STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MAX'S SMOKES, INC.	:	DETERMINATION DTA NO. 821897
for Review of a Notice of Proposed Cancellation of a License as a Wholesale Dealer of Cigarettes and as a Wholesale Dealer of Tobacco Products under Article 20 of the Tax Law.	:	

Petitioner, Max's Smokes, Inc., filed a petition for review of a notice of proposed cancellation of a license as a wholesale dealer of cigarettes and as a wholesale dealer of tobacco products under Article 20 of the Tax Law.

A hearing was commenced before Dennis M. Galliher, Administrative Law Judge, in New York, New York, on November 18, 2008 at 10:30 A.M., and was continued to conclusion at the same location on November 19, 2008, with all briefs to be submitted by April 27, 2009, which date commenced the six-month period for issuance of this determination. By a letter dated October 16, 2009, this six-month period was extended for an additional three months (Tax Law § 2010[3]). Petitioner appeared by Allen & Overy, LLP (Michael S. Feldberg, Esq., and Brian A. deHann, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Herbert M. Friedman, Jr., Esq., and Michelle M. Helm, Esq., of counsel).

ISSUE

Whether the Division of Taxation (Division) has established an adequate basis supporting the cancellation of petitioner's licenses as a wholesale dealer of cigarettes and as a wholesale dealer of tobacco products under Articles 20 and 20-A of the Tax Law.

FINDINGS OF FACT

1. Petitioner, Max's Smokes, Inc., was formed and was licensed in or about July 1998 as a wholesale cigarette dealer and a wholesale dealer of tobacco products. As a wholesale dealer, petitioner is engaged in the sale of cigarettes and tobacco products to retail dealers or other persons for purposes of resale. As licensed, petitioner is not authorized to purchase or sell untaxed cigarettes (i.e., packs of cigarettes not bearing stamps affixed thereto indicating the payment of tax), and is not authorized to impose or collect cigarette or tobacco products tax. Petitioner was considered a "sub-jobber," an industry term meaning a nonagent wholesaler whose customers are typically smaller retail businesses. Petitioner's owner, sole shareholder, director and officer, Max Ruda, age 94, opened petitioner at the age of 83 with the aim of making the business a family enterprise to provide future employment and income for his daughter's family, then residing in Israel.

2. For several years following its formation and initial licensing, petitioner did only a minimal wholesaling business and experienced periods of inactivity as well as periods of limited sales, comprised mainly of non-cigarette tobacco products. Prior to April 2008, Max's highest sales volume was approximately four million dollars per year, principally resulting from sales of cigars, tobacco products, some nontobacco products and some, though not a large volume of, cigarettes. The customer accounts maintained by petitioner after its initial licensing in 1998, through the time its relicensing process was commenced in 2002 and for some time thereafter,

were dealt with (serviced) by petitioner's owner, Max Ruda, who at that time was in his mid-to-later 80s.

3. All of petitioner's products were purchased from Gutlove & Shirvent, Inc. (G&S). G&S is licensed by the Division as a "stamping agent" (authorized to purchase untaxed packages of cigarettes and affix cigarette tax stamps thereto), as a "wholesale dealer" (authorized 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 as a "distributor" (authorized to import or cause to be imported into New York any tobacco products for sale and to make returns and pay the tax on tobacco products sold, shipped or delivered by it to any person in New York). G&S is owned and operated by Max Ruda's son, Joseph Ruda, and its premises are located at 39-26 23rd Street, Long Island City, New York, directly across the street from Max's premises at 39-25 23rd Street, Long Island City, New York.[1]

4. As described hereinafter, the physical aspects of petitioner's business, such as taking customers' orders and performing computer data-entry functions with respect thereto, generating purchase and sales invoices, staging orders, delivering products to customers, and collecting, counting and accounting for customer payments, were handled by G&S at G&S's facilities using a phone line dedicated to petitioner's business and G&S employees, equipment and delivery vehicles. Petitioner reimbursed G&S for providing these services.

5. Petitioner applied to be relicensed as a wholesaler in 2002, as part of the Division's relicensing program for wholesalers. In connection with its relicensing, petitioner filed an Application for a License as a Wholesale Cigarette Dealer Other than Those Who Only Operate

[1] Petitioner's location was described as covering an entire city block, with entrances on two streets (front and back).

Vending Machines (Form CG-100-W), dated August 26, 2002, a Personal Questionnaire for Max Ruda (Form CG-100-P), dated August 30, 2002, and a Cigarette Agent/Wholesaler-Lessor Identification (Form CG-100-L), dated August 7, 2002. The Form CG-100-W and the Form CG-100-P were each signed by Max Ruda under the title president/treasurer of Max's Smokes, Inc. The Form CG-100-L, which identifies G&S as the entity from which petitioner leases its business premises and as petitioner's only supplier of cigarettes, bears a "Signature of lessor" which is not clearly legible. However, inasmuch as the Form CG-100-L identifies Joseph Ruda as the "controlling person" of the lessor, G&S, and the signature line is followed by the title president/treasurer on the line "Title of lessor," it is presumed that it is Joseph Ruda's signature on Form CG-100-L. The forms consistently reflect and disclose the relationship between petitioner and G&S as a debtor/creditor relationship, in which petitioner is a premises lessee (sub-lessee) and customer of G&S.

6. The person listed on Form CG-100-W as petitioner's sole owner and shareholder (at Item 7-c) and its sole officer and director (at Item 7-e and f) is Max Ruda, owning 100% of petitioner's stock and holding the offices of president and treasurer. Form CG-100-P also lists Max Ruda's title as petitioner's president/treasurer, and describes his role as petitioner's chief operating officer. Max Ruda's duties and authority on behalf of petitioner, as set forth on Form CG-100-W (at Item 7[c] and [e]) and on Form CG-100-P (at Item 4[c]), are as follows:

–Signing checks on the company's bank account;
–Signing the business's tax returns;
–Paying creditors;
–Making the final decision on which bills are to be paid;
–Conducting the business's general financial affairs;
–Filing returns or paying taxes imposed;
–Complying with any other requirement of the Tax Law;
–Ordering, receiving or picking up cigarette stamps.

7. Item 10 to Form CG-100-W asks:

> Was any application for a license or permit under the cigarette laws of this state or country, or of any other state or country, ever made by the applicant, applicant's spouse, or *controlling person as defined in Item 20*? (Emphasis added.)

In response to this question, the box for "No" is checked.

8. Item 20 on both Form CG-100-W and Form CG-100-P contains the following identical paragraph:

> *For purposes of this application*, the term **controlling person** means any person who is an officer, director, or partner (or, in the case of limited liability company, an officer, member or a person having, with respect to such limited liability company, authority analogous to that of an officer or director with respect to a corporation) of an applicant for an agent's or wholesale dealer's license under Article 20 of the Tax Law, or if the applicant is a corporation, a shareholder, directly or indirectly, owning more than 10% of the number of shares of voting stock of such corporation. *It also includes persons who do or will exercise authority within the business comparable to the authority normally exercised by corporate officers, regardless of the form of business organization or lack of actual title* (italicized emphasis added).

9. Form CG-100-W-I (Instructions for Form CG-100-W) defines a "controlling person" in the identical manner and terms as are set forth at Item 20 above and provides, with respect to Items 7(e) and 7(f) and Item 10(b), in its item-by-item instructions for completing Form CG-100-W, as follows:

> **Items 7(e) and 7(f)**- You must provide a complete actual home address for each person listed. List officers and **controlling persons** in 7(e) or directors in 7(f). Include all employees responsible for the [duties enumerated above in Finding of Fact 6]. (Emphasis added.)
>
> **Item 10(b)** - Include the name of applicant or spouse, and/or **controlling person**, address of premises, date filed and disposition. Give the license or permit number if issued. (Emphasis added.)

