

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
LEONARD SCHWARTZ : **DECISION**
D/B/A GLOBE WHOLESALE COMPANY : **DTA No. 811785**
: :
for Revision of a Determination or for Refund of Cigarette :
Tax under Article 20 of the Tax Law for the Year 1991. :

Petitioner Leonard Schwartz d/b/a Globe Wholesale Company, 5406 Third Avenue, Brooklyn, New York 11220, filed an exception to the determination of the Administrative Law Judge issued on September 15, 1994. Petitioner appeared by Phillips, Nizer, Benjamin, Krim & Ballon, Esqs. (Thomas G. Jackson, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

Petitioner filed a brief in support of his exception, the Division filed a brief in opposition and petitioner filed a reply brief. Oral argument was heard on February 15, 1995 and began the six-month period for the issuance of this decision.

The Tax Appeals Tribunal renders the following decision per curiam. Commissioner Donald C. DeWitt took no part in the consideration of this decision.

ISSUE

Whether the Division of Taxation properly denied petitioner's refund claim of cigarette tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "8" which has been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified finding of fact and the additional finding of fact are set forth below.

Petitioner, Leonard Schwartz d/b/a Globe Wholesale Company ("Globe"), is a wholesale dealer and distributor engaged in the sale of cigarettes, tobacco products, candy and sundries to retail buyers and subjobbers for purposes of resale in the State of New York. Globe is located at 5406 Third Avenue in Brooklyn, New York.

Globe has been in business since 1946 and, since 1963, has been a licensed agent of the State and City for the collection of cigarette taxes. Leonard Schwartz became a partner in Globe in the late 1970's or early 1980's (his father began the business) and became the sole owner upon his father's death in 1984. By 1990, Globe's sales had risen to approximately \$90,000,000.00 per year with cigarette sales accounting for the bulk of the business.

In its position as a licensed agent for the collection of State and City cigarette taxes, Globe purchases joint cigarette tax stamps from an agent or bank authorized to sell the stamps and affixes the stamps to each package of cigarettes sold as evidence of payment of the cigarette taxes.

Globe purchased cigarettes from six manufacturers and received a delivery once a day. All six manufacturers used Elk Transportation which delivered 500 to 600 cases (a delivery consisted of cigarettes from all of the manufacturers) per day to Globe.

During the period at issue herein, Globe ordered and obtained delivery of cigarette tax stamps from Key Bank which acted as fiscal agent of the State and City. The stamps were purchased on 30-days' credit secured by a bond filed with the State. Globe usually kept, in inventory, enough stamps to satisfy its stamping requirements for a two to three-day period.

Mr. Schwartz or his manager signed for the stamps. They were stored in a steel cabinet in Globe's money counting room. Globe had two money counters. Delivery men would drop off their bags of money in the money counting room after completing their deliveries.

A roll of stamps is approximately the same size as a roll of paper towels. Globe utilized a Meyercord stamping machine which was a heat-sealing machine. When the stampers needed a new roll of stamps, they would see Mr. Schwartz or his manager who would take a roll from the

steel cabinet and hand it to the stamper. The stamping machine used one roll of stamps at a time. Approximately seven to nine rolls of stamps were used per day by Globe.

In August 1989, one of Globe's customers (Mike's Wholesale of 9225 Third Avenue in Brooklyn) notified Leonard Schwartz that one of Globe's employees had offered to sell him 10,000 stamps (1/3 of a roll). At Mr. Schwartz's request, the customer made a recording of his conversation with the employee and, thereafter, Mr. Schwartz and his head of security, Robert Nesbit, went to the 72nd Precinct to report the theft. They met with Detective Statfeld who prepared a police report dated August 5, 1989 (see, Exhibit "1").

The police contacted the employee, Habib Alsabeh, who admitted to the theft. The stamps, which had been cut in strips or pieces from the roll, were eventually recovered. No charges were pressed against Mr. Alsabeh, but he was discharged from his employment with Globe. A follow-up report (Exhibit "2"), dated August 8, 1989, was prepared by Detective Statfeld. This report stated, in part, as follows:

"1. On 8/5/89, the assigned did interview the complainant and the alledged [sic] perpetrator. At this time the complainant stated that he wanted no police action taken against the perpetrator if he was to return the stolen property, tax stamps.

