corporations, if appropriate, in various states which had Native American reservations on them for the purpose of being able to . . . sell them Native American brands and sell cigarettes to them (Tr., p. 635). However, there was no evidence introduced to show that any of these Wholly Smokes entities were ever used for such purpose. Rather, the sole use of *any* of these entities consisted of petitioner’s using Wholly Smokes of Kentucky, Inc., in order to obtain Philip Morris product in light of the termination of all direct sales to petitioner by Philip Morris on April 7, 2008, as detailed in finding of fact “14.”

it could no longer “be sure as to the safeguarding of our revenue since we were now denied third-party information [from manufacturers or other states] to verify receipt of cigarettes in this state” (Tr., pp. 106-107).

16. During a regulatory inspection of petitioner’s Long Island City warehouse on May 22, 2008, Investigator Janet Mullins was concerned when she saw Philip Morris product in petitioner’s warehouse because she knew that Philip Morris had barred petitioner from purchasing its product because of the Peace Pipe Smoke Shop scheme. As a result, she “requested and received invoices for the past two months on which Philip Morris product was ordered and delivered,” including an invoice dated May 19, 2008 of A & A of Tupelo, Inc. d/b/a Globe Distributing of Tupelo, Mississippi, showing Philip Morris product billed to Wholly Smokes of Kentucky, Inc., 2333 Alexandria Drive, Lexington, KY, and shipped to Wholly Smokes of Kentucky, Inc., 39-26 23<sup>rd</sup> Street, Long Island City, NY. This invoice itemized over 3,000 cartons of Marlboro cigarettes. Petitioner’s record of its wire transfers shows that it did not pay Wholly Smokes of Kentucky, Inc., for the cigarettes shown on the invoice until May 23, 2008, four days after the invoice’s date and a day after the regulatory inspection. Consequently, it is reasonable to make a finding that 3,000 cartons of Marlboro cigarettes as noted on the invoice of the Mississippi cigarette distributor to Wholly Smokes of Kentucky, Inc., were in petitioner’s warehouse on May 22, 2008, the date of the inspection with title to these cigarettes still in the Kentucky entity’s name. Therefore, unstamped product was introduced into New York by a Mississippi cigarette distributor and delivered to Wholly Smokes of Kentucky, Inc., at petitioner’s Long Island City facility. Little weight can be given to the invoice dated May 22, 2008 from Wholly Smokes of Kentucky, Inc., to petitioner since it was not available for the



inspector's review on May 22, 2008, the date of her inspection, especially since it was created on petitioner's own computers and the date could have been manipulated.

17. As part of an ongoing investigation with the Nassau District Attorney's Office, state investigators conducted surveillance on June 6, 2008 in and around petitioner's warehouse location in Long Island City. A tractor trailer with a delivery manifest indicating the delivery of Marlboro cigarettes to Wholly Smokes of Kentucky, Inc., 39-26 23<sup>rd</sup> Street, Long Island City, NY 11101, by a shipper identified as Globe Wholesale Inc., Tupelo, Mississippi, was stopped. The investigators seized 3,750 cartons of cigarettes.

#### ***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

At the outset, the Administrative Law Judge addressed the procedural issues raised by petitioner. The Administrative Law Judge concluded that the Division was not collaterally estopped from asserting facts concerning the Peace Pipe Smoke Shop scheme in this administrative proceeding. The Administrative Law Judge stated that the proceeding at issue in the federal court action was for a violation of a federal statute, whereas in this proceeding, the issue was whether the notice of cancellation was proper. Additionally, the Administrative Law Judge found that there was not an identity of parties, which is required in order for collateral estoppel to be applied.

The Administrative Law Judge then laid the foundation for his permitting the introduction into evidence of the tape recorded conversations that involved Joseph Ruda. The Administrative Law Judge noted that the tape recorded conversations were a pivotal piece of the Division's case against petitioner and that to refuse such recordings into evidence would amount to an "abuse of discretion" (conclusion of law "D," Determination of the Administrative Law Judge). The Administrative Law Judge discussed the public policy concerns surrounding the law and

regulations that control the cigarette industry and explained that to refuse to accept the conversations into evidence would be a disservice to the Division's enforcement of the Tax Law.

In turning to the merits of the case, the Administrative Law Judge noted that the statute provides that a license may be cancelled for knowingly aiding and abetting another person in violating any of the provisions of Article 20 (*see*, Tax Law § 480[3]). The Administrative Law Judge found that there existed ample evidence that petitioner was involved in an elaborate scheme to provide non-tax paid cigarettes to Peace Pipe Smoke Shop. The Administrative Law Judge determined that petitioner's scheme amounted to committing fraud and deceit with respect to its agreement with Philip Morris that petitioner would not provide any product to Peace Pipe.