Form CG-100-W-I includes, among the "Other requirements for a license," the filing of a:

> *Personal Questionnaire*, Form CG-100-P, (including all attachments required with this form) for each owner, officer, shareholder or any other person who would be defined as a **Controlling Person**. These may be mailed separately if the **controlling person** desires confidentiality. (Emphasis added; italicized material as in original.)

10. Form CG-100-P-I (Instructions for Form CG-100-P) specifies, with regard to "Who must file this form," that:

> A separate *Personal Questionnaire* is required for each **controlling person** of an applicant for license as a *cigarette agent*, a *cigarette wholesaler*, a tobacco products wholesaler, or for appointment as a tobacco products distributor. (Emphasis added; italicized material as in original.)

Form CG-100-P-I goes on to define a "controlling person" in the identical manner and terms as are set forth in Form CG-100-W-I and at Item 20 of Form CG-100-W and Form CG-100-P.

11. In addition to specifying the duties and authority to be exercised, as set forth above in Finding of Fact 6, the instructions to Form CG-100-P specify that the filer is to "List any other duties that you have regarding your participation in significant business decisions, such as":

> –supervising the preparation of tax returns and insuring remittance of tax;
> –authority for management of business;
> –knowledge and control over financial affairs;
> –authority to pay or direct payment of creditors;
> –responsibility for maintaining/managing business records;
> –the authority to deal with the business's tax accountant or tax counsel;
> –authority to negotiate with the Tax Department or to sign any of the following: tax returns, consents extending the periods of limitation, power of attorney, audit method election agreements, consents fixing tax (for example *Statement of Proposed Audit Adjustment*), installment payment agreements;
> –responsibility for handling business receipts;
> –authority to negotiate loans/borrow money for business or guaranteeing of business loans;
> –authority to hire or fire employees.

12. In response to Item 15 on its license application form, petitioner notified the Division that G&S intended to employ an unused portion of petitioner's warehouse for extra storage

space. In turn, the Division issued a notice proposing to refuse to relicense petitioner. As the result of conciliation proceedings conducted in the Division's Bureau of Conciliation and Mediation Services (BCMS), the parties settled the issue via a February 23, 2004 letter-stipulation by which petitioner agreed that G&S could not use a portion of petitioner's warehouse for storage space. Thereafter, an inspection of petitioner's warehouse space confirmed that petitioner was abiding by the terms of the agreement, and petitioner's relicensing was formally approved by the Division. Subsequent inspections of petitioner's warehouse in July 2006, January and March 2007, and May and July 2008 did not reveal that petitioner was permitting G&S to store any G&S cigarettes or tobacco products in petitioner's warehouse. In fact, the Division's July 19, 2006 inspection revealed that there was no inventory or products and no equipment in petitioner's warehouse. The Division's investigators were provided access and accompanied in their inspection by Joseph Ruda, who advised that Max Ruda was unable to attend to business and that all of petitioner's orders were processed and delivered by G&S.

13. The record includes a number of documents concerning petitioner's premises at 39-25 23rd Street, including leases, lease modifications and extensions, and lease assignments and assumptions, as follows:

> a) Petitioner entered into a lease for the premises with Ciampa North Co. (Ciampa) as landlord, dated April 1, 1999 for the lease term April 1, 1999 through December 31, 2001.
>
> b) Petitioner executed an Assignment and Assumption of Lease effective January 1, 2002 by which it assigned its leasehold interest in the premises to G&S.
>
> c) G&S, as tenant/assignee of petitioner executed a Lease Modification and Extension Agreement with Ciampa, dated January 24, 2002 and effective as of January 1, 2002, extending the lease term from January 1, 2002 through December 31, 2006.

d) Petitioner and G&S executed a Commercial Lease dated December 31, 2001 by which G&S leased the premises to petitioner for a term spanning January 1, 2002 through December 31, 2004, including provisions for extending the lease term thereafter.

e) G&S, as the assignee of petitioner pursuant to the January 1, 2002 Assignment and Assumption Agreement, and petitioner executed an Assignment and Assumption of Lease dated February 1, 2004, by which G&S assigned its leasehold interest in the premises to petitioner for the balance of the lease term (i.e., through December 31, 2006).

f) A Second Lease Modification and Extension Agreement dated March 27, 2007 was executed extending the term of the lease to the premises from January 1, 2007 through January 1, 2011. The landlord continues to be Ciampa, while the tenant is identified as "Gutlove and Shirvent, Inc. d/b/a Max's Smokes, a New York Corporation with its principal place of business located at 39-26 23rd Street, Long Island City, New York."[2]

14. From the time of petitioner's formation and initial licensing through the present, Max Ruda has remained petitioner's sole shareholder, sole director and only officer. Since petitioner had only a limited sales volume during its first several years of existence, petitioner operated its business by paying G&S, an established distributor (stamping agent) and wholesaler, to perform several services for petitioner. As described earlier, these services included taking telephone orders from customers, making computer data processing entries, generating purchase and sales invoices, collecting payments from customers, counting cash, and delivering products including cigarettes and tobacco products. This method of conducting business spared petitioner the time and expense of hiring and training a staff of employees, provided security for its receivables, and avoided the significant capital investment necessary for the purchase and maintenance of its own delivery vehicles and other equipment. Petitioner paid G&S monthly for the services G&S provided. During the period when petitioner had limited business, it paid G&S $250.00 per

[2] This document references assignment of the original lease from petitioner to G&S, the reassignment of the lease from G&S back to petitioner, and the rereassignment of the lease from petitioner to G&S d/b/a Max's Smokes.

month for taking orders from customers and for data-entry services performed by G&S employees, and $1,500.00 per month for auto and delivery services performed by G&S employees. Petitioner paid its own rent expense to G&S as its landlord and its own utility (electricity) expenses. G&S stored certain of its records in the office space at petitioner's facility, and paid petitioner, via reimbursement of 85% of petitioner's rent expense, for this storage space. Petitioner allowed an entity known as Gallo Investigations to utilize the office space at its facility. Gallo Investigations provides security services for petitioner and for G&S.

15. Following resolution of the warehouse storage issue that arose during the 2002 relicensing process, the Division continued to express concerns regarding a perceived "commingling" of petitioner's business with G&S's business. When petitioner inquired as to what it might do to allay these concerns, it was advised by the Division to move its warehouse to another location. Petitioner submitted in evidence an unsigned sublease from G&S to petitioner for premises described as "3 rooms in the back of the building located at 821 Lydig Avenue, Bronx, New York," for the period February 1, 2007 through January 31, 2010. Petitioner alleged, and the Division has not disputed, that this space was previously approved by the Division for use as a warehousing facility for G&S. G&S used these premises from 1976 through 1995, at which time there was a fire at the premises. The extent of resulting damage and the present condition of the premises are not detailed in the record beyond the comment in testimony that only cosmetic, as opposed to structural, changes have been made.

16. By letters dated November 28, 2006 and January 9, 2007, i.e., prior to commencement of the term set forth in the sublease document, petitioner sought formal approval and permission from the Division to move its warehouse to the facility in the Bronx. Petitioner did not receive any response to its application to relocate its warehouse until February 20, 2008, i.e., after the

Division's issuance of the subject Notice of Proposed License Cancellation, when petitioner received a letter of denial stating that the premises at 821 Lydig Avenue did not comply with the requirements of the Tax Law. Petitioner was advised that the lease for the premises named G&S as the tenant and did not name petitioner, and that the space in question was a "storage area" located underneath a 62-unit residential apartment building, which is not a separate and distinct warehouse.

17. In 2008, as a result of civil litigation initiated against G&S by the City of New York (which litigation was dismissed December 4, 2008), G&S's contract with one of its major suppliers, Philip Morris, was cancelled and G&S lost its ability to purchase Philip Morris cigarettes directly from that manufacturer. Philip Morris cigarette sales constituted a significant percentage of G&S's business. Joseph Ruda, on behalf of petitioner, approached two separate cigarette distributors, Resnick and Finkle, who agreed to sell Philip Morris products, with tax stamps affixed, to petitioner. As a result of this arrangement and through its use of G&S's employees, equipment and delivery system, petitioner significantly increased its sales volume by providing Philip Morris products to customers G&S was no longer able to supply. In view of its significantly increased volume of business,[3] petitioner began to pay G&S an increased monthly amount for order taking, data-entry, product delivery, receivables security and cash collection and counting. The monthly amount for such services rendered was calculated as a comparative percentage of sales volume between G&S and petitioner. Petitioner continued to directly pay its own rent and electricity expenses, as noted earlier.

[3] Petitioner's sales volume for the period July 2008 through October 2008 increased to approximately $9 million.

18. At the time of this change in the volume of petitioner's business, the Division began to conduct regular inspections of G&S's premises to discover how its customers were obtaining Philip Morris products. During these inspections, the Division found Philip Morris products (approximately 15,000 cartons of cigarettes) invoiced to petitioner (from Resnick and Finkle as petitioner's suppliers of such products) located at and being staged on a conveyor ramp at G&S's premises and loaded onto G&S's delivery vehicles. At the same time, the Division found Philip Morris products (approximately 12,500 cartons of cigarettes) invoiced to petitioner and located at petitioner's facility. These products were all identifiable as invoiced to petitioner as opposed to G&S. Petitioner further distinguishes such products by describing those cartons located at petitioner's facility as being "received and stored for distribution," versus those cartons located at G&S's facility as being "staged and loaded for delivery." The Division advised Joseph Ruda that this practice of staging petitioner's orders at G&S's premises violated the requirement that G&S, as a wholesaler, maintain a separate and secure warehousing facility. In response, petitioner began receiving all of its cigarettes and maintaining an inventory of such cigarettes at its own warehousing facility. In turn, the cigarettes were "carted" across the street to G&S's warehouse for staging and delivery. Eventually, petitioner changed this practice and began staging orders and loading the delivery trucks at its own warehouse, utilizing G&S employees to do so and continuing to reimburse G&S as set forth above (***see*** Finding of Fact 17).

19. On March 26, 2007, petitioner received the Notice of Proposed Cancellation which is the subject of this proceeding. The Division initially proposed to cancel petitioner's licenses as a wholesale dealer of cigarettes and tobacco products upon four specified grounds. Petitioner challenged this proposed cancellation by filing a Request for a Conciliation Conference and, thereafter, a petition. The Division filed its answer to the petition and, pursuant to permission

granted, an amended answer asserting two additional grounds for cancellation. The six grounds upon which the Division proposed cancellation were as follows:

> a) By virtue of a symbiotic relationship between petitioner and G&S, petitioner has reduced its cost of doing business by the Cigarette Marketing Standards Act (CMSA) wholesale dealer, thereby inducing or procuring a rebate in violation of Tax Law § 484(a)(2)(B);
>
> b) Petitioner has failed to provide its employees with disability and workers' compensation insurance in violation of Tax Law § 480(1)(e);
>
> c) Petitioner has committed fraud or deceit in its operations as a wholesale dealer or has committed fraud or deceit in procuring its licenses in that Max Ruda, the sole person identified to the Division in petitioner's license applications as controlling petitioner's operations is not, in fact, involved in petitioner's operations, and in that petitioner did not, and has not, identified or disclosed Joseph Ruda as the person who in fact and in concert with G&S controls petitioner's operations, in violation of Tax Law § 480(3)(b)(i);
>
> d) Petitioner has failed to maintain a secure and separate warehousing facility in violation of Tax Law § 480(1)(d);
>
> e) Petitioner has failed to notify the Division of any change to the information shown on its application for a license, in violation of 20 NYCRR 72.1(c)(1), in that while petitioner's application lists Max Ruda as the sole individual responsible for running petitioner's daily operations, Division investigations have revealed that Joseph Ruda, and others, are intricately involved in running petitioner's operations.
>
> f) Petitioner has collected New York State tobacco products tax from its customers, yet petitioner has never been registered to collect such tax, or filed any tobacco products tax returns, or remitted the tax it collected, in violation of Tax Law § 480(3)(a)(ii).

20. On June 9, 2008, petitioner brought a motion for summary determination, in response to which the Division cross-moved for summary determination in its favor. By an order dated October 23, 2008, summary determination was granted in petitioner's favor with respect to the first ground upon which the Division proposed to cancel petitioners' licenses (illegally inducing or procuring a rebate in violation of Tax Law § 484[a][2][B]). The motion was otherwise denied,

as was the Division's cross-motion for summary determination. In addition, by a letter dated December 10, 2008, the Division withdrew its second ground for cancellation (failure of petitioner to provide worker's compensation and disability insurance coverage for its employees, in violation of Tax Law § 480[1][e]). As a result, there remain four separate grounds upon which the Division proposes to cancel petitioner's licenses, as set forth above (***see*** Finding of Fact 19 c-f).

21. The testimony at hearing, given by a number of Division employees who have conducted investigations and numerous inspections of the premises and operations of both petitioner and G&S, and the testimony given by Joseph Ruda, reveal that with the passage of time, Max Ruda has become entirely uninvolved in, and apparently unaware of, the ongoing operations of petitioner's business. The process of declining involvement included a fall by Max Ruda at petitioner's premises which required a period of convalescence at home. Petitioner's continued business operation has been possible under the business operational model whereby G&S carries out the physical aspects of petitioner's business, as described. At the same time, all business decisions of significance are made by, and control of petitioner rests with, Joseph Ruda, who candidly testified at hearing that such has been the case for the last two years (i.e., at least from 2006). The decisions and types of duties enumerated in Findings of Fact 6 and 11 are carried out, in fact, by persons other than Max Ruda, including G&S's owner Joseph Ruda, G&S's chief financial officer, Steven Sussner, G&S's controller, Erin Martin, and G&S employee Rachel Ruda. Required signatures on various documents are affixed by the foregoing individuals, as well as by the use of a signature stamp bearing the signature of Max Ruda and kept under the custody of Rachel Ruda, who is Max Ruda's granddaughter. Joseph Ruda was the person who arranged, on behalf of petitioner, for the purchase of (stamped) Philip Morris

products (cigarettes) so as to be able to supply the same to G&S's customers, and he has also been the person who provided the Division's employees with access to petitioner's premises for inspections and allowed access to petitioner's records for inspection and audit.

22. Petitioner had no employees of its own during the period in question, save for having hired one person for a period of approximately one year in connection with the proposed move of petitioner's warehouse to Lydig Avenue. Rather, petitioner used G&S employees to generate sales and to service customer accounts, as well as to manage and carry out its day-to-day operations. The Division's investigations and inspections of petitioner's premises, reviews of petitioner's records, and personal interviews have revealed, notwithstanding that petitioner's books and records reflect ongoing sales of cigarettes and tobacco products by petitioner, that none of petitioner's day-to-day activities, and indeed none of petitioner's activities save for the recent receipt of cigarettes and staging of customer orders for delivery, are carried out at petitioner's premises. This more recent receipt and staging of cigarettes at petitioner's facility followed the Division's inspections and observation that no products were being received, stored at, or delivered from petitioner's premises (***see*** Finding of Fact 12). Thereafter, to the extent products were received at petitioner's premises, no products were in fact being staged or distributed from petitioner's premises, but rather were being "carted" across the street to G&S's premises for staging, loading and delivery, until the Division's expressed concern caused petitioner to begin staging and loading products for delivery at its own premises (***see*** Finding of Fact 18).