"2. The perpetrator made a telephone call to a friend of his and the property, tax stamps were returned. An unknown amount of stamps valued at an unknown amount of money was missing, but Habib had no idea where they were. He states numous [sic] employees are involved in the stealing of tax stamps."

Leonard Schwartz testified that the police found no other persons involved. However, to satisfy himself that no additional stamps were missing, he conducted a physical inventory on October 31, 1989, at which time it was discovered that Globe had a surplus of six rolls of stamps. Mr. Schwartz stated that he assumed that this surplus resulted from an error made in the receiving of cigarettes. It was subsequently determined, during an audit conducted by the Division of Taxation ("Division") in November 1990, that Globe had failed to log in six rolls of stamps in April 1989 which accounted for this surplus.

Leonard Schwartz stated that despite the fact that Globe was a high-volume (but low-margin) business, he oversaw everything, i.e., he made all deposits, watched over all receivables, called in stamp orders and hired and fired all employees. Sometime during February or March 1990, he felt that his accounts were out of balance. Therefore, in April 1990, another physical inventory was taken. This inventory, which was concluded on the 1st or 2nd day of May 1990, revealed that Globe was missing 55 or 56 rolls of stamps. After checking over his receiving slips several times, he reported the shortage to his Director of Security, Robert Nesbit, who then reported it to the police. A police report, prepared in conjunction with this investigation, stated, in part, as follows:

"1. Upon the request of Mr Scwartz [sic], the assigned conducted an investigation at the Globe Wholesale Corp. 5406 3 Ave. into the disappearance of tax stamps from his premises.

"2. During August of 1989, an investigation revealed that stamps had been taken by an employee, Habib Alsaabeh [sic], and an unknown person. A large quantity of stamps were recovered, but there were still stamps missing.

"3. Interview with Robert Nesbit, Security officer of G.W.C. reveals that many employees were lax in their application of the stamps. However, that has been corrected, and a strict accounting of the stamps have been implemented.

"4. Both Mr. Nesbit and the assigned have conducted interviews with several employees who process the stamps onto the packs of cigarettes, and Mr. Nesbit has instructed these employees into the usage of the stamps.

* * *

"6. None of the above named individuals have admitted to any wrongdoing, but inspections by the security manager Mr Nesbit reveals that some have been less than careful in the usage of the stamps and he has taken steps to prevent losses in the future.

"7. Attempts were made to locate the person who originally had stolen the stamps in August of 1989, Habib Alsabeh, but efforts to locate him have been without results to date. It is quite possible, since there was another unapprehended person, that many more stamps had been taken by the two men, other than what had been recovered."

Sometime during May or June 1990, Mr. Schwartz contacted the Division and requested that an audit be performed. David Margolin was assigned by the Division to perform the audit. He contacted Mr. Schwartz in June and again in July and, ultimately, scheduled a physical inventory for early September 1990. The initial inventory was completed, but because there were large quantities of loose, unaffixed stamps which Mr. Margolin felt were too numerous to count, he asked Mr. Schwartz to reduce the number of these loose stamps. A second physical inventory was taken on October 1, 1990. After completion thereof, Mr. Margolin provided Globe with an estimate that approximately 55 to 56 rolls of tax stamps were missing. Globe was not insured against this loss.

Globe's Resident Agent Cigarette Tax Return for the month of July 1990, prepared and signed by Leonard Schwartz on October 15, 1990, was the first return filed after completion of Mr. Margolin's second physical inventory. This return was the first to note the shortage of the 55 to 56 rolls of stamps.

After completion of his physical inventory of Globe, Mr. Margolin scheduled a field audit for November 12, 1990 in order to complete the reconciliation of the stamp inventory and the remaining audit procedures. Globe noted, on its July and August 1990 returns, that this audit was scheduled for November 12, 1990 (see, Exhibits "4" and "5"). The July and August 1990 returns were prepared on the same date (October 15, 1990). Admittedly (by Mr. Schwartz), these returns were not timely filed; however, he stated that he had not filed his returns on time for the last 15 years. When the audit was completed, Mr. Margolin determined that six rolls of stamps, purchased by Globe in April 1989, had been overlooked when it recorded its stamp purchases at that time. This explained the six-roll surplus found by Leonard Schwartz in his October 1989 inventory (see, above). Mr. Margolin prepared a summary tax return estimate for the period November 1, 1987 through September 30, 1990 which reflected over stamping of 1,781,040 39-cent joint tax stamps to be affixed to packs containing 20 cigarettes (approximately 60 rolls) and

11,010 48 3/4-cent stamps to be affixed to packs containing 25 cigarettes (approximately one roll).