Moreover, the Administrative Law Judge found that petitioner knowingly aided and abetted Wholly Smokes of Kentucky, Inc. with the importation and possession of non-tax paid cigarettes in New York, with product invoiced to Wholly Smokes found in its warehouse, which was a violation of the requirement that petitioner must maintain a secure and separate warehousing facility, and that petitioner failed to notify the Division of such usage of its warehouse by its sister corporation.

Based upon the totality of the evidence adduced at hearing, the Administrative Law Judge determined that the State properly cancelled petitioner's Licenses as a Cigarette Stamping Agent & Wholesale Dealer, Distributor and Wholesaler of Tobacco Products.

### ***ARGUMENTS ON EXCEPTION***

In its exception, petitioner continues to argue that the Division is collaterally estopped from asserting claims against it arising from the Peace Pipe Smoke Shop scheme to the extent that the Division was permitted to introduce evidence into the record that it had previously withheld from petitioner on the basis of a claim of privilege. Petitioner claims that the tape

recorded conversations of Alyse Pierce were improperly admitted since the Division previously withheld the tapes from mandatory disclosure on the basis that the tapes were protected by privilege.

Petitioner further takes exception to the Administrative Law Judge's characterization of its operations as a scheme or a sham. Petitioner objects to the Administrative Law Judge's commentary on the dangers of smoking and what it characterizes as the Administrative Law Judge's overly broad interpretation of the law and regulations based upon what the Administrative Law Judge stated was a reflection of the "societal need to regulate cigarettes and control their consumption" (Petitioner's exception, ¶ 10, unnumbered p. 3).<sup>14</sup>

Petitioner asserts that many of the Administrative Law Judge's rulings on the admissibility of certain evidence, which evidence it claims was not made available to it prior to the hearing, deprived petitioner of the opportunity to present a meaningful defense to the claims against it.

Petitioner continues to stress that it has always been completely open and cooperative in all of its dealings with the Division. Petitioner states that it filed every report required and disclosed its sales to AJ's Candies and Peace Pipe, as well as its purchases from Wholly Smokes. Thus, it argues that the Division's action to cancel its licenses was arbitrary and capricious.

In opposition, the Division urges us to sustain the determination of the Administrative Law Judge. The Division states that petitioner violated the statute with respect to its Peace Pipe

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<sup>14</sup>We must address the overwhelming dicta contained within the determination as issued below. Clearly, the health issues involving the dangers of smoking are well known. However, the public policy issue surrounding the cigarette industry is not at the heart of this proceeding. As such, it is improper, as a quasi-judicial administrative body, to provide extraneous commentary on facts and issues that fall outside the focus of this proceeding, which is whether petitioner's licenses were properly cancelled due to its actions. Therefore, we find that the dicta concerning the cigarette industry was unnecessarily included in the determination below and has been disregarded by us in rendering this decision.

Smoke Shop scheme by engaging in fraud and deceit in its operations, by providing false information on its invoices and by providing false information on its cigarette tax returns.

In addition, the Division notes that petitioner also committed numerous violations arising from its operations with Wholly Smokes. The Division states that through its purchases from Wholly Smokes, petitioner knowingly aided and abetted another person in violation of Article 20, violated Tax Law § 480.1(d) by failing to maintain a secure and separate warehouse, and failed to notify the Division of any change to its license application.

In response to petitioner's claims with respect to the procedural issues addressed by the Administrative Law Judge, the Division argues that petitioner's assertions are unsupported in the law and are factually inaccurate. The Division states that the record demonstrates that petitioner committed each and every one of the violations that were cited in the Notices of Cancellation, which shows a blatant disregard for the Tax Law and regulations. Thus, the Division requests that the Notices of Cancellation be sustained.

### ***OPINION***

We affirm the determination of the Administrative Law Judge.

Tax Law § 480(3) provides, in relevant part, as follows:

(a) Acts of licensee. The license of any wholesale dealer<sup>15</sup> may be cancelled . . . upon:

\* \* \*

(ii) Its failure to comply with *any* of the provisions of this article or article twenty-A [Cigarette Marketing Standards] of this chapter or *any rule or regulation* adopted pursuant to this article or article twenty-A of this chapter by the department or the commissioner . . .

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<sup>15</sup> Pursuant to Tax Law § 472(1), the provisions of Tax Law § 480 relating to the cancellation of licenses of wholesale dealers are made applicable to cigarette stamping agents' licenses.

(iii) Its *knowingly aiding and abetting another person* in violating *any* of the provisions of this article or article twenty-A of this chapter or *any rule or regulation* adopted pursuant to this article or article twenty-A of this chapter by the department or the commissioner . . .

(b) Acts of licensee or controlling person. A license may be cancelled . . . if the [commissioner] determines that a licensee or any *controlling person*:

(i) Commits *fraud or deceit in his or its operations* as a wholesale dealer . . . (emphasis added).

The regulations mirror the above broadly defined statutory grounds for cancellation of a wholesale dealer's license at 20 NYCRR 72.3 and of a cigarette stamping agent's license at 20 NYCRR 71.6, and specifically provide that the determination for cancellation "will be made by the department *on the basis of the circumstances in each case*" (emphasis added). Further, the regulations specify that "[t]he relationship which exists between the department and a licensed cigarette agent must, at all times, be one of *good faith and cooperation*," and that "[a]s a licensee of the State, an agent is responsible for the *honest and expeditious payment and collection of the cigarette tax*" (20 NYCRR 71.1[a][ii], emphasis added).

We begin by addressing the Peace Pipe Smoke Shop scheme orchestrated by Mr. Ruda. Petitioner's attempt at characterizing such deceptive activities as a private matter between it and a third party, i.e. Philip Morris, without any impact on its status as a cigarette licensee, is wholly disingenuous and flies in the face of the Tax Law and regulations.

The record before us is replete with evidence of a well-calculated scheme that cannot be explained away by semantics. Petitioner used AJ's Candies as the alleged purchaser of Philip Morris products through petitioner when, in fact, it was Peace Pipe Smoke Shop that was obtaining the product surreptitiously. The evidence in the record demonstrates that petitioner would supply Peace Pipe Smoke Shop with the ordered product by shipping it to AJ's Candies,

which placed the order on behalf of Peace Pipe Smoke Shop, in violation of petitioner's agreement with Philip Morris.

In fact, Mr. Ruda did not expressly deny involvement in this scheme, but rather, argued that his actions only affected Philip Morris and implied that his dishonest business practices have no impact on his commission of a fraud against the State of New York. In essence, he claims that he can cheat anyone in his business dealings and maintain his license. Clearly, such action is contrary to the law and public policy.

Tax Law § 480(3)(b)(i), as quoted above, provides for the cancellation of a license for committing fraud or deceit in a licensee's operations as a wholesale dealer. Clearly, petitioner's operations are fraudulent and deceptive with respect to its relationship with Philip Morris. We reject petitioner's argument that the deceit or fraud must be only toward the Division to qualify as a grounds for cancellation. Petitioner construes the statute much too narrowly. Given the public policy concern in regulating the cigarette industry, it would be a nonsensical result to have petitioner only act in good faith in its dealings with the Division, while authorizing or acquiescing to petitioner's deceptive tactics in all of its other business dealings. Clearly, such a result was not intended. Furthermore, if the statute was intended to explicitly refer to the dealings between a wholesale dealer and the Division, such clarifying language would have been included in the statute.

As set forth in the findings of fact, the Division stated six separate violations that resulted in its decision to cancel petitioner's licenses. Any of the six grounds would justify the notices of cancellation. In this case, the Administrative Law Judge concluded that the record made at the hearing included ample evidence to sustain every ground asserted by the Division for cancellation. We find that the Administrative Law Judge addressed each ground outlined in the

notice and adequately concluded that the Division's action to cancel the licenses was appropriate. We agree and we rely on the Administrative Law Judge's thorough analysis and conclusions with respect to the remainder of the grounds set forth in the notice of cancellation.

We reject petitioner's argument that it was prejudiced by the admission of certain evidence into the record. As stated by the Administrative Law Judge, it is important to note that this proceeding is administrative in nature and not a criminal proceeding. As such, the standard of proof is not as high and there is no jury to be prejudiced by the testimony. Therefore, once the Division established a reasonable basis for its action, the burden of proof shifted to petitioner to show error on the part of the Division in issuing the notices (*see*, State Administrative Procedure Act § 306[1]; 20 NYCRR 3000.15[d]). Given the totality of the circumstances, we find that the notices of cancellation were properly sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Gutlove & Shirvint, Inc. is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Gutlove & Shirvint, Inc. are denied; and
4. The Notice of Proposed Cancellation of Licenses as a Cigarette Stamping Agent & Wholesale Dealer, Distributor and Wholesaler of Tobacco Products dated April 8, 2008 and the Notice of Cancellation of such licenses dated June 30, 2008 are sustained.

DATED: Troy, New York  
March 29, 2010

/s/ Carroll R. Jenkins  
Carroll R. Jenkins  
Commissioner

/s/ Charles H. Nesbitt  
Charles H. Nesbitt  
Commissioner