23. The Division's witnesses noted that petitioner's address as listed on its bank statements and checks is 39-26 23rd Street, Long Island City, New York, which is G&S's address, and also noted that certain of petitioner's tax returns reflect petitioner's address while others reflect the

address for G&S. Petitioner's tax returns and other documents have been signed by persons other than Max Ruda, including in many instances by the use of the stamp bearing the signature of Max Ruda. Petitioner, in contrast, explained the use of G&S's address as resulting from delivery problems with the postal service which led to certain returns being filed late.

24. Petitioner is not licensed or registered as a stamping agent or distributor, and the Division has no record of receiving any tobacco products tax returns filed by petitioner for any of the years 2003 through 2007. The Division audited petitioner's records (and G&S's records) and provided at hearing a listing of petitioner's sales invoices for the month of September 2005, as well as certain of the actual sales invoices for such month, as exemplars, purporting to show that petitioner was collecting tobacco products tax from its customers, notwithstanding that it was not licensed or registered to do so. The Division does not question that the amount paid by petitioner for tobacco products it purchased included the 37% tobacco products tax (as collected by G&S as part of its cost recoupment on such products it sold to petitioner). However, the Division's auditor pointed out that the amount petitioner charged and collected from its customers on its sales of such products, as shown on the sales invoices issued to petitioner's customers, included an amount labeled tobacco tax. The amount so labeled was calculated upon the selling price petitioner charged its customers, i.e., the amount labeled "tobacco tax" was calculated as imposed on petitioner's cost for the tobacco products (including the tax already therein), plus the markup amount charged by petitioner to its customers. Stated differently, the amount was calculated as 37% of the selling price as opposed to 37% of the wholesale cost paid by petitioner's supplier (G&S).

25. On July 10, 2008, Division cigarette tax agents stopped a G&S delivery truck carrying merchandise owned by both G&S and petitioner. Two misdemeanor citations were issued each

to petitioner and to G&S charging that the joint delivery violated the requirement of Tax Law § 480(1)(d) that wholesale dealers must maintain a "secure and separate warehouse." This charge is premised upon the same statutory basis for license cancellation (failure to maintain a separate and secure warehouse) as is raised by the Division in this proceeding.[4] On January 12, 2009, petitioner (and G&S) moved for dismissal of the criminal charges on the ground that they failed to state a claim for violation of the Tax Law. The motions were granted by the Queens County Criminal Court on February 23, 2009 and the charges were dismissed.

SUMMARY OF PETITIONER'S POSITION

26. Petitioner asserts that its license application was accurately and correctly completed, and included all of the required information called for in such application and other required forms. Petitioner's position is that since Max Ruda has always owned 100% of petitioner's stock, been its sole officer and director, and is the only person with ultimate legal authority and responsibility for petitioner, then by statutory definition Max Ruda was and is petitioner's only "controlling person." Thus, petitioner maintains Max Ruda was the only individual required to be identified to the Division as a "controlling person" and listed on petitioner's license applications, and the only person for whom requested information had to be supplied. According to petitioner, since the application does not ask the applicant to list "persons responsible for running the daily operations" or "persons intricately involved in running business operations," and since Max Ruda has remained at all times petitioner's sole shareholder, officer and director, there has been no change in the information required and supplied on petitioner's application, and thus petitioner was under no obligation to notify the Division of any change to the

[4] The citations also charged that G&S was providing an "illegal rebate or concession" to petitioner, in violation of Tax Law § 484(a)(2)(B), the same basis for cancellation as was raised by the Division in this proceeding and dismissed on petitioner's motion (***see*** Finding of Fact 19).

information shown on the application. On this basis, petitioner seeks dismissal of the first (fraud or deceit in license procurement or operations as a licensee) and third (failure to notify of change) grounds for license cancellation.

27. As to the second ground for cancellation, petitioner asserts that it continues to maintain a separate and secure warehouse facility at its business address, 39-25 23rd Street, Long Island City, New York, the address listed as its only storage location on its license application. Petitioner notes that as a result of the Division's allegation that such premises do not constitute a separate and secure warehouse facility, it has also subleased from G&S premises located at 821 Lydig Avenue, Bronx, New York, a facility previously approved by the Division as a separate and secure warehouse for another licensed wholesale tobacco dealer (G&S). Petitioner applied for permission to relocate its warehouse facility to this address and maintains that it has, in fact, two separate and secure warehouse facilities.[5]

28. Petitioner claims that the line item for tobacco products tax appearing on its sales invoices was provided to show its customers the amount of tax it paid on its products and passed through to its customers, as part of the overall price of its products. According to petitioner, this information was presented so as to provide its customers with "more information," and allow its customers to see that its products are priced competitively with those of other wholesalers (who allegedly list the amount of tobacco products tax paid by such wholesalers and passed through to their customers). In response, the Division's auditor explained that the amount of tax shown on petitioner's customer invoices was higher than the amount petitioner paid upon its purchase because the amount shown was being calculated upon petitioner's selling price for the product.

[5] The Division has denied petitioner's request to relocate its warehouse facility and maintains that the premises at 821 Lydig Avenue do not constitute a separate and secure warehouse facility per Tax Law § 480(1)(d) and 20 NYCRR 80.2(b)(2)(i).

That selling price, upon which the amount shown as tobacco products tax was calculated, included petitioner's cost for the product (what it paid to its distributor including the tobacco products tax therein), plus its markup to its customers. Petitioner does not dispute the mathematical correctness of the auditor's calculation, but explains the situation as a "computer programming error." Petitioner notes that although this computational method has been ongoing for approximately five years, petitioner corrected its programming error as soon as the same was discovered and pointed out by the Division's auditor. Petitioner also notes that since the amount of tobacco tax due on the products it purchased was imposed on and remitted as required by its supplier, the Division has received the full amount of tobacco products tax due. Thus, petitioner maintains that the nomenclature on its invoices is essentially irrelevant, that additional tax is not in fact being collected by petitioner, but rather that the tax petitioner paid to its distributor is being recouped along with a markup amount. Petitioner argues in this vein that it is entitled to charge whatever price it chooses and the market will bear in selling its products. Petitioner maintains that there was no failure to register, no unauthorized collection, and no failure to remit tobacco products tax, and hence, no violation of the Tax Law supporting license cancellation. Finally, petitioner points out that in some instances, such as where a manufacturer offers certain incentives or rebates to wholesalers, the amount shown as tax on its invoices might be less than the amount it paid upon its purchase of the products.

29. In sum, petitioner asserts it has complied with the law, in both the manner of filing its application and required accompanying forms, and in operating its business under its chosen business model utilizing the services of G&S, such that the Division may not cancel its licenses.

CONCLUSIONS OF LAW

A. Tax Law § 480(3)(b)(i) and 20 NYCRR 72.3(b)(2)(i), pertaining to "acts of licensee or controlling person," provide that:

> a license may be cancelled or suspended if the [Commissioner of Taxation] determines that a licensee or any controlling person * * * commits fraud or deceit in his or its operations as a wholesale dealer or has committed fraud or deceit in procuring his or its license.

Tax Law § 480(3)(b)(i) is broadly worded and addresses itself to fraud or deceit in the procurement of a license by an applicant, as well as fraud or deceit in a wholesale dealer's operations thereafter as a licensee. Review of a proposed cancellation under this provision thus requires examination of the facts at the time application for a license is made, as well as thereafter with regard to the manner in which the licensee's business is operated.

B. The Division's first basis for license cancellation is that, per Tax Law § 480(3)(b)(i), petitioner committed fraud or deceit in the *procurement* of its licenses by its failure to disclose and include Joseph Ruda as a "controlling person" on its license application, as that term is defined for purposes of such application. The Division also maintains that petitioner committed fraud or deceit in its *operations*, since actual operational direction and control of petitioner rested, in fact, in Joseph Ruda at and through G&S and its employees, equipment and facilities, notwithstanding that Max Ruda remained the only person identified to the Division as controlling petitioner and its operations. The Division specified at hearing that the license procurement portion of the charge pertains to petitioner's application for relicensing in 2002 as part of the Division's relicensing process. Thus, the accuracy and completeness of the information provided by petitioner as the *applicant*, including the accuracy of who petitioner reported as its "controlling person(s)" at the time of relicensing, in comparison to the manner in which

petitioner's business was actually operated at such time, will be addressed first. Thereafter, the separate aspect of the charge concerning fraud or deceit in the operation of petitioner's business as a *licensee* will be addressed.

This two-pronged review of the Division's first basis for cancellation is to be distinguished from review of the Division's third basis for cancellation, which speaks to petitioner's alleged failure to notify the Division of any changes in the operations or ownership of petitioner as a *licensee* subsequent to the filing of its application in 2002, per 20 NYCRR 72.1(c)(1). At the same time, these two separate bases for cancellation clearly overlap, in that the second prong of the first charge (fraud or deceit in operations as a licensee) and the third charge (failure to notify the Division of changes to the information reported to the Division) both turn upon the actual operation of petitioner's business as a *licensee*. Review of the record reveals that petitioner prevails on the first prong of the first charge (accuracy of information in its application at the time of filing), but not on either the second prong of the first charge (actual operations thereafter as contrasted with the information provided on the application) or on the third charge (failure to notify).

C. Several provisions of the Tax Law and regulations are relevant in addressing the first charge under Tax Law 480(3)(b)(i), and the question of whether petitioner committed fraud or deceit in its *application* for a license or in its operations thereafter as a *licensed* wholesale dealer. Furthermore, these same provisions are directly relevant in addressing the Division's third basis for license cancellation, premised on petitioner's failure to notify the Division of any changes to the information shown on its application or as last reported to the Division, per 20 NYCRR 72.1(c)(1).

First, Tax Law § 480(3)(a)(ii), pertaining to "acts of licensee," provides that:

> a wholesale dealer's license may be cancelled or suspended for the licensee's failure to comply with 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* . . . (emphasis added; ***see*** 20 NYCRR 72.3[b][2]).

In turn, 20 NYCRR 72.1(b)(1), pertaining to "licensing of wholesale dealers of cigarettes," provides that:

> an application for a license as a wholesale dealer of cigarettes must be made on a form prescribed by the Department of Taxation and Finance for such purpose and *must fully disclose all information requested therein* (emphasis added).

In addition, 20 NYCRR 72.1(b)(3) authorizes the Division to "periodically review the status of a licensed wholesale dealer and may, *at any time*, require a wholesale dealer to submit to the department any information necessary for the completion of such review." (Emphasis added.)

Further, 20 NYCRR 72.1(c)(1) provides as follows:

> A wholesale dealer of cigarettes must immediately inform the Department of Taxation and Finance, in writing, of any change to the information shown on the application for a license as a wholesale dealer *or as last reported to the department*, including *but not limited to*, any change of name or any change in such dealer's officer, directors or partners or such persons' addresses. However, any change of location of the wholesale dealer, including any additions or deletions of individual places of business, must be reported to the department, in writing prior to such change (emphasis added).

Finally, 20 NYCRR 72.1(d)(1) provides, in relevant part, as follows:

> A license as a wholesale dealer of cigarettes is not assignable. That is, such license shall not be transferred to any person. *In addition to any other meaning*, a license shall be *deemed assigned*, if any change in partnership interest has occurred or if shares of stock of a corporate wholesale dealer are acquired by any person such that the person owns, directly or indirectly, more than 10 percent ([25% in the case of a licensee with four or fewer shareholders]) of the number of shares of voting stock of such wholesale dealer. Except as provided herein, an assignment of a license is invalid and shall immediately result in the cancellation of such license.

D. Distilled from the foregoing, a wholesaler's license may be cancelled for failure to comply with any provision of Article 20 or 20-A, or with any rule or regulation properly adopted thereunder (Tax Law § 480[3][a][ii], 20 NYCRR 73.2[b][2]). An applicant for such a license must complete an application form as prescribed by the Division, and must provide thereon all of the information requested with respect to such form (20 NYCRR 72.1[b][1]). The manner in which the Division's application process is carried out requires an applicant to provide information concerning anyone who acts in the capacity of a controlling person, regardless of actual title (***see*** Findings of Fact 8 - 11). The Division's regulations make clear that a wholesaler's license is not assignable (20 NYCRR 72.1[d]), and go on to require that a licensee must thereafter report to the Division, in writing, any changes to the information shown on its application for such license or as last reported to the Division (20 NYCRR 72.1[c][1]).

E. Tax Law § 480(6)(a) and (b) and 20 NYCRR 72.2(a)(2) define a "controlling person" as an officer, director or partner of an applicant or a shareholder, directly or indirectly owning more than 10% of the shares of stock of the applicant (25% in the case of an applicant with four or fewer shareholders). There is no dispute that from the time of petitioner's initial application for licenses in 1998, through the filing of its 2002 reapplication, and continuing to the present, Max Ruda was and is the only person who met the foregoing statutory definition of "controlling person." Furthermore, the record bears out that in both 1998 and 2002, Max Ruda was in fact involved in controlling and directing petitioner's ongoing operations. Thus, Max Ruda was properly identified to the Division as a "controlling person" on petitioner's applications. Petitioner did not list Joseph Ruda as a "controlling person" on its applications and accompanying filings, and argues that he did (and does) not meet the statutory definition of "controlling person," thus leaving no reason or requirement to list him as such. However, the

Division's application for a license and its accompanying instructions provide a more expansive definition of "controlling person," requiring an applicant for a license to disclose, and submit a personal questionnaire for, "persons who do or will exercise authority within the business comparable to the authority normally exercised by corporate officers, regardless of the form of business organization or lack of actual title" (***see*** Findings of Fact 8 - 11). From the Division's perspective, this requirement obligated petitioner to list Joseph Ruda as a controlling person on its applications.

F. Until recently, G&S was petitioner's only supplier of products,[6] and also provided extensive operational services to petitioner, as detailed and for which G&S was paid. This was the case at the time petitioner's applications were filed in 1998 and 2002. The record does not disclose the extent of Joseph Ruda's involvement in or authority over petitioner's operations, if any, in either 1998 or 2002. While the nature and extent of petitioner's operations have changed significantly since 2002, it appears that as of 2002 ,when its application for relicensing was filed and for at least some short period of time thereafter, petitioner's operations were very limited in scope and were directed by Max Ruda (***see*** Finding of Fact 2). While it has become abundantly clear that Max Ruda is neither directing nor operating petitioner's business at this juncture and has not done so for some period of time, and that Joseph Ruda has become the person who in fact operates petitioner's business, the same was not the case in 1998 or in 2002. Thus, it cannot be said that petitioner's failure to list Joseph Ruda as a "controlling person" on either its 1998 or its 2002 applications, or to furnish a personal questionnaire made by Joseph Ruda, constituted a "false statement" such that petitioner committed fraud or deceit in its application to initially

[6] In 2008, this supplier role was partially reversed when petitioner became the supplier of Philip Morris products to G&S's customers (***see*** Finding of fact 17).

procure its license in 1998, or in the application it filed for relicensing in 2002. Accordingly, the first prong of the Division's first charge may not be sustained.

G. Treated next is the second prong of the Division's first basis for cancellation. As petitioner points out, there is a specific definition of "controlling person" set forth in the statute and regulations, and Max Ruda was and remains the only person who meets that specific definition of a "controlling person." Petitioner argues that it is entitled to rely upon such definition in filing its application and in its operations thereafter and that the Division may not expand upon such definition so as to require other persons who do not strictly meet this statutory definition, such as Joseph Ruda, to be identified as controlling persons.[7] This argument is rejected. First, the regulation at 20 NYCRR 72.1(b)(1) specifically requires an applicant for a license to furnish all information requested in the application, and the regulation at 20 NYCRR 72.1(c)(1) requires the applicant who becomes licensed to report any changes to the information shown on its application. The change of information in this instance is not a small or inconsequential change, but rather reflects a complete change of control from the listed "controlling person" to someone else. Further, to the extent the statute and regulations specify a precise definition of a "controlling person," so that such a person may be subjected to the obligations and penalties which apply to those who meet that specific definition, the same does not foreclose the Division's ability to require additional information, including the identities of those who are or become significantly involved in the actual operation and control of a licensee. The Division does not have entirely unfettered authority to require applicants to provide information. However, the information required on the license application and related required

[7] Petitioner's cite to and reliance on ***Matter of Kumar*** (Division of Tax Appeals, May 9, 2008) is misplaced, since such determinations may not be cited or considered as precedent in other matters (Tax Law § 2010[5]; 20 NYCRR 300015[e][2]).

filings, including identification and information concerning individuals defined as controlling persons for purposes of such application and filings, as well as the required notification of any changes thereto, is clearly relevant and important to the Division in carrying out its function of regulating those involved in the sale of cigarettes and tobacco products. Moreover, the application form and information to be furnished thereon is authorized by a duly adopted regulation (20 NYCRR 72.1[b][1]), and the requirement to update such information is likewise authorized by a duly adopted regulation (20 NYCRR 72.1[c][1]).

H. Under the facts of this case, petitioner has simply failed to comply with the foregoing identify and disclose requirements, and this failure provides sufficient basis to support cancellation of petitioner's licenses under the second prong of the Division's first charge, as well as under the Division's third charge. While Max Ruda was involved in operating petitioner's business when its license applications were filed, this situation has completely changed with the passage of time such that Joseph Ruda and others have come to control and operate petitioner's business. The business model under which petitioner operates, including specifically paying for the services provided by G&S as described, is not per se fraudulent, deceitful or unlawful. However, given the extent to which petitioner's business has evolved, to the point where operation and control has passed entirely from Max Ruda to others, the lack of any disclosure of the same to the Division does constitute deceit in petitioner's operation as a licensee. The most salient fact, as made clear through the testimony at hearing, is that Max Ruda is no longer operating petitioner's business, and that the actual authority and responsibility for such operations have been undertaken (or taken over) by Joseph Ruda, and are carried out by Joseph Ruda in conjunction with the operations of G&S and its personnel. This may be simply a result driven by the passage of time and the realities of changed circumstances. Nonetheless, there is a

clear legal obligation to advise the Division, in writing, of any changes to the information shown on a licensee's application for a license or as last reported to the Division 20 NYCRR 72.1[c][1]). Here, the change to the information presented on petitioner's application is clear. Petitioner would prefer to avoid the responsibility of informing the Division, as required, and seems to argue that since Max Ruda remains the only person with ultimate authority and responsibility for the operation and control of petitioner there was no change to report. This argument is not consistent with the requirement of the noted regulations, or with the actual manner in which petitioner's business is operated and controlled, nor does it give cognizance to the Division's legitimate interest in being apprised of who is actually conducting business under the licenses the Division issues and administers. Accepting petitioner's argument that Max Ruda remains the only person with ultimate authority and responsibility over petitioner not only ignores the reality of how petitioner's business is operated, but results in the untenable situation where G&S effectively gains the convenience, benefits and advantages of holding a second wholesaler's license without bearing any of the responsibilities or accountability which rightfully accompany the licensee's privilege of holding such a license. These circumstances, where a person undisclosed to the Division as required is in fact operating a licensee's business, constitutes deceit in operations per Tax Law § 480(3)(b)(i) and 20 NYCRR 72.3(b)(2)(i).

Petitioner's argument, in simplest terms, is that its business essentially "runs itself" under its chosen business model, given that nearly all of the physical aspects of such business are simply carried out by G&S employees and administrators in return for payments for such services made on the basis of an allocation reflective of the two entities' relative sales volumes. While this may be true as to the ongoing physical operation of the business, it does not address the

decision-making aspects of petitioner's operation.[8] All of the Division's dealings with petitioner have come through Joseph Ruda, and there have been no interactions of consequence with Max Ruda, allegedly the only person controlling petitioner's business and the only person so-identified to the Division. Necessary signatures are affixed either by using a stamp facsimile signature of Max Ruda or, in some instances, by signature of those carrying out the particular function requiring a signature. Those persons carrying out these activities are all employees of G&S, and petitioner pays G&S to compensate it for providing the manpower to carry out these functions. The evidence further fully supports the conclusion that Joseph Ruda possesses the greatest de facto overall authority with respect to these daily and ongoing activities, and has been given authority to act without limitation on Max Ruda's behalf via a durable general power of attorney given by Max Ruda, itself a step (under the circumstances of this case) tantamount to an assignment of petitioner's license. Max Ruda is no longer carrying out, directing or involved in the duties enumerated in the Division's application and in the controlling person's personal questionnaire (***see*** Findings of Fact 6 and 11). All operating authority and control has been ceded to Joseph Ruda and G&S employees, such that the "controlling person" as identified in name to the Division is no longer controlling anything in fact.

Petitioner does not concede that authority and control over petitioner has been ceded to or taken over by other persons. Implicit in this position is that Max Ruda not only continues to possess authority and control over petitioner, as is set forth in its license application and other related required documents, but also that he in fact continues to exercise such authority and

---

[8] The conflicts created in the actual method of operation may be seen even in this method of "reimbursement" for services between G&S and petitioner. That is, with Joseph Ruda (as opposed to Max Ruda) in actual authority and control over the operation of petitioner's business and also the owner of G&S, there is no means by which petitioner could even effectively challenge the terms or the cost appropriateness of the reimbursement agreement.

control as the person "controlling" the licensee's operations. Under the actual facts of its operations, petitioner's argument is rejected as unsupported by the evidence. It is entirely reasonable for the Division to cancel the license of a wholesaler when the only person identified and held out to the Division as controlling the licensee and having authority over its operations is entirely uninvolved, and is apparently unable to be involved, in the licensee's operations. The fact that other persons may step in to control the licensee's ongoing operations does not ameliorate this situation, especially where the Division is not notified of the same (20 NYCRR 72.1[c][1]). In sum, petitioner was obligated to advise the Division of the changes to the information set forth on its application (20 NYCRR 72.1[c][1]). Its failure to do so constitutes deceit in operations as a licensee under Tax Law § 480(1)(b)(i) and 20 NYCRR 72.3(b)(2)(i), and supports license cancellation thereunder, as well as under the Division's third charge (failure to notify as required, per 20 NYCRR 72.1[c][1]).

I. The Division has also proposed license cancellation upon the charge that petitioner failed to maintain a secure and separate warehouse. Relevant to this charge is Tax Law § 480(1)(d), which provides as follows:

> Each applicant shall file satisfactory proof that it will maintain a secure separate warehousing facility for the purpose of receiving and distributing cigarettes or tobacco products and conducting its wholesale business. Such proof shall consist of a copy of a deed, or a copy of an *executed* lease for a minimum period of two years, to a separate, secure warehouse. If the applicant carries on another business in conjunction with the warehouse facility, the other business shall also be identified (emphasis added).

In addition, 20 NYCRR 80.2(b)(2)(i) provides as follows:

> A *separate warehousing facility* for the purpose of receiving and distributing cigarettes and conducting wholesale business shall mean a warehouse, storehouse or other commercial building, or a group of such buildings, wherein cigarettes are received, stored and distributed and the dealer's day-to-day wholesale business activities are conducted. Such a warehousing facility must be separate and distinct

> from any other person's facilities. A warehousing facility shall not include a mere enclosure within a larger facility, nor a means of transportation (i.e., a truck or van).

