

NOT FOR PUBLICATION WITHOUT APPROVAL OF
THE TAX COURT COMMITTEE ON OPINIONS

TAX COURT OF NEW JERSEY



Mala Sundar
JUDGE

R.J. Hughes Justice Complex
P.O. Box 975
25 Market Street
Trenton, New Jersey 08625
Telephone (609) 815-2922x54630
TeleFax: (609) 984-0805
taxcourttrenton2@judiciary.state.nj.us

August 9, 2017

Lawrence N. Shapiro, Esq.
ANSELL GRIMM & AARON
1500 Lawrence Avenue, CN 7807
Ocean, New Jersey 07712

Heather Lynn Anderson
Deputy Attorney General
R.J. Hughes Justice Complex
25 Market Street, P.O. Box 106
Trenton, New Jersey 08625-0106

Re: Cigar Stop, Inc. v. Director, Div. of Taxation
Docket No. 015587-2014

Dear Counsel:

This is the court's opinion on the parties' respective summary judgment motions. Plaintiff filed a complaint challenging the assessment of Tobacco Products Wholesale Sales and Use Tax ("TPT") and a civil fraud assessment imposed by defendant ("Taxation") for the period 01/01/2008 to 03/31/2013. Plaintiff moved for summary judgment asserting that no TPT is due because its primary sales were to an out-of-state vendor, or else TPT was collected by the wholesaler upon plaintiff's purchases of tobacco products, and that all supporting documentation in this regard was provided to Taxation. It also maintained that the civil fraud assessment was erroneous since Taxation did not produce clear and convincing evidence of plaintiff's fraud.

Taxation cross-moved for summary judgment contending that its audit and concurrent civil fraud assessment was entirely proper because plaintiff provided scant documentation; when more was requested, plaintiff provided documents which were fabricated after the fact (i.e., for purposes of the audit), and plaintiff's allegations of out-of-state sales were equally fabricated. Taxation further maintained that the civil fraud assessment comported with the objective standards of clear and convincing evidence set forth in the regulations, therefore, the same should be affirmed.

For the reasons stated below, the court upholds the assessment of TPT. However, it will defer decision on the propriety of the civil fraud assessment until after a hearing on this issue.

PROCEDURAL HISTORY

After completion of an audit of plaintiff, Taxation issued a Notice of Assessment dated August 30, 2013 imposing \$336,696.04 (TPT of \$186,221.34, interest of \$55,590.49, amnesty penalty of \$1,773.54, and civil fraud assessment of \$93,110.67¹) for the period January 2008 to March 2013. Plaintiff filed a timely protest to Taxation's Conference & Appeals Branch, which upheld the audit determination. Taxation then issued a final determination on August 28, 2014 demanding \$359,406.40, the increase being due to accrual of additional interest. Plaintiff timely appealed the final determination to this court.

Plaintiff then moved for summary judgment. In support, it provided a certification of its manager, samples of purchase invoices issued to plaintiff, sales invoices issued by plaintiff to one buyer J.J.J&G Wholesale (hereinafter "J.J.J&G"), printout from websites relative to J.J.J&G's alleged existence, copy of a certification from an alleged employee of J.J.J&G, and one TPT return.

¹ Civil fraud assessment is 50% of the tax assessment amount. N.J.S.A. 54:49-9.1.

Taxation's cross motion for summary judgment was supported by certifications of its auditor who had performed the audit and of its conferee who heard the administrative protest, the audit report (with computational schedules), the conference report, and the report from Taxation's fraud unit concluding that civil fraud assessment was properly imposed.

FACTS

Plaintiff is a New Jersey wholesaler and retail dealer of tobacco products, including cigars. It is owned by Arthur Simon, and managed by his son, Steve Simon. It transacted business (purchase and sale) through mail order. Per plaintiff, most of its sales are wholesale to J.J.J&G Wholesale (hereinafter "J.J.J&G"), a buyer allegedly located in Pennsylvania.

Plaintiff filed monthly TPT returns (Form TPT-20) starting January 2008. Except for a few months, the returns through June 2011 had all zeroes, i.e., zero imports, zero exports, zero taxable sales, zero non-taxable sales and zero tax due. Actual figures were on the June 2008, July 2008, October 2008, December 2008, March 2009, and May 2009 returns, and then only as to the amount of "tobacco imports" (i.e., purchases). Thus, information as to tobacco products exported (i.e., sold) and/or sold but non-taxable, was not provided.

During audit which commenced early 2011, plaintiff's accountant provided amended monthly TPT returns for periods starting 2008 to the auditor (all returns were amended in 2012), but which were apparently formally filed only subsequently. Those returns (except for January 2008) contained actual figures of tobacco purchased and sold (this time, some of the purchase amounts and sales amounts for a particular month differed, however, the purchase and sales amounts were the same for the months of November and December 2008; January to April 2009; June 2009 to December 2010, and December 2011). The returns for the months in 2012 reported all zeroes. According to plaintiff, there was no TPT ever due because it bought from vendors that

it knew either collected tax on plaintiff's retail sales, or did not collect tax on plaintiff's non-taxable sales.

Taxation compared the reported gross receipts on plaintiff's Corporation Business Tax ("CBT") returns versus its Sales and Use ("S&U") tax returns for 2008-2010. The difference was over \$150,000 per year. Plaintiff claimed that the amounts on the S&U reports were much smaller since it was only reporting net sales, and deducting therefrom non-taxable amounts. Taxation therefore requested source documents such as purchase invoices, sales records (journals, register tapes, sales invoices and the like) and bank statements for reconciliation.

As to records of its purchases of tobacco products, plaintiff provided certain invoices to the auditor. The auditor found that for a 28-month period of October 2008 to January 2011, no purchase included TPT on the invoice. TPT was collected thereafter on some purchases. Taxation also found that the invoice from a vendor called "House of Oxford," numbered 615934, showed a date of 02/24/2011 however, upon the auditor's contact with that seller it was discovered that the invoice was actually dated 05/02/2008. This led the auditor to believe that plaintiff altered the date of the original invoice. The auditor noted that plaintiff had provided her four other invoices from the same company dated May 2008, however "none of them had tax collected." Additionally, the auditor felt that plaintiff did not provide all purchase invoices because she had requested but did not receive information about purchases from one tobacco seller for which plaintiff had made an electronic payment.

Most of the purchase invoices provided by plaintiff to the court in support of its summary judgment motion showed zero TPT charged. Some April 2008 invoices from in-state sellers indicated that TPT was collected (i.e., charged to) plaintiff. Other vendors explicitly shifted responsibility to the buyer ("buyer agrees it is solely responsible for all state and local taxes that

may be imposed on the purchase.”). The purchase invoices did not otherwise indicate whether the products would be resold in or out of New Jersey.

One sample purchase invoice plaintiff provided to the court was from House of Oxford dated April 2, 2008 (numbered 616045). The bottom portion of the bill showed zero in the line item “tax.” Below that was a notation that the TPT would “automatically be added to [the] invoice on tobacco items only” for “New Jersey customers,” whereas out-of-state customers were responsible for such tax. Post-trial, the court brought up the issue of whether the auditor properly included all purchases from House of Oxford for purposes of extrapolating plaintiff’s taxable sales because of this notation. In response, Taxation produced a copy of invoice numbered 615934 (the one on which plaintiff allegedly changed the date). That invoice showed the unit prices of the tobacco items, a \$1 shipping and handling charge, and itemized the amount of TPT charged.

As to records of its sales, plaintiff provided Taxation with six sheets of paper, its sales journal. Those sheets had three columns, “Wholesale,” “rental fees – storage, lounge, lockers;” and “gifts and accessories – Retail – All,” with dollar amounts. None of the dollar amounts had any source or backup information, thus, it was unclear whether the “retail” sales included tobacco products. The wholesale amount represented sales by plaintiff to J.J.J&G. The column amounts showed that the wholesale of tobacco products totaled \$73,608.59 (for April through September 2009), rental fees totaled \$78,581.71 for that same period, and \$17,947.81 was from gifts, accessories, and retail. The wholesales amount for each month was the same as reported on the amended TPT returns for those months (all amended in 2012). Plaintiff provided a 2010 general ledger, which Taxation deemed as unreliable as account or payee names were redacted and no backup or source information was provided. Plaintiff’s 2009 bank statements provided to Taxation showed that the total deposits exceeded the total sales reported on the CBT or S&U tax

returns by about \$50,000 for a six-month period. The compiled totals showed that for April 2009 to September 2009 (the period for which plaintiff provided the six sheets of sales journal), the bank deposits were larger than the sales amounts by \$2,700 to \$13,152 each month.²

All of plaintiff's sales invoices were made out to J.J.J&G. The invoices did not show an address for this customer. Instead each one stated "packing list enclosed, shipped out of state – USPS Parcel Post." When Taxation requested a description of items sold, plaintiff resubmitted the originally provided invoices, now including hand-written product description (and a name change from J.J.G. Wholesale to J.J.J&G Wholesale). Plaintiff claimed that the now-included product descriptions on each sales invoice was from an erstwhile list. It failed to provide this list or the packing slips to Taxation. Each invoice included a shipping and handling fee. In addition was another unexplained "fee" amount. Taxation found that the total charges from 2008-2011 (price + shipping + "fee") was \$567,800 (rounded), and for the months in 2009 exceeded the total sales per plaintiff's sales journal (i.e., the six sheets of paper) by about \$12,600.

The sample sales invoices provided to this court by plaintiff were for the months of 2008. All were made out to J.J.J&G, sometimes several on the same date (5/29/08; 6/18/08; 6/25/08; 7/30/08; 8/19/08; 10/15/08; 10/28/08; 11/07/08). Two invoices (3/19/08; 3/28/08) did not state the prices for each item of tobacco product listed, but only the total invoice amount. Only two invoices in May (5/6; 5/9) listed unit prices. The invoices showed a "subtotal" of the products sold, shipping/handling charges, and a "fee" or profit. The shipping/handling fee was a flat \$25 or \$30.³ There was an additional "fee" of usually 20% of the invoiced amount, in twelve instances

² The total sales for this period was \$170,138.11 whereas the total bank deposits for this period was \$219,404.90 for a difference of \$49,266.79.

³ One invoice dated 5/28/08, for \$70 had a \$10 shipping/handling fee but total \$83.85 though no other "fee" was included.

at 10%, and no “fee” charged on two invoices. On a separate sheet, plaintiff totaled those “grand totals” to \$132,279.56. To this was added three other totals (\$158,890.08; \$152,994.96; \$105,314.84) which were presumably the grand totals of sales to J.J.J&G for 2009 to 2011, for a final sum of \$549,479.44. The TPT at 30% of this amount was shown as \$164,843.83.

After plaintiff declined to retrieve additional bank records as being a costly exercise, Taxation subpoenaed records from two banks. Those records indicated that almost all deposits were cash. Of the 23 checks deposited, not one of them indicated or referenced J.J.J&G as being the payor (i.e., the purchaser).⁴ Plaintiff did not provide information as to J.J.J&G’s method of paying plaintiff or whether it used any other bank to deposit payments from J.J.J&G.

To prove its sales to J.J.J&G, plaintiff provided Taxation with an unsigned letter from an individual on a letterhead of J.J.J&G, which included a phone number, address, website, and e-mail address, listing dates and dollar amounts but no product description. Taxation’s auditor left messages at the phone number listed, however did not receive a call back (and a subsequent call was answered as the number being temporarily unavailable), nor did she receive a response to the e-mail sent to the e-mail address on the letter. The auditor also personally visited the address provided for this entity (1110, Lincoln Highway, Fairless Hills, PA) and found no such street address. A google search of the website showed a street address of 110 Lincoln Highway, and Steve Horowitz as its President and Treasurer. Mr. Horowitz used to be affiliated with plaintiff’s owner’s son and plaintiff’s manager, Steve Smith, in a different New Jersey cigar store. Taxation’s letters to both addresses (110 Lincoln Highway and 1110 Lincoln Highway) were returned as undeliverable. Plaintiff also provided Taxation with a notarized letter (copy provided to the court)

⁴ Almost all payors of the checks (i.e., buyers) were individuals with New Jersey addresses, and one with a New York address. Taxation did not include credit card sales in its analysis since they were for in-store retail sales and further the bank statements did not identify the payor (i.e., the purchaser of tobacco products).

from an alleged J.J.J&G employee of “many years,” that as its “shipping and receiving manager,” he handled receipts of all cigars sent by plaintiff and oversaw “all incoming invoices and packing slips.” A video of the employee making the same statement as the letter was also provided to Taxation. Since there were no details or documentation in this regard, Taxation did not consider this “proof” as credible.

Because of the above history of (i) incomplete (and one altered) purchase invoices; (b) bank deposits being higher than the provided sales information; (c) unreliable information of the purported sales to J.J.J&G in Pennsylvania; (d) unreliable TPT returns; (e) non-provision and lack of requested documents, Taxation estimated average purchases as follows: when purchase invoices were available, the total amount of purchases for which TPT was not collected by the vendor was used. For the months without TPT returns or purchase invoices, average purchases were estimated from records in that month in other years. By this method, and because taxpayer had not proven any out-of-state sales, the auditor determined that all sales were made in New Jersey and thus taxable, but excluded purchases where TPT was collected by the vendor. The result was an estimated purchase and sale of tobacco products of \$620,738 (rounded) for the period 2008-2011, resulting in TPT of \$186,221.34.⁵

Taxation also imposed a civil fraud assessment based on the following indicators: (1) bank deposits exceeded total sales reported, (2) lack of source documentation, (3) CBT and S&U gross receipts did not match, (4) amended TPT returns filed during audit, (5) no evidence of out-of-state (exempt) sales, (6) altered purchase invoice of House of Oxford, (7) altered/hand-written sales

⁵ After initially contending that it only started operating in 2008 not 2007, plaintiff later claimed it only began to operate in 2009, therefore, maintained that the audit period cannot cover 2008. However, since its CBT, TPT & S&U returns were all filed starting early 2008, and its purchase invoices were also during that time, Taxation retained 2008 as the start of the audit period.

invoices to J.J.J&G without support, (8) receipts on filed returns did not match the sales journal, (9) purchases in general ledger did not match purchase invoices, (10) general ledger was redacted, and, (11) refusal to provide bank statements. These reasons were included in an “FDR” (“fraud development recommendation”) report signed by Taxation’s auditor and her supervisors. The report also elucidated that plaintiff had among others, claimed “fictitious deductions – [Taxation] believed that exports do not occur and reported exports actually sold in NJ”; deducted personal expenses such as car and credit card payments, and hindered the audit by delaying the same unreasonably. The report noted that plaintiff was a “knowledgeable” taxpayer since the “manager has been through a few audits as he has managed or owned other tobacco stores,” however, “recordkeeping has not improved with time and audits.” Taxation also expressed consternation at its auditor’s fruitless attempts to locate J.J.J&G, its nonfunctioning website, automated phone message, undeliverable mail, and incredible employee certification.

A Taxation employee designated as an “FTA,”⁶ examined the FDR report. He concluded that his review of the audit file and work papers showed “clear and convincing evidence that” plaintiff had “engaged in certain conduct that is indicative of fraudulent intent.” Listing all of the same factors as the FDR recommendation, the agent concluded that Taxation “satisfied its burden of proving that an underpayment of tax was attributable to fraud,” which proof is required for imposing a civil fraud assessment. The agent stated that Taxation showed plaintiff’s intent to evade TPT “known to be [owing] by conduct [i]ntended to conceal, mislead or otherwise prevent collection of taxes.” The agent therefore recommended imposition of the civil fraud assessment

⁶ Taxation’s regulations pertaining to the civil fraud penalty assessment largely mirrors the federal tax law, I.R.C. §6653. Per the Internal Revenue Manual on civil fraud penalty assessments, “FTA” is the Fraud Technical Advisor, a person to whom the auditor submits for approval a report proposing the fraud assessment. See Internal Rev. Manual §25.1.1.

under N.J.S.A. 54:49-9.1 due to (1) failure to comply with recordkeeping requirements of the law (but citing to the S&U statute not the TPT statute); (2) failure to pay tax under N.J.S.A. 54:52-9; (3) false/altered documents; and (4) evasion of payment.

During its administrative protest, plaintiff's accountant stated that Taxation's auditor was mistaken in sending letters addressed to J.J.J&G because that entity was a "back office operation" of one "County Seat Tobacco." In support of its summary judgment motion plaintiff included its internet search results of County Seat Tobacco, www.cigarcigarspa.com, which lists 110 Lincoln Highway, in Fairless Hills, PA as one of the locations. It also provided a printout from websites to show that J.J.J&G is not a fictional entity. Plaintiff's manager certified that he could not obtain information from House of Oxford due to lack of cooperation and closure of that entity.

ANALYSIS

(A) Summary Judgment

An order granting summary judgment shall be rendered if "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law." R. 4:46-2(c). An issue of fact is genuine "only if, considering the burden of persuasion at trial, the evidence submitted by the parties on the motion, together with all legitimate inferences therefrom favoring the non-moving party, would require submission of the issue to the trier of fact." Ibid. Although the evidence is to be viewed most favorably toward the non-moving party, summary judgment may not be denied simply because the non-movant demonstrates the existence of a disputed fact. Brill v. Guardian Life Ins. Co. of Am., 142 N.J. 520, 540-41 (1995). Rather, denial is appropriate only where the evidence is of such a

quality and quantity that reasonable minds could return a finding favorable to the party opposing the motion. Id. at 534, 540.

Both parties agree that out-of-state sales of tobacco products are not subject to the TPT. Plaintiff contends that since it provided “competent independent evidence” of out-of-state sales to preclude the audited TPT assessment, and that “sloppy” recordkeeping without mal-intent does not warrant a civil fraud assessment, it is entitled to summary judgment. Taxation argues for summary judgment in its favor since plaintiff’s evidence was not only inadequate but also incredible. Both parties’ proofs indicate that no further evidence will be forthcoming on the out-of-state sales, should this issue be tried. The documents which are material to decide this issue such as invoices and the TPT return, are undisputed. There is no challenge to the methodology employed by Taxation in computing the TPT. Therefore, based on the objective and undisputed evidence produced in support of their respective motions as to the basis for, and the validity of, the TPT audited assessment, the matter can be decided by summary judgment.

(B) The TPT

The TPT statute imposes a 30% tax on the “wholesale price” of a “tobacco product,” which is sold, used or distributed in New Jersey. N.J.S.A. 54:40B-3(a).⁷ The sales tax, or compensating use tax (at 30%) is levied upon the wholesaler or distributor. If the sales or compensating use tax is not paid by the distributor or wholesaler, then the 30% tax is due from the “retail dealer or consumer” and is computed on the “price paid or charged for the tobacco product.” N.J.S.A. 54:40B-3(c). The statute thus makes clear that the sale/purchase of the tobacco product cannot be subject to multiple taxation.

⁷ A separate provision addresses TPT on the sale of “moist snuff.” N.J.S.A. 54:40B-3.1. Tobacco products do not include cigarettes, see N.J.S.A. 54:40B-2, which are taxed under N.J.S.A. 54:40A-1.

The liability to pay the TPT arises when the distributor or wholesaler “has sold or otherwise disposed of the tobacco product to the retail dealer or consumer.” N.J.S.A. 54: 40B-4. If the buyer pays for the tobacco products in installments, then the distributor or wholesaler can, if Taxation’s regulations so provide, file a TPT return and pay TPT on each installment. Ibid. The distributor or wholesaler must give “an invoice, receipt or other statement or memorandum” to the buyer, which document must state “that the tax has been paid or will be paid by the distributor or wholesaler.” Ibid. Monthly returns must be filed by the distributor or wholesaler showing the “total amount of the wholesale price” and the tax due (sales tax or compensating use tax) thereon. N.J.S.A. 54:40B-8.

The statute also imposes recordkeeping requirements upon the taxpayer. Thus, N.J.S.A. 54:40B-7 provides as follows:

Every distributor or wholesaler required to pay [the TPT]. . . shall keep records of every charge for and of all amounts of wholesale price paid or due thereon and of the tax payable thereon, in such form as . . . [Taxation] . . . may require. Records shall include a true copy of each invoice, receipt, statement or memorandum upon which the provisions of [N.J.S.A. 54:40B-4] . . . require that the tax paid be stated. Records shall be available for inspection and examination at any time upon demand by . . . [Taxation] and shall be preserved for a period of three years, except that the . . . [Taxation] may consent to their destruction within that period or may require that they be kept longer.

In this connection, Taxation is also empowered to “require” a distributor or wholesaler which is subject to the TPT, “to keep detailed records of all amounts of wholesale prices paid for the tobacco products on which taxes are payable, and names and addresses of wholesalers, distributors, retail dealers and consumers, and other facts relevant in determining the amount of tax due and to furnish such information upon request to the director.” N.J.S.A. 54:40B-12.

If Taxation questions a TPT return as incorrect or insufficient (or if a return is not filed), then it is authorized to determine the TPT “from such information as may be available.” N.J.S.A.

54:40B-10. See also N.J.S.A. 54:40B-12(e) (Taxation can “[a]ssess, determine, revise and readjust” the TPT). Information can include “external indices, such as purchases, location, scale of charges, comparable charges, number of employees or other factors.” N.J.S.A. 54:40B-10.

The TPT is also subject to all provisions of the State Tax Uniform Procedure Law (“STUPL”) unless it conflicts with the TPT. N.J.S.A. 54:40B-11. Thus, interest and penalties can be imposed under the STUPL. N.J.S.A. 54:40B-13.

(C) Standard of Review for TPT Audits

There are no regulations interpreting the TPT provisions. However, the TPT provisions requiring recordkeeping and retention for three years of, (1) the wholesale prices; (2) invoices; receipts; statements; (3) contact information of buyers and sellers; and (4) any relevant facts in this connection, are plain on their face. Also plain is the Taxation’s authority to estimate TPT using external indices. Clearly then, the statute itself provides Taxation broad discretion to estimate an assessment in the absence of adequate books and records.

There are no cases addressing the issue before this court in the context of applying the TPT provisions. Cases addressing the issue in the context of the general S&U Act, N.J.S.A. 54:32B-1 et seq. however, provide guidance. See Yilmaz, Inc. v. Director, Div. of Taxation, 22 N.J. Tax 204, 231, 235 (Tax 2005), aff’d, 390 N.J. Super. 435 (App. Div.), certif. denied, 192 N.J. 69 (2007); Alpha I, Inc. v. Director, Div. of Taxation, 19 N.J. Tax 53 (Tax 2000) (indicating that where taxpayer destroys records prematurely, it places itself in jeopardy for additional tax). These cases are instructive since the S&U statute and implementing regulations have almost identical provisions requiring recordkeeping, and absent credible records, Taxation’s authority to estimate taxes using external indices. See, e.g., N.J.S.A. 54:32B-16; N.J.S.A. 54:32B-19; N.J.A.C. 18:24-2.3; N.J.A.C. 18:24-2.4 (taxpayer to retain copies of “all sales slips, invoices, receipts, statements,

memoranda of price, or cash register tapes, issued to any customer . . . and records of every purchase”).⁸ Both parties agree with this proposition in their respective motions.

Thus, for TPT purposes also, Taxation’s final determination is attendant with a presumptive correctness, which must be rebutted by “cogent evidence that must be ‘definite, positive and certain in quality and quantity’ . . . [and] . . . must focus on the reasonableness of the underlying data [and] . . . methodology used” by Taxation. Yilmaz, supra, 22 N.J. Tax at 236 (citations omitted). An “imperfect” methodology will not destroy the presumptive correctness of the assessment, an “aberrant” one can. Ibid. (citations omitted).

Absent “documentary evidence or records or corroborative testimony,” the “bare testimony is insufficient” to overcome the presumptive correctness of Taxation’s assessment. TAS Lakewood v. Director, Div. of Taxation, 19 N.J. Tax 131, 139 (Tax 2000); Ridolfi v. Director, Div. of Taxation, 1 N.J. Tax 198 (Tax 1980). However, the presumptive correctness can be overcome with proof of “bona fide business records” which are qualitatively and quantitatively credible. Duncan Truck Stop, Inc. v. Director, Div. of Taxation, 4 N.J. Tax 367, 375-76 (Tax 1982).

The TPT statute does not specifically exempt sales to out-of-state buyers. Cf. N.J.S.A. 54:32B-8.10 (no sales tax on out-of-state purchases since those are not within the taxing power of the State); N.J.S.A. 54:32B-3(b) (no sales tax on services performed upon certain tangible personal property from sales tax if that serviced property is “delivered to the purchaser outside this State for use outside this State”); N.J.S.A. 54:40A-19 (stamped cigarettes shipped out-of-state entitled

⁸ The only difference is that the three-year record statutory retention period under the TPT (N.J.S.A. 54:40B-7), is shorter than the four-year period under the S&U Act. See 48 N.J.R. 824(a) (May 16, 2016) (effective May 16, 2016, records must be maintained for a period of four years from the last date of the most recent quarterly period for the filing of sales tax returns,” and “summary sales records” must be retained for at least “four years from the last date of the quarterly period for the filing of sales tax returns”).

to a refund of cigarette tax). However, Taxation concedes that sales of tobacco products to out-of-state buyers will not be subject to the TPT, akin to such a construal under the S&U Act.

In sum, plaintiff would be required to keep true copies of its sales and purchase invoices along with additional corroborating documentation that would allow Taxation to determine the amount of TPT due. This is so even if that tax would potentially be zero due to out-of-state sales. However, and to the extent there was TPT collected on plaintiff's purchases of tobacco products, Taxation cannot collect such tax again under the audit.

(D) Findings as to Taxation's TPT Audit

Here, the only contention is whether plaintiff had adequate records to prove that it had made out-of-state sales of tobacco products to a single buyer, J.J.J&G. The court finds plaintiff did not have credible records, let alone adequate records, which so established. The sales invoices are questionable. Plaintiff's 2008 total sales to J.J.J&G is incorrect because the subtotals on several individual invoices are incorrect. For instance, the subtotals on the 2008 invoices dated 4/18; 4/24 (which showed 6 items sold at \$334.58 but a subtotal of \$2,228.07); 5/5; 5/6; 5/12; 5/29 (showing a subtotal of \$453.24); 5/29 (showing a subtotal of \$4,502.56); 6/5; 6/11; 6/20; 6/25; 6/30; 7/15; 7/18; 7/22; 7/30; 7/31; 8/13; 9/18; 10/6; 10/28; 11/07; 11/28; 12/17; and 12/18 are all incorrect. On the 6/25/08 invoice, the \$300 "fee" is deducted to arrive at the grand total whereas on all other invoices the "fee" is added to the grand total. There is no explanation as to why the "fee" (the presumed profit or the markup for plaintiff) is 10% of the invoice amount in some instances and 20% in other instances. Plaintiff did not refute Taxation's surmise that vendors do not usually itemize or state their profit amounts separately on an invoice, thus, the "fee" (as was the shipping and handling fee, which was far in excess of what other vendors charged plaintiff), was tacked on just so that the total of the invoices would match the purchases.

Moreover, the sales to J.J.J&G were not corroborated by the invoices since there were no packing slips to verify J.J.J&G's address. The mailing address provided to Taxation was incorrect. It is strange that plaintiff relies upon internet searches for the address and location of its single largest out-of-state customer. Per the invoices, J.J.J&G was placing orders almost every day in a month, yet plaintiff could not provide a verifiable contact telephone number. It claimed this customer was a legal and existing entity yet relies upon internet searches for this purpose. The internet search results are for County Seat Tobacco, www.cigarcigarspa.com, not J.J.J&G, although 110 Lincoln Highway, in Fairless Hills, PA is listed as one of the locations. There is no mention of "County Seat Tobacco" in this web-based information, or even of J.J.J&G as being its "back office operation." Plaintiff did not refute that those internet searches indicated the principal Mr. Horowitz, as being an individual known to plaintiff, yet it did not produce anything from that individual to prove that J.J.J&G ordered the tobacco products (sometimes several times on one day if the invoices were to be believed) in the amount plaintiff claims to have sold, or how it paid plaintiff. For this same reason, it is also incredible that plaintiff resorts to providing a certification of an alleged employee of J.J.J&G. That certification in any event is not credible since it recites that the individual oversaw invoices and allegedly received plaintiff's shipments, yet the court finds the 2008 sample invoices are themselves incomplete, inaccurate, and questionable.

The most disconcerting lack of proof however, is the total absence of any corroborating bank deposit information. The subpoenaed bank records (which showed mostly cash deposits per Taxation), did not have even one check deposit traceable to J.J.J&G. Yet every one of the invoices made out to J.J.J&G (provided to this court) had a stamp on it "paid," next to the stamp "shipped." Plaintiff did not provide information as to J.J.J&G's method of paying plaintiff or whether it used any other bank to deposit payments from J.J.J&G. Nor did it have any bookkeeping records such

as accounts receivable entries for J.J.J&G. Even if the cash deposits are deemed to be payments from J.J.J&G, it is not necessarily proof that tobacco products were shipped to Pennsylvania when one considers the fact that the internet searches for this customer included a New Jersey location (in Freehold).

The court is also satisfied that Taxation had proper and reasonable basis to conclude that the purchases from House of Oxford were made without TPT being charged to plaintiff. The invoice number 615934 (with the allegedly altered date) showed that this vendor listed TPT separately when it charged the tax. This itemization conforms to the statutory requirement that “the tax paid be stated” on “each invoice.” See N.J.S.A. 54:40B-4; 40B-7. Whereas four invoices from the same vendor showed zero in the tax column. It is a reasonable conclusion therefore that regardless of the notation on the invoice that New Jersey customers would have TPT included in the unit prices, if the invoice showed zero TPT charged, then no TPT was collected because when so charged, this vendor specifically itemized it.

In sum, plaintiff failed its statutory obligation to retain adequate business records. That most of its sales may have been nontaxable does not pacify the obligation to maintain and retain adequate records. In any event, from the purchase invoices, there is no way of discerning the products’ eventual destination by plaintiff, thus, there is no way of corroborating plaintiff’s claim that it sold all its purchases only to J.J.J&G, and since that was a Pennsylvania entity, all those sales were non-taxable. There was no source documentation for the altered sales invoices, no proof of mailing the alleged shipments, and no proof of payment from J.J.J&G. The sales invoices reverse-engineered from purchase invoices were not much more than bare testimony of the type insufficient to overcome the assessment.

For these reasons, Taxation properly determined an extrapolation was necessary, and plaintiff has not refuted the ensuing assessment with cogent evidence. The court finds that Taxation reasonably and properly concluded that plaintiff's books and records did not support the alleged out-of-state sales of tobacco products, thus, properly assessed TPT on all of plaintiff's purchases for which TPT was not charged/collected. Therefore, the court grants Taxation's motion for summary judgment as to the validity of its TPT assessment.

(E) Findings on Civil Fraud Assessment

Pursuant to the STUPL "[i]f any part of an assessment is due to civil fraud," then an amount of "50% of the assessment" will be "added to the tax." N.J.S.A. 54:49-9.1. The regulations make it clear that there must be an "intent to evade or avoid" paying tax which the taxpayer "know[s] to be due" to the State. N.J.A.C. 18:2-2.9(b). The taxpayer's conduct must have been "intended to conceal, mislead or otherwise prevent" Taxation from "the administration and collection of the taxes." Ibid. The 50% assessment is imposed if "there is clear and convincing evidence of the taxpayer's intent to commit fraud." N.J.A.C. 18:2-2.9(d). "Intent" does not include "inadvertence, reliance on incorrect technical advice, honest difference of opinion, negligence, or carelessness." Ibid.

The following non-exhaustive list indicate fraud:

1. A pattern of substantially understating income (or sales, in the case of sales tax);
2. A history of failing to maintain adequate books and records;
3. Implausible or inconsistent explanations of behavior;
4. Concealing or transferring assets;
5. Repeated or continuing failure to cooperate meaningfully and fully with the Division of Taxation;
6. Collecting and/or withholding any trust fund tax and failing to remit the tax funds collected to the Division of Taxation;
7. A pattern of failing to file tax returns, remit taxes, or report income or sales;
8. Destruction of records;
9. Making misrepresentations of material facts;

10. Accounting irregularities (two sets of books, false entries on documents);
11. Taking fictitious or improper deductions (for example, overstatement of deductions, personal items deducted as business expenses);
12. Engaging in illegal activities; and/or
13. Maintaining or presenting false or altered documents.

[N.J.A.C. 18:2-2.9(e).]

The regulations also clarify that a “finding” of “one or more” of the fraud indicators explicated above, or any other such indicator, can suffice “to establish that any part of an assessment is due to civil fraud.” N.J.A.C. 18:2-2.9(f).

The above regulations are very similar to the standards used to interpret I.R.C. §6663 which imposes a penalty of 75% of the unpaid tax liability attributable to civil fraud. The taxing authority has the burden of proof in a case where the issue is the taxpayer’s “fraud with intent to evade tax.” I.R.C. §7454(a). In Clayton v. Commissioner, 102 T.C. 632, 646-647 (U.S. Tax Ct. 1994) the court held that the government must prove fraud by clear and convincing evidence. In Bradford v. Commissioner, 796 F.2d 303, 307-308 (9th Cir. 1986), the appellate court included a nonexclusive list of fraud indicators such as, among others, understating income, maintaining inadequate records, failing to file tax returns, giving implausible or inconsistent explanations of behavior, concealing assets, failing to cooperate with tax authorities, and dealing in cash.⁹

The court finds that federal tax law on the civil fraud penalty assessment issue provides useful and persuasive guidance in the interpretation and application of N.J.S.A. 54:49-9.1. I.R.C. §6663 is very similar to the New Jersey counterpart (except as to the amount imposable).¹⁰

⁹ The federal factors also list “deception, evasion (i.e., diversion or omission), dealing in cash, education and experience,” as other fraud “badges.” The “pattern” for underreporting taxable income should be “over several years.” Internal Rev. Manual, supra, at §25.1.6.3.

¹⁰ The civil fraud assessment penalty was aimed as a deterrent. See H.R. Rep. 99-34 (1st Sess. 1985), reproduced in 1985-2 Cum. Bulletin 351 (July 1985) (“[w]hile minor, inadvertent record-keeping or computational errors should not lead to the imposition of a substantial penalty, the committee believes that it is vital to the integrity of the tax system

Taxation's regulations are patterned after federal tax law as to the standard of proof, the burden of proof being on the government, and the non-exclusive list of fraud indicators. See, e.g., 46 N.J.R. 595(a) (April 7, 2014) (noting that "[t]he indicia of fraud listed in the proposed rule are consistent with Federal case law and the Internal Service Manual on civil fraud.").

The parties agree on the standards of proof whereby Taxation must show this court, by clear and convincing evidence, that plaintiff intended to commit fraud by claiming all of its sales to be exempt from the TPT. Due to this, the court must examine the facts as a whole. See Pena v. Commissioner, 2016-208 T.C. Memo 18 (U.S. Tax Ct. 2016) ("[t]he existence of fraud is a question of facts and circumstances that a court must consider on the basis of an examination of the entire record and the taxpayer's entire course of conduct").

Plaintiff correctly argues that Taxation's civil fraud assessment is not entitled to any special deference normally afforded Taxation's determination. Simply because facts supporting the imposition of a deficiency tax assessment were not overcome by cogent evidence (as here), does not mean that Taxation has no further burden to prove that the facts gleaned during audit (or otherwise) also show plaintiff's fraud (i.e., intent to evade TPT). See, e.g., Biggs v. Commissioner, 440 F.2d 1, 5 (6th Cir. 1971) ("The mere fact that a taxpayer is unable to prove that the [Internal Revenue Service's] deficiency assessments are erroneous, even if a number of taxable years are involved, is not sufficient to sustain the [government's] burden of proving fraud"). Courts should not quickly "bootstrap a finding of fraud upon a taxpayer's failure to prove [the Internal Revenue Service's] deficiency determination erroneous." Parks v. Commissioner, 94 T.C. 654, 661 (U.S. Tax Ct. 1990).

that honest taxpayers know that others who claim tax benefits far in excess of what can be justified will be subject to the negligence and fraud penalties").

However, Taxation does not ask for such deferential treatment. Rather, it maintains that based on all of the documents provided by each party, the court has sufficient proof to infer plaintiff's intent to evade payment of the TPT, therefore, summary judgment motion on the civil fraud assessment issue can be granted.

Evidence to prove civil fraud can be circumstantial. See Biggs, supra, 440 F.2d at 5 (“Obviously, tax fraud is never, or at least rarely, admitted but direct circumstantial evidence can make a case of alleged tax fraud so strong that no other conclusion can be reached”); see also Clayton, supra, 102 T.C. at 647 (“Fraudulent intent may be established by circumstantial evidence and reasonable inferences drawn from the record”). Such circumstantial evidence are, among others, the badges of fraud listed in N.J.A.C. 18:2-2.9(e).

Here, the issue is whether plaintiff deliberately did not report any of its sales, because it did not intend to pay TPT lawfully owed. Plaintiff asserts that no TPT was lawfully owed since it sold and shipped almost all its purchases to J.J.J&G, a Pennsylvania entity, thus, its TPT reports showing only purchases, zero sales, and zero TPT was not fraud. The court finds that plaintiff's filed TPT reports, in and of themselves, do not establish fraud or fraudulent intent to evade tax payment because Taxation agrees that out-of-state sales are not subject to the TPT. Although the TPT reports were, as Taxation's audit report notes, “incorrectly filed,” i.e., with no dollar amounts other than purchases, it also notes that those purchases were of “tax included purchases,” which was due to plaintiff's choice of vendor which it believed would collect TPT on its retail sales. For instance, the audit report notes that two purchase invoices from a vendor Harold Levinson Associates showed that TPT was collected. Plaintiff did not conceal this belief and choice to Taxation. Thus, although a majority of the invoices showed no tax collected, there were also some invoices showing that TPT was collected.

Taxation's claim that fraud existed since plaintiff had deducted personal expenses such as car and credit card payments is, here, just an allegation. It provided absolutely nothing in this regard to the court, let alone proof that was clear and convincing.

No proof was also provided to this court as to Taxation's claim that the civil fraud assessment penalty was appropriate because plaintiff was a "knowledgeable" taxpayer, familiar with cigar store operations, and had undergone a few audits. There is not information as to which "audits" Taxation is referring to, the results of those audits, and the instances or circumstances in those audit findings which showed fraud.

The court also finds that for purposes of fraud, plaintiff did not fail to cooperate willfully with Taxation during the audit. While as a whole, it had inadequate books and records to substantiate all of its purchases, the audit report itself evidences that plaintiff provided several purchase invoices from 2008 to 2010, which formed the auditor's "Schedule of purchase invoices."

Plaintiff also provided bank statements for 2009 per the auditor's reports. Although the auditor requested but did not get copies of the "imaged or canceled checks," she had information about the "total amount deposited per month," which she compared to the reported sales to conclude excess deposits over sales. Therefore, the court does not find that there was such paucity of books and records to merit an inference of attempted concealment by plaintiff of its transactions, thus, to establish fraudulent intent.

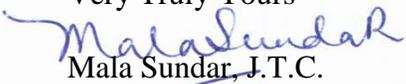
Thus, and based on the pleadings here, the court cannot conclude that plaintiff had a "pattern" of understating income, or a "history" of failing to maintain books/records, or "repeated or continuing failure to cooperate meaningfully and fully with" Taxation, as specified in the regulations.

Factors indicating possible fraud/fraudulent conduct by plaintiff are (1) altering a purchase invoice from House of Oxford; (2) reverse generating sales invoices to match its purchases; and (3) inability to prove any sales to J.J.J&G, implying that plaintiff fabricated J.J.J&G. However, plaintiff disputes each of these allegations. While Taxation surmises that plaintiff must have altered the date because Taxation procured the source invoice from House of Oxford, the same is not clear and convincing proof that it was plaintiff which altered the date. While plaintiff does not dispute that it generated the sales invoices to J.J.J&G, it claims that they were not fabricated information but were reconstructed. Thus, while the documents (i.e., sales invoices) are undisputed, the reason for their creation is disputed. As to the existence of J.J.J&G, Taxation acknowledges that the web entries do show J.J.J&G as a registered entity, and in fact pointed out that its owner had once done business with plaintiff's owner's son.

These disputed facts then prevent this court from granting summary judgment to Taxation on the issue of civil fraud in this case. The audit report which is the basis for the summary judgment on the civil fraud assessment is a hearsay document, thus, is not clear and convincing "evidence." Moreover, as noted above, the court must consider a taxpayer's entire course of conduct to determine whether there was an intent to evade payment of the TPT and commit fraud. Therefore, the court will hold a hearing on the issue of civil fraud assessment, after which Taxation can renew its motion for summary judgment.

CONCLUSION

For the above reasons, the court grants Taxation summary judgment on the TPT assessment, and denies both parties' summary judgment on the civil fraud assessment.

Very Truly Yours

Mala Sundar, J.T.C.