We modify the Administrative Law Judge's finding of fact "8" to read as follows:

Globe followed the practice of preparing and filing monthly tax returns by calculating its month-end inventory of unstamped cigarettes based upon its stamp purchases, its purchase of unstamped cigarettes and its closing inventory on prior months' tax returns, thereby balancing out any over stamping or under stamping at the end of each month.

This practice is common among wholesale cigarette agents and was accepted by the Division. The audit narrative (see, Exhibit "K") prepared by Mr. Margolin, stated that "[t]his procedure is accepted by the primary cigarette tax auditor for N.Y.S. in N.Y.C. and TTTB/FACCTS, but not by this auditor."

At the hearing, the Division's only witness was Stanley Zimmerman, Senior Special Tax Investigator, who had no involvement with the audit. Mr. Zimmerman disputed the fact that the practice of large agents balancing their returns was accepted by the FACCTS (Fuel, Alcohol, Cigarette and Carrier Tax Section) of the Transaction and Transfer Tax Bureau (TTTB) of the Division. Globe provided the testimony of Mr. Zimmerman's former supervisor, Emanuel Urzi, presently the Special Assistant to the Deputy Commissioner of Tax Enforcement, who stated that, in his opinion, the "primary cigarette tax auditor" referred to in the audit narrative was Mr. Zimmerman. Mr. Urzi further testified that when Mr. Zimmerman worked for him during the years as Director of the Cigarette Tax Bureau, he accepted the "balancing out" procedure referred to herein.¹

Stanley Zimmerman appeared on behalf of the Division to testify as to how the audit was performed which was as follows:

(a) Took physical inventory, at close of audit period, of unstamped cigarettes and unaffixed stamps;

¹We modified the Administrative Law Judge's finding of fact by altering the first sentence of the second paragraph. This sentence had read as follows:

"It is the position of Globe that this practice is common among wholesale cigarette agents and that it is accepted by the Division."

We made this change, at the request of petitioner, because it was clearly supported by the record and because the Administrative Law Judge did not state any reason not to make such an explicit finding.

(b) Reconciled purchases of cigarettes with what manufacturers state that they sold to the agent; and

(c) Reconciled stamp purchases (what Globe states that it purchased) with sales records of bank.

Mr. Zimmerman testified that there was no indication in the audit report as to when the missing rolls (60 rolls of 20's stamps and 1 roll of 25's stamps) were purchased.

On July 25, 1991, Globe filed a claim for refund or replacement of unaffixed stamps in the amount of \$699,973.00. By letter dated November 25, 1991 (see, Exhibit "D"), the Division's Transaction and Transfer Tax Bureau (Fuel, Alcohol, Cigarette and Carrier Tax Section) denied Globe's request for refund.

In his opening statement at the hearing, the Division's representative, while not pleading it as an affirmative defense, raised the issue that Globe failed to show that the stamps allegedly stolen were purchased within the two-year time frame of the Article 20 refund provision (Tax Law § 476).

In addition to the facts found by the Administrative Law Judge, we find the following:

Petitioner proved that the stamps were stolen and that he exercised due care in the conduct of this business.

OPINION

With respect to the timeliness of petitioner's claim for a refund, the Administrative Law Judge determined that the Division did not raise the statute of limitations at the hearing and, therefore, this defense was waived. As a result, the Administrative Law Judge concluded that the refund claim was timely. The Division has not taken exception to this conclusion.

On the merits, the Administrative Law Judge concluded that petitioner was not entitled to a refund. The Administrative Law Judge stated that there is no provision in either the applicable law, Tax Law § 476, nor regulations, 20 NYCRR 337.1, which allowed a refund based on stolen

stamps. While noting that section 471(2) of the Tax Law provides that the ultimate incidence of the tax is on the consumer, the Administrative Law Judge pointed out that this section also states that the tax shall be advanced and paid by the agent and that the Court in Matter of Mandel Tobacco Co. v. State Tax Commn. (58 AD2d 930, 397 NYS2d 23, lv denied 43 NY2d 645, 402 NYS2d 1027) allowed an agent to bear the incidence of the tax when the Court sustained the assessment of tax on unstamped cigarettes stolen from an agent.

On exception, petitioner first complains that the Administrative Law Judge failed to find fundamental facts that were crucial to its claim despite petitioner having submitted detailed and uncontroverted evidence.

As indicated in the findings of facts, we have modified the facts at petitioner's request to state that: petitioner followed industry practice in its method of reporting inventories on its monthly cigarette tax returns which was accepted by the Division; the cigarette tax stamps were stolen; and petitioner established due care in the conduct of its business. We have made these modifications because they are supported by the evidence in the record and they are not significantly controverted by the evidence in the record. Further, the Administrative Law Judge explicitly stated that petitioner's testimony "cannot be found to be anything but credible" and that this testimony indicated that the loss of the stamps was not due to any fault on petitioner's part (Determination, conclusion of law "B").

We did not make a finding, as requested by petitioner, that the Division has consistently maintained the same position as petitioner, i.e., that a cigarette tax agent does not acquire title to the tax stamps, as that allegation is not supported by the record. The record indicates only that the Division took that position in Lincoln First Commercial Corp. v. New York State Tax Commn. (136 Misc 2d 478, 518 NYS2d 904).

Turning to the legal arguments, section 471 of the Tax Law imposes the tax on all cigarettes possessed for sale in the State. Section 471(2) provides that:

"[i]t is intended that the ultimate incidence of and liability for the tax shall be upon the consumer, and that any agent or dealer who shall pay the tax to the tax commission shall collect the tax from the purchaser or consumer. Except as hereinafter provided, the tax shall be advanced and paid by the agent. The agent shall be liable for the collection and payment of the tax on cigarettes imposed by this article and shall pay the tax to the tax commission by purchasing . . . adhesive stamps"

Section 476 of the Tax Law states, in pertinent part, that:

"[w]henver any cigarettes upon which stamps have been placed or tobacco products upon which the tax has been paid have been sold and shipped into another state for sale or use there or have become unfit for use and consumption or unsalable, or have been destroyed, or whenever the commissioner of taxation and finance shall have determined that any tax imposed by this article shall have been paid in error, the agent . . . shall be entitled to a refund of the actual amount of tax so paid."

Petitioner relies on the portion of the statute that allows a refund of tax paid in error asserting that:

"it paid the cigarette tax erroneously because it purchased tax stamps that it could not affix to cigarettes [footnote omitted] and thus was required to bear the tax itself. Since the Legislature has explicitly expressed its intention that the consumer bear the burden of the tax in Tax Law § 471(2), Petitioner paid the tax in error, and therefore should be reimbursed" (Petitioner's brief, p. 29).

The Division responds that:

"[t]here is no evidence that the petitioner's payment of tax on cigarettes in its possession by the purchasing of cigarette tax stamps was erroneous. There is no contention that the stamps at issue were not purchased by the petitioner pursuant to his duties as a cigarette tax agent. They were purchased with the apparent intention that they would be affixed to cigarette packages possessed in this State for sale. The fact that the stamps became unavailable for the petitioner's use some time after their purchase does not convert the stamp purchase into an erroneous tax payment" (Division's brief, pp. 6-7).

We agree with the Division. As an agent authorized to purchase stamps, petitioner purchased the stamps at issue for the purpose of affixing them, within two or three days, to cigarettes held by petitioner. Petitioner has not demonstrated the error in this purchase of stamps

and payment of tax. Although petitioner could not affix the stamps after they disappeared, we do not see that this fact transforms the purchase of the stamps into an erroneous payment of tax.

Further, we do not agree with petitioner that the tax payment later became erroneous because, as a result of the loss of the stamps, petitioner was required to bear the cost of the tax. As the Administrative Law Judge noted, Matter of Mandel Tobacco Co. v. State Tax Commn. (supra) establishes that this result is permissible. The fact that this result occurred in Mandel as a result of stolen unstamped cigarettes rather than stolen stamps does not, in our view, preclude the application of Mandel here. In each case, the agent was required to bear the cost of stamps that would not be affixed to cigarettes. We do not see that the reason for the additional purchase of stamps -- loss of stamps or loss of unstamped cigarettes -- is important when considering whether the agent can be required to bear the cost of the tax.

In our view, if the Legislature had intended to allow for a refund of tax when stamps were lost or stolen, this basis for a refund would have been explicitly stated in section 476 along with the other specifically enumerated grounds, e.g., when the cigarettes have become unfit for use or have been destroyed. The legislative decision not to allow a refund on the basis of lost or stolen stamps is supported by the fact that the agent, having custody of the stamps, is the only person in a position to ensure that the stamps are cared for properly. If an agent were able to obtain a refund for lost or stolen stamps, agents would have little incentive to safeguard the stamps and the Division would not have the ability to do so.

As an independent basis for recovery, petitioner renews his argument, which was rejected by the Administrative Law Judge, that as an agent of the State for collecting the cigarette tax, petitioner had no legal title nor interest in the tax stamps and, therefore, cannot be held to bear the risk of loss of the stamps. The Administrative Law Judge also rejected petitioner's contention that the Division was bound by the position taken by it in Lincoln First Commercial Corp. v. New York State Tax Commn. (supra), i.e., that a "stamping agent possessed neither legal title nor ownership of the cigarette tax stamps or the proceeds thereof and, therefore, the taxing authority

expressly and/or impliedly reserved title and ownership thereto and to the proceeds thereof" (Determination, Summary of the Parties' Positions).

We agree with the Administrative Law Judge that the positions stated by the Division in Lincoln were legal arguments, not facts, and that the Division is not bound by these arguments and affirm his determination on this point for the reasons stated in it.

With respect to the merits of the argument, we conclude that if the location of title is relevant, then the provisions of Article 20 indicate that the Legislature intended that title to the stamps pass to the agents. As the Division noted, Tax Law § 470(11) defines an agent as "[a]ny person licensed by the commissioner of taxation and finance to purchase and affix adhesive or meter stamps on packages of cigarettes . . ." (emphasis added). Section 472 of the Tax Law, setting forth the means by which stamps are sold and affixed states, in part:

"[t]he tax commission shall make provisions for the sale of such stamps at such places and at such times as it may deem necessary and may license agents for such purpose. . . . Whenever the tax commission shall sell and deliver to any such agent any such stamps, such agent shall be entitled to receive as compensation for his services and expenses as such agent in selling or affixing such stamps, and to retain out of the moneys to be paid by him for such stamps, a commission on the par value thereof. The tax commission is hereby authorized to prescribe a schedule of commissions, not exceeding five per centum, allowable to such agent for buying and affixing such stamps. Such schedule shall be uniform with respect to the different types of stamps used, and may be on a graduated scale with respect to the number of stamps purchased. The tax commission may, in its discretion, permit an agent to pay for such stamps within thirty days after the date of purchase" (emphasis added).

The consistent use of the terms selling and purchasing in this statutory scheme negates petitioner's contention that he did not have title to the stamps. Even petitioner recognizes (Petitioner's brief, p. 33) that the principal and agent can explicitly alter the common law rule that an agent does not obtain title to the principal's property. We conclude that the Legislature did so in the above quoted provisions.

In any event, we believe that the location of title to the stamps is not determinative of this case. The stamps have no inherent value as tangible personal property, their significance is based solely on what they represent: payment of tax by the agent. Accordingly, the issue is not who bears the risk of loss of the stamps but is, instead, whether petitioner is entitled to a refund of tax. Because, as explained above, we have found no authority in Article 20 to require a refund in the present circumstances, this tax refund case must be resolved against petitioner.

Lastly, the Administrative Law Judge held that petitioner was not entitled to a redemption of stamps because there is no authority in the statute or regulations for the redemption of lost stamps. On exception, petitioner acknowledges that there is no express provision allowing for the redemption of lost stamps but argues that there is no provision limiting redemption to the situations where stamps are affixed to cigarettes that are sold outside the State, damaged, destroyed or otherwise rendered unusable.

We affirm the determination of the Administrative Law Judge on this issue for the reasons stated in the determination.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Leonard Schwartz D/B/A Globe Wholesale Company is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Leonard Schwartz D/B/A Globe Wholesale Company is denied; and
4. The Division of Taxation's denial of petitioner's refund claim is sustained.

DATED: Troy, New York
July 6, 1995

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