J. The Division alleges that petitioner's business is being carried on by persons not employed by petitioner, from a location other than petitioner's facility. According to the Division, petitioner specifically violated Tax Law § 480(1)(d); § 483(a)(2) and 20 NYCRR 80.2(b)(2)(i) in that petitioner did not maintain a secure, separate warehouse where cigarettes and tobacco products are received, stored and distributed and did not conduct its day-to-day wholesale business activities from such a warehouse. The Division asserts that petitioner and G&S regularly "commingled" cigarettes and tobacco products, citing among other instances its discovery, upon investigation of G&S's premises, that approximately 15,000 cartons of cigarettes invoiced from Resnick to petitioner were located in a loading area of G&S's warehouse "headed for distribution." According to the Division this presence, as opposed to the presence of such product in petitioner's own warehouse, represents a failure to maintain a secure and separate warehouse from which petitioner's purchased and stored products were being distributed. While the Division agrees that products may be delivered by another entity, it argues that such products must at least be received and distributed out of the licensee's own warehouse facility. Further, the Division noted upon its inspections that petitioner shared office space with an unrelated business, Gallo Investigations, a firm which provides security services for petitioner, thereby allowing access to its warehouse space in violation of the secure and separate warehouse requirement. Finally, the Division maintains that on various occasions, untaxed cigarettes and tobacco products owned by G&S were stored at petitioner's premises when one of G&S's trucks containing such products was parked overnight on petitioner's premises. This allegedly violated the "secure" component of the law, since G&S "had complete access to" petitioner's warehouse,

as well as the "separate" component, since G&S stored inventory there. In sum, the Division argues that the operations of petitioner and G&S are so intermingled that they are essentially the same business.[9]

K. Tax Law § 480(1)(d) requires a licensee to provide proof that it will maintain a separate and secure warehousing facility for the purpose of receiving and distributing cigarettes and tobacco products and conducting its day-to-day wholesale business (20 NYCRR 80.2[b][2][i]). Such proof shall include a copy of an executed lease to a separate and secure facility. Careful review of the lease documents submitted in evidence reveals that the most recently executed lease for the premises at 39-25 23rd Street, held out as petitioner's warehouse, is dated March 27, 2007 and identifies the tenant as "Gutlove and Shirvent, Inc. d/b/a Max's Smokes," with its address listed as 39-26 23rd Street, i.e., G&S's address. This lease is signed by Joseph Ruda on behalf of Gutlove and Shirvent, Inc., as the tenant (***see*** Finding of Fact 13). The evidence in the record does not include any sublease or other such interest in the premises at 39-25 23rd Street being thereafter conveyed to petitioner. Thus, it appears not only that G&S has stepped into the shoes of petitioner (Gutlove and Shirvent, Inc. *d/b/a Max's Smokes*), but that as a result, petitioner does not in fact maintain any facility, secure or otherwise. On this basis alone, the Division's proposed cancellation must be sustained.

L. Petitioner has alleged that for many years it conducted minimal activities and had periods of inactivity, and thus did not have inventory in storage but rather fulfilled whatever

---

[9] The argument that a sealed G&S truck, allegedly containing unstamped packages of cigarettes and other tobacco products, parked on a delivery ramp at (as opposed to inside) petitioner's facility means that petitioner was "in possession of" G&S's products and that G&S had "complete access to petitioner's warehouse facility" in violation of the secure and separate warehouse requirement of Tax Law § 480(1)(d) is rejected. This argument would appear more properly directed to G&S and the manner in which it handled its products, or perhaps to the first basis for license cancellation concerning the control over, access to and use of petitioner's premises by G&S and its owner Joseph Ruda.

customer orders it had by paying G&S for the necessary products and for directly staging and delivering the same on petitioner's behalf. According to petitioner, the Division is claiming that none of a wholesaler's business can be conducted outside of that wholesaler's separate and secure warehouse facility. Petitioner posits that this is tantamount to a prohibition on a wholesaler having its accounting or tax functions carried out at an accountant's own premises, or its payroll functions handled by an off-premises third-party vendor, or its banking functions carried out at a bank's location. Petitioner's chosen business model and its modest business activities prior to 2008, when its sales volume increased as described, enabled it to conduct the physical aspects of its business without needing to use the warehouse facility it maintained.

Notwithstanding petitioner's characterization of the Division's position as prohibiting any off-premises business functions, the facts in this case reveal that until such time as petitioner began to provide Philip Morris products to G&S's customers, no part of petitioner's business was conducted in any manner in or from petitioner's warehouse facility, with the same essentially an unused shell maintained only as a required condition of obtaining a license.[10] These circumstances support the conclusion that petitioner simply did not conduct its wholesale business activities, much less its day-to-day wholesale business activities, from the warehouse facility it was required to maintain and use for such purposes (Tax Law § 480[1][d]; 20 NYCRR 80.2[b][2][i]). Petitioner points out that when it had inventory, i.e., starting in 2008 when it began to supply Philip Morris products to G&S's customers, such products were initially received, staged, loaded and delivered from G&S's facility, then later were received at "petitioner's" facility but carried over to and staged, loaded and delivered from G&S's facility,

[10] G&S reimbursed petitioner for approximately 85% of petitioner's rental expense for the premises in return for which G&S stored certain of its records at the premises. It appears, however, that all of petitioner's business records were created, maintained and stored at G&S's facility.

and eventually (in the face of the Division's expressed concerns) were received, staged, loaded and delivered from "petitioner's" facility. Apparently, this argument is in part to address petitioner's use of a warehouse facility in conducting business when the need to do so occurred. However, since this change to using petitioner's facility occurred in 2008, i.e., after the lease to such facility was held by G&S, it cannot be concluded that petitioner was maintaining a warehouse facility or conducting its business from that facility at such time, nor does the argument address the fact that no business was conducted from petitioner's facility prior thereto.

M. Finally, petitioner argues that the Division arbitrarily denied its application to move its warehouse facility to 821 Lydig Avenue. The Division's denial was based on the assertions that it only had been given a lease naming G&S, but not petitioner, as the tenant to the premises, and that the premises did not comply with the statutory requirements for a warehouse facility. As to the first basis for denial, petitioner provided in evidence a copy of a sublease between G&S and petitioner which named petitioner as the tenant sub-leasing "3 rooms in the back of the building . . ." (***see*** Finding of Fact 15). While petitioner alleged that this sublease was provided to the Division at some point during the process of seeking approval to move petitioner's warehouse location, it would appear that the Division had not seen the same as of the date of its denial letter. In any event, it remains that the sublease document in the record is not signed, and thus does not meet the requirement that an executed lease be provided (Tax Law § 480[1][d]). Finally, petitioner pointed out that G&S used the premises as a warehouse from 1976 through 1995, as approved by the Division during that period of time. Petitioner bears the burden of establishing the suitability of the premises as a warehouse facility, per Tax Law § 480(1)(d) and 20 NYCRR 80.2(b)(2)(i). Petitioner noted that there was a fire at the leased premises in 1995, and stated that there were no structural changes but only cosmetic changes to the premises thereafter. The

record contains no photos and scant testimony describing the actual premises, such as would enable a determination herein as to the suitability of such premises as a warehouse facility at present.

N. The Division's final basis for license cancellation concerns petitioner's alleged imposition and collection of tobacco products tax without authority to do so, and its failure to remit such taxes as were allegedly collected. The Division maintains such actions of imposing and collecting tax without authority, and failing to remit such tax, were violations of Articles 20 and 20-A, thereby authorizing license cancellation pursuant to Tax Law § 480(3)(a)(ii) for failure to comply with any provision of Tax Law Article 20 or 20-A or any rule or regulation adopted thereunder. Specifically, the Division's charge is based on the fact that petitioner's sales invoices to its customers note a line item for "NYS Tob Tax" (New York State Tobacco Products Tax) and that the amount shown thereon exceeds the amount of tax which would be imposed based on the wholesale cost for such products.

O. Petitioner admits that it has neither applied for appointment as nor been appointed by the Division as a distributor, or been authorized as such to collect and remit tobacco products tax. Petitioner alleges that it is not in the category of businesses to which such collect and remit obligations apply, and that it has not in fact collected, or failed to remit, such tax. Petitioner asserts that listing tobacco tax on its customer sales invoices was done to provide more information to its customers, in keeping with the practice of its competitors. Petitioner does not dispute that the amount labeled and shown as tobacco tax was calculated as described on its product cost (including tax previously imposed on and paid by its supplier) plus its markup, but attributes this calculation method to a computer programming error leaving the amount shown as

tobacco products tax slightly overstated in some instances.[11] Petitioner also asserts that the 37% tax was imposed in the first instance on its supplier's cost for the products, and since its supplier remitted the tax so imposed, the Division has already received all of the tax to which it is entitled and the ensuing amounts involve only recoupments of tax plus profit down the chain to the retail level.

P. Payment of tobacco products tax to the Division, calculated as 37% of the wholesale price for such products, is made by and at the level of the distributor of such products, with the amount so calculated and paid to be passed down and recouped thereafter, ultimately, from the end-using consumer. This method of imposition and payment of the tax is accomplished as follows:

Tax Law § 471-b(1), "Imposition of tobacco products tax," provides:

> There is hereby imposed and shall be paid a tax on all tobacco products possessed in this state by any person for sale . . . . Such tax on tobacco products shall be at the rate of *thirty-seven percent of the wholesale price*, and is *intended to be imposed only once* upon the sale of any tobacco products (emphasis added).

Tax Law § 471-b(2), specifying that the "distributor" shall be liable for payment of such tax, which is "intended to be *imposed only once,*" 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] 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 (emphasis added).

Tax Law § 472(3) provides:

> The [Commissioner] may appoint dealers in tobacco products, manufacturers of tobacco products and other persons within or without the state as *distributors* and

---

[11] Petitioner notes that, where certain rebates or credits were provided by its suppliers, this method of calculation could result in the invoice amount labeled "tobacco tax" to be slightly understated.

> may authorize them to make returns and to pay the tax on tobacco products sold, shipped or delivered by them to any person in the state (emphasis added).

Tax Law § 473-a, describing the methods for filing tobacco products tax returns and paying the tax imposed and due thereon provides:

> (1) Every distributor shall, on or before the twentieth day of each month, file with the [Commissioner] a return on forms to be prescribed and furnished by the commissioner, showing the quantity and wholesale price of all tobacco products imported or caused to be imported in the state by him or manufactured in the state by him, during the preceding calendar month. Every distributor authorized by the commissioner to make returns and pay the tax on tobacco products sold, shipped or delivered by him to any person in the state shall file a return showing the quantity and wholesale price of all tobacco products so sold, shipped or delivered during the preceding calendar month . . . .
>
> (2) Every distributor shall pay to the commissioner with the filing of such return the tax on the tobacco products for such month imposed under this article.

Q. Unlike certain other taxes (e.g., sales tax), where the retailer is under an obligation to collect and remit taxes to the Division, the imposition and obligation to remit tobacco products tax is placed by law early in the chain of distribution and squarely upon the distributor. Petitioner is not licensed as a distributor and thus is neither authorized nor obligated to collect tax, make returns, or remit tobacco products tax to the Division. Petitioner does pay the amount of such tax (or perhaps an amount in excess of such tax) to its supplying distributor when it pays its distributor for such products.[12] This is the means by which the distributor recoups the tax it pays. In turn, petitioner recoups its cost, including tax (or in this case an amount greater than simply the amount paid by petitioner to its supplying distributor) from its customers via the price it charges to its customers. This is the means by which the tax continues to be passed down to

---

[12] The record does not disclose whether petitioner simply made its distributor (G&S) "whole" by paying only the 37% G&S paid in tobacco products tax, or rather whether the price at which petitioner bought products from G&S was calculated based on a markup percentage applied to G&S's cost for the products plus the tax paid thereon, similar to the manner in which petitioner's selling price to its customers was calculated.

the end user who purchases and consumes the products. Such "pass-through" recoupment does not represent an additional imposition of tobacco products tax, or mean that petitioner was imposing or collecting tobacco tax, and petitioner has reasonably explained the circumstances by which it appears it was collecting but not remitting what is denominated tobacco products tax on its sales invoices. The presentation of an amount on an invoice for "informational purposes" allegedly (albeit inaccurately) representing the amount of tobacco tax collected by petitioner's supplying distributor does not mean, under the statutory method by which tobacco products tax is imposed and collected, and then recouped "down the line", that petitioner was imposing, collecting and thereafter failing to remit tobacco products tax. Therefore, there was no violation of the Tax Law as asserted by the Division. Accordingly, the Division's fourth basis for license cancellation, premised on failure to comply with any provision of Tax Law Articles 20 or 20-A or any rule or regulation adopted pursuant thereto and based on petitioner's alleged unauthorized imposition, collection, and failure to remit tobacco products tax, is rejected.

R. Notwithstanding the foregoing conclusion, however, the facts set forth with respect to the Division's fourth charge bear on and provide additional support for the Division's first charge concerning deceit in operations, per Tax Law § 480(3)(b)(i). That is, despite its professed aim and desire, it is clear that petitioner was not simply identifying to its customer the amount of tax petitioner had paid to its supplier and was passing through to (and recouping from) its customer. While petitioner would minimize the importance of the label "tobacco tax" on its sales invoices, it seems only reasonable that the identification of an amount as "tax" on an invoice to a customer would lead that customer to accept and rely upon such labeled amount as a tax required to be paid. In fact, only a portion of the amount specifically labeled as tax was, in reality, the tax which had been initially imposed and was being recouped. The balance of the amount labeled as

tax in fact constituted an additional sales amount realized by petitioner. While petitioner describes the Division's charge as "baffling," and would dismiss the impact of the label "tobacco products tax" on its sales invoices, it remains that the alleged "programming error" clearly resulted in a portion of petitioner's selling price being misidentified to its customers as tobacco tax. This manner of presentation is in direct contravention to the claim that the tobacco products tax amount was simply segregated out on the customer invoices to provide additional information or clarity to petitioner's customers. At best, petitioner's sales invoice presentation provided its customers with inaccuracy, confusion and less information. Though attributed to a simple programming error, it strains credulity to accept that G&S, which prepared the invoices in question for petitioner, did not understand the nature of the calculation being performed or the resulting information being set forth on the invoices provided to petitioner's customers. Given that G&S prepared all of petitioner's invoices under the "business model" adopted by petitioner, one might expect petitioner to have caught this "programming error" upon simple review of such invoices at some point over the course of approximately five years before the same was discovered on audit and thereafter rectified by G&S. However, since Max Ruda, allegedly the only person with final or ultimate authority for petitioner, was not in fact involved in petitioner's operations for the majority of the period during which the "programming error" was ongoing, it is not surprising that petitioner "overlooked" or "did not catch and correct" this "error." If nothing else, this situation highlights the circumstances which can result from absentee ownership and ceding of control, and bears out the legitimacy of the Division's interest in being accurately apprised of who, in fact, is controlling the operations of its licensees. Ultimately, as a direct consequence of the manner in which petitioner was being operated, its customers received invoices which incorrectly and deceptively reflected the portion of their purchase price which

was attributable to tobacco products tax. The most reasonable conclusion to be reached upon the facts is that although it identified an amount as tax on its invoices petitioner was not imposing and collecting "tax," especially given that the tax in question is imposed by statute farther "up the stream." Rather, petitioner was collecting a markup amount while misidentifying the same to its customers as tax in a purposefully deceptive manner intended to disguise the amount of markup being charged by petitioner.

S. The petition of Max's Smokes, Inc. is hereby denied and the Notice of Proposed Cancellation dated March 26, 2007 is sustained.

DATED: Troy, New York
January 14, 2010

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE