STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	DETERMINATION DTA NO. 820885
J.C. NEWMAN CIGAR COMPANY	:	
for Revision of a Determination or for Refund of Cigarette Tax under Article 20 of the Tax Law for the Period May 1, 2000 through April 30, 2003.	:	

Petitioner, J.C. Newman Cigar Company, P.O. Box 2030, Tampa, Florida 33601-2030, filed a petition for revision of a determination or for refund of cigarette tax under Article 20 of the Tax Law for the period May 1, 2000 through April 30, 2003.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on October 31, 2006 at 10:30 A.M., with all briefs to be submitted by April 3, 2007, which date began the six-month period for the issuance of this determination. Petitioner appeared by Helms & Green, LLC (James J. Mahon, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Michele W. Milavec, Esq., of counsel).

ISSUES

I. Whether there is a sufficient nexus between petitioner and the State of New York such that New York may impose an obligation on petitioner to register as a distributor of tobacco products and to pay tobacco products tax.

II. Whether petitioner has established that the audit methodology was erroneous or that the amount of tax determined to be due was incorrect.

III. Whether a penalty imposed pursuant to Tax Law § 481 was properly imposed.

FINDINGS OF FACT

1. Petitioner, J.C. Newman Cigar Company, is a firm which manufactured cigars at its facility in Tampa, Florida. In addition to manufacturing cigars, it also imported cigars from various countries such as the Dominican Republic, Honduras and Nicaragua for sale to customers in the United States. Petitioner did not have any offices other than its main office which was located in Tampa, Florida.

2. Petitioner sold tobacco products to customers in New York State and arranged for their transportation. Petitioner shipped tobacco products to customers in New York through a common carrier or by a freight line truck if a large quantity of products was going to the same location. A portion of the tobacco products was sold cash on delivery. Petitioner's salesman did not make deliveries of products. During the same period, petitioner filed New York State sales and use tax returns. Petitioner is not registered in New York State as a distributor or wholesaler of tobacco products and did not file tobacco products tax returns in New York State during the periods in issue.

3. Manufacturing cigars is a very calculated and time-consuming process. Petitioner utilizes the services of a number of different departments in the production of cigars. In addition to the departments engaged in the production of cigars, petitioner has a returns department, a receiving department and a shipping department. In the office, petitioner has an accounts receivable department, a sales department and departments involving human resources, marketing, graphics design and accounting.

4. Petitioner retains almost every record that is produced including invoices, packing slips and accounting records. In addition to keeping shipping records, petitioner has the daily sales logs, accounts receivable records, daily receipts journals and ledgers. The papers are kept for at least seven years in a space that has numerous rows of paperwork. In 2001, these records were in existence for 2000.

5. In order to promote the sale of its cigars, petitioner mails catalogs or informational brochures from its home office in Tampa, Florida. It also sends out promotions or specials.

6. Petitioner employs nine people in its in-house sales department. Their duties consist of answering incoming sales calls over the telephone, discussing products and determining if petitioner has the product on the site. They also process orders through the system until the order goes to shipping.

7. Petitioner also employs a sales force of approximately 17 people that go into the field to educate customers and promote products. Petitioner's sales strategy is to use brochures and then follow up with a name and face to talk about the product.

8. Petitioner sells to tobacconists, tobacco outlets, chain stores and certain pharmacy chains. It does not sell directly to individuals.

9. During the period in issue, petitioner employed a salesperson whose territory consisted of New York and portions of New Jersey and North Carolina. Petitioner filed New York State withholding tax returns and paid New York State withholding tax on this employee. The salesperson visited existing accounts in his designated sales territory from once every six weeks to once every four months depending on the location and needs of the customer.

10. When petitioner's salesperson visited existing accounts he could take a customer's order for tobacco products. Alternatively, the customer could place the order directly with

petitioner at its office in Florida. Petitioner's salespersons solicited new accounts on petitioner's behalf and visited the location of prospective customers to make sure that there was a humidor and a proper place to store the inventory.

11. If petitioner was trying to sell a new product or item it would, from time to time, send samples of the new product to its salespeople. During the period in issue, petitioner's salesperson in New York was Karl Herzog and samples of tobacco products were shipped to Mr. Herzog at 12 Gainsborough Road, Holbrook, New York 11741. Petitioner's salesman used the samples to show to petitioner's customers. The salesperson did not give samples to a customer.

12. Every new salesman is given a strict policy statement which sets specific limits on the salesman's role within the company. The outside sales force may not maintain an office; may not use their homes as a business address or reference on a business card, store inventory or maintain company property. The official business address of each salesman is the office in Tampa, Florida. The outside sales force is not involved in collecting delinquent accounts, does not make any decisions on credit and is not authorized to accept the return of a product.

13. In order to establish a customer account with petitioner, the prospective customer is required to complete a credit application with the accounts receivable department. The application asks for, among other things, the name, address, contact information and trade information in order to obtain references. The accounts receivable department also asks for a copy of a sales tax certificate and tobacco license.

14. Petitioner will not sell cigars until a customer establishes that it is licensed to sell cigars as well as to import them. Petitioner also requires a salesman to visit the location because petitioner prefers its product to be in select stores.

15. Petitioner has a strict policy on credit which is handled by petitioner's accounts receivable department. All customers are subject to the same policies.

16. The decision to discontinue a product is made in the Tampa office. The decision involves petitioner's stopping production of the product or not bringing the product in from the Dominican Republic or another country.

17. In or about April 2001 the Division of Taxation ("Division") commenced a tobacco tax audit of petitioner for the period May 1, 2000 through April 30, 2003. Petitioner was selected for an audit in order to determine if it should be registered as a distributor of tobacco products. The auditors sent an appointment letter which listed the books and records that the Division wanted to review and petitioner responded that it did not think that New York State had the jurisdiction to review the books and records. After exchanging correspondence, the Division was told that it would be given limited access to books and records, and the Division arranged a visit to petitioner's facility in Tampa, Florida.

18. Prior to the audit, it was petitioner's understanding that the Division was going to be conducting a sales tax audit. When the first meeting took place it seemed to petitioner that the Division had shifted gears and that it was examining tobacco tax.

19. During the initial visit to petitioner's location in Tampa, the Division was given pick tickets[1] and shipping records for February and March 2001. The Division reviewed these documents in order to determine the customer base, the method of shipment and whether the New York customers to whom petitioner shipped its tobacco products were registered in New

[1] A pick ticket will differ from an invoice in that the pick ticket will have the bin location so the person packing the box will know where to find the item. An invoice may not have that information. A pick ticket will usually accompany the product whereas the invoice is actually mailed to the customer and has the best mailing address. Petitioner retains a copy of the pick ticket as well as the invoice.

York as distributors of tobacco products. The Division developed a list, based on the documents provided, of the customers in New York which it believed were not registered as distributors of tobacco products and the tobacco products tax due on the tobacco products which were sold by petitioner to the purportedly unregistered customers in New York.

20. The Division returned to petitioner's headquarters in Tampa, Florida in June 2003 in order to complete the audit. At this time, petitioner provided the Division with greater access to the books and records it requested including a list of petitioner's customers in New York State as of June 20, 2003, accounts receivable information and other pick tickets.[2] The Division created a complete listing of all of petitioner's customers in New York to whom petitioner sold tobacco products during the audit period based upon documentation provided to the Division by petitioner including: the New York customer list provided by petitioner, New York customers determined during the initial audit visit in April of 2001 from pick tickets and invoices for the period February 1, 2001 through March 31, 2001, and New York customers that might have been on the accounts receivable lists that were not on the New York customer list provided by petitioner.

21. The Division used database information for New York State tobacco products tax registration as a wholesaler or distributor of tobacco products to determine if petitioner's customers in New York State were validly registered as tobacco products distributors in New York State for the period in issue. The Division also reviewed additional documentation provided by petitioner to prove the registration status of its New York customers including Certificates of Registration for Cigarettes and Tobacco Products; Appointments of Distributors

[2] Source records were unavailable for the period May 1, 2000 through December 31, 2000.

of Tobacco Products; Licenses of Wholesale Dealers of Tobacco Products; Sales Tax Certificates of Authority; Blanket Certificates of Resale; Certificates of Individual Exemptions from Sales and Excise Taxes on Property or Services Delivered on a Reservation; Permits for Manufacturers of Tobacco Products; Business Licenses and Accounts Receivable information. The Division incorporated this information in a listing of all of petitioner's customers in New York State to whom petitioner sold tobacco products during the period in issue.

22. After the Division attempted to determine which of petitioner's New York customers were not validly registered as New York State distributors of tobacco products during the period in issue, the Division requested account histories from petitioner for those customers which the Division considered to be unregistered. Petitioner responded that the account histories were not available for the year 2000 due to problems with the computer system. Consequently, account histories were not provided to the Division for the period May 1, 2000 through December 31, 2000.

23. The Division issued a Statement of Proposed Audit Adjustment, dated June 21, 2004, which explained that sales and use taxes were due for the period May 1, 2000 through April 30, 2003 in the amount of $37,581.68, plus penalty and interest, for a balance due of $54,705.90. In order to calculate the amount of tax due for the audit period, the Division computed petitioner's tobacco tax liability using the available account histories for the period January 1, 2001 through April 30, 2003 to determine that taxable tobacco product sales to unregistered New York customers totaled $118,234.65 and that the average monthly sales were $4,222.67. The amount of tax asserted to be due was based upon the application of the average monthly sales to the period where account histories were unavailable and to the subsequent period where they were

available. An accompanying letter explained that the Division determined that petitioner was required to register as a distributor of tobacco products.

24. The Division issued a Notice of Determination, dated November 4, 2004 (Notice # L-024694507) to petitioner assessing sales and use tax in the amount of $37,581.68 plus penalty and interest for the period May 1, 2000 through April 30, 2003.

25. At the hearing in this matter, petitioner offered additional documents in evidence that were not provided to the Division prior to the issuance of the Notice of Determination. Following the hearing, the Division examined the exhibits which petitioner entered into evidence and based upon this additional documentation, the Division determined that petitioner's New York customers, 100 St. Paul Street, Inc. d/b/a World Wide News and Richard J. Krantz, Jr. and William Krantz d/b/a Little Havana Trading Company were validly registered as distributors of tobacco products in New York State during the period in issue. Thereafter, the Division recalculated the total taxable invoice amount of tobacco products sold by petitioner to customers in New York for the period January 1, 2001 through April 30, 2003 by removing the invoice amounts for sales by petitioner to 100 St. Paul Street, Inc. d/b/a World Wide News and Richard J. Krantz, Jr. and William Krantz d/b/a Little Havana Trading Company. Based on the testimony given at the hearing, additional documentation provided at the hearing and the recalculations performed by the Division's auditor, the Division waived the portion of the tobacco tax assessment relating to the May 1, 2000 through December 31, 2000 for which no account histories showing taxable invoice amounts of sales of tobacco products from petitioner to its unregistered New York customers were used in calculating the tobacco products tax due. The Division calculated the revised tobacco products tax due from petitioner, which only assessed tax for the period January 1, 2001 through April 39, 2003, to be $29,893.10 plus penalty and interest.

26. In accordance with State Administrative Procedure Act § 306(1), the Division's proposed findings of fact have been generally accepted and incorporated herein. It is noted that proposed finding of fact "13" was rejected as misleading as it is not clear that a job description was requested. Proposed findings of fact "14," "18," "26," "27," "28" and "30" through "32" were rejected as unnecessary to the determination. Proposed finding of fact "24" was redundant with proposed finding of fact "25" and therefore the proposed finding of fact "24" was omitted.

CONCLUSIONS OF LAW

A. Relying upon an analysis of a series of United States Supreme Court cases dealing with nexus, petitioner submits that New York State cannot require petitioner to register and pay tobacco tax under the Commerce Clause of the United States Constitution since petitioner's only contact with New York consists of a roving salesperson with no power to process orders, deliver merchandise, or accept the return of defective merchandise. According to petitioner, cases subsequent to ***Matter of Orvis v. Tax Appeals Tribunal*** (86 NY2d 165, 630 NYS2d 680, ***cert denied*** 516 US 989, 133 L Ed 426) now recognize that the presence must be substantial. Petitioner submits that it has no more than a slight nexus to New York State.

B. In ***Orvis*** the New York State Court of Appeals set forth a detailed analysis of the United States Supreme Court decisions discussing nexus and concluded that in order impose tax without contravening the Commerce Clause, the taxpayer's activities in New York had to be more than the "slightest presence." Specifically, the Court stated:

> We think the foregoing survey of the decisional law discloses the true import of the physical presence requirement within the substantial nexus prong of the ***Complete Auto*** [***Complete Auto Transit v. Brady***, 430 US 274, 51 L Ed 2d 326] test under contemporary Commerce Clause analysis. While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence" (***see, National Geographic Socy. v. California Bd. of Equalization,*** 430 US 551, 51 L Ed 2d 631). And it may be manifested by

> the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf (***Matter of Orvis Co. v Tax Appeals Tribunal***, ***supra,*** 630 NYS2d, at 686-687).

C. Petitioner's activities clearly satisfy the forgoing test given the fact that petitioner assigned a salesperson to New York who visited petitioner's New York customers anywhere from every six weeks to every four months depending on the location and need of the customer. While traveling in New York, petitioner's salesperson examined the locations of potential new customers, reviewed the operations of established customers in order to promote sales and took orders. Petitioner's salesperson also introduced new products.

Petitioner attempts to distinguish ***Orvis*** on the basis of a lack of testimony by Orvis' officers at the hearing as well as the circumstantial evidence of extensive dealings in New York. According to petitioner, the litigants in ***Orvis*** had a "less than candid posture" which justified the negative ruling. This attempt to distinguish ***Orvis*** is without merit. In ***Orvis***, as well as in this case, there were systematic visits to the taxpayer's customers in New York. It was these visits which exceeded the "slightest presence" threshold.

The Division has correctly pointed out that the result reached herein is supported by the decision of the Tax Appeals Tribunal in ***Matter of Ohio Table Pad Co., Inc.*** (Tax Appeals Tribunal, April 22, 1999). In ***Ohio Table Pad***, the taxpayer, whose headquarters were in Ohio, utilized the services of independent contractors to seek out, solicit and maintain business on its behalf in exchange for a monthly commission on sales. The Tribunal concluded that these activities constituted more than the "slightest presence."

D. Petitioner's reliance upon ***Dell Catalogue Sales v. Commr. of Rev. Ser.*** (48 Conn Sup 170, 830 A2d 812) is misplaced as that case involved the issue of whether an out-of-state

vendor with no physical presence in Connecticut had a nexus with Connecticut by reason of paying a vendor to provide service to Dell's customers under a contract between the customer and the vendor. After inferring that the number of on-site calls by the vendor in Connecticut was minimal, the Court concluded that a nexus did not exist. In contrast, in this matter the record shows that an employee of petitioner was making regular visits to its customers in New York. Petitioner's reference to a determination of an Administrative Law Judge will not be addressed as it may not be cited as precedent (Tax Law § 2010[5]).

E. Tax Law § 471-b(2) provides:

> The distributor shall be liable for the payment of the tax on tobacco products which he imports or causes to be imported into the state, or which he manufactures in the state, and every distributor authorized by the commissioner of taxation and finance to make returns and pay the tax on tobacco products sold, shipped or delivered by him to any person in the state shall be liable for the payment of the tax on all tobacco products so sold, shipped or delivered.

Tax Law § 470(12) defines distributor as follows:

> "Distributor." Any person who imports or causes to be imported into this state any tobacco product (in excess of fifty cigars or one pound of tobacco) for sale, or who manufactures any tobacco product in this state, and any person within or without the state who is authorized by the commissioner of taxation and finance to make returns and pay the tax on tobacco products sold, shipped or delivered by him to any person in the state.

F. Here, petitioner shipped products to its customers in New York through a common carrier such as UPS or through a freight line truck if a large quantity of product was going to the same location. Petitioner also shipped tobacco products to customers in New York State requiring the payment of cash on delivery. It follows that since petitioner imported or caused to be imported tobacco products into New York State, petitioner is a distributor as defined by Tax Law § 470(12) and bears responsibility for the payment of tobacco products tax. Petitioner submits that it does not owe the tobacco taxes since these taxes were the primary responsibility

of the New York based customer who presumably paid the taxes. However, the potential liability of petitioner's New York customers for tobacco tax is irrelevant insofar as petitioner's potential liability is concerned.

G. The next question is whether the audit methodology resulted in an incorrect determination of the amount of tax determined to be due. The Division projected the amount of tax due for the period May 2000 through December 2000 on the basis of its audit for a subsequent period time. Since petitioner offered documents showing that the assessment of tax for this period was erroneous, the Division agreed to cancel the tax assessed for this period. The tax assessed for the balance of the period in issue was based on a detailed audit of petitioner's books and records. Contrary to the arguments raised by petitioner, any error in the audit for the earlier period which was cancelled is irrelevant. Petitioner bears the burden of proof of establishing by clear and convincing evidence that the audit methodology led to unreasonably inaccurate results or that the amount of tax assessed was erroneous (***Matter of Del's Mini Deli v. Commr. of Tax.***, 205 AD2d 989, 613 NYS2d 967). If petitioner had evidence that the any of the remaining customers were registered and paying tobacco tax to New York State, it should have been offered at the hearing. Petitioner has not presented any evidence showing that the audit methodology for the balance of the period remaining in issue led to unreasonably inaccurate results or that the amount of tax assessed was erroneous. Therefore, the results of the audit, as adjusted, are sustained.

H. The Division argues that it properly imposed a penalty pursuant to Tax Law § 481 since petitioner has not established a basis for waiver of the penalty. Tax Law § 481(a)(iii) provides that if the failure to file a return or pay the tax due "was due to reasonable cause and not

willful neglect" all or part of the penalty may be remitted. Here, petitioner has not presented any reason for the waiver of penalty and therefore the imposition of the penalty is sustained.

I. The petition of J.C. Newman is denied, and the Notice of Determination, dated November 4, 2004, as modified in Finding of Fact "25," is sustained together with such penalty and interest as is lawfully due.

DATED: Troy, New York
September 27, 2007

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE