

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Sales and Use)
Tax for the period November 1, 1997 through)
December 31, 2000, by the Secretary of)
Revenue of North Carolina)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2002-207

This matter was reviewed by the Assistant Secretary of Administrative Hearings, Eugene J. Cella, upon application for hearing by the Taxpayer wherein it protested our proposed assessment of tax, penalty, and interest for the period November 1, 1997 through December 31, 2000. The Taxpayer waived its right to appear in person for the hearing, and the matter of the administrative tax hearing was handled by written communications between the Assistant Secretary and the Taxpayer's [Attorney].

The Taxpayer is a corporation engaged in the business of operating a restaurant and making retail sales of food and drink. On August 8, 2001, an auditor with the Department completed an examination of the taxpayer's records. The additional tax assessed resulted primarily from the underpayment of sales tax and from failure to collect and remit sales tax on retail sales of alcoholic beverages.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment dated September 21, 2001 to the Taxpayer, assessing tax, penalty, and interest in the amount of \$17,755.14. The Taxpayer's attorney, in a letter dated October 5, 2001, objected to the assessment and timely requested a hearing before the Secretary of Revenue.

ISSUES

The issues to be decided in this matter are as follows:

1. Is the State estopped from assessing the fraud penalty in a civil assessment after the Taxpayer has pled guilty to and been fined for attempting to evade and defeat State and local taxes in criminal court?
2. Is the State estopped from assessing tax in the civil assessment against the Taxpayer in an amount greater than the principal amount found to be fraudulently underpaid in criminal court?

EVIDENCE

The following items were introduced into evidence:

1. Copy of memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated Exhibit E-1.
2. Copy of the audit report dated August 8, 2001 covering the period November 1, 1997 through December 31, 2000, designated Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated September 21, 2001, designated Exhibit E-3.
4. Copy of letter dated October 5, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-4.
5. Copy of letter dated October 21, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-5.
6. Copy of letter dated November 20, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-6.
7. Copy of letter dated November 28, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-7.
8. Copy of letter dated December 5, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-8.
9. Copy of letter dated December 13, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-9.
10. Copy of letter dated February 18, 2002 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-10.
11. Copy of letter dated March 4, 2002 from the Taxpayer's attorney to the Sales and Use Tax Division and attached copy of Collection Information Statement for Businesses, Form RO-1063, designated Exhibit E-11.
12. Copy of letter dated March 11, 2002 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-12.
13. Copy of letter dated March 19, 2002 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-13.
14. Copy of State of North Carolina v. James Richard Davis, 96 N.C. App. 545, 386 S.E.2d 743 (1989), designated Exhibit E-14.
15. Copy of State of North Carolina v. Joe Louis Wilson, 127 N.C. App. 129, 488 S.E.2d 303 (1997), designated Exhibit E-15.

16. Copy of Helvering, Commissioner of Internal Revenue v. Mitchell, 303 U.S. 391; 58 S. Ct. 630; 82 L. Ed. 917 (1938), designated Exhibit E-16.
17. Copy of the Brief for Tax Hearing prepared by the Sales and Use Tax Division, designated Exhibit E-17.

The Taxpayer presented the following information into evidence:

18. Letter dated August 23, 2002 from the Taxpayer's attorney to the Assistant Secretary of Revenue and the attached Brief in Support of Objections to the Assessment, designated Exhibit TP-1.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. The Taxpayer was engaged in business operating a restaurant during the audit period.
2. The president of the corporation pled guilty to two felony counts of attempting to evade or defeat North Carolina [State] and [North Carolina county] sales tax for the period January 1, 1998 through June 30, 2000 and was ordered by the courts to pay \$9,142.02 in restitution to the Department and a fine of \$2,000.00 to the courts.
3. Subsequent to the criminal trial, the Department assessed additional tax, penalty and interest against the Taxpayer in a civil assessment for the period of November 1, 1997 through December 31, 2000.
4. The Department's civil assessment included the transactions to which the president of the corporation pled guilty to attempting to evade or defeat the North Carolina [State and local] sales tax and the transactions where the Taxpayer failed to collect and remit sales tax on the retail sale of alcoholic beverages, which were not included in the criminal trial.
5. The Department's civil assessment included a 50% fraud penalty in the amount of \$5,201.39.
6. The notice of sales and use tax assessment was mailed to the Taxpayer on September 21, 2001.
7. The Taxpayer protested the assessment and timely requested a hearing before the Secretary of Revenue.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. The taxpayer was a retailer and was at all material times engaged in the business of making retail sales of tangible personal property subject to sales tax.
2. The Department is not estopped from assessing additional tax on transactions not addressed in the criminal courts, notwithstanding they were included in the same audit period. The principle of res judicata does not apply to those transactions not addressed in the criminal courts.
3. In accordance with the findings of State of North Carolina v. Joe Louis Wilson, 127 N.C. App. 129, 488 S.E.2d 303 (1997), the 50% fraud penalty included in the Department's civil assessment is remedial and not punitive.
4. The Notice of Proposed Assessment for the period of November 1, 1997 through December 1, 2000 was issued pursuant to G.S. 105-241.1.

DECISION

The Taxpayer operated a restaurant, charging and collecting State and local sales and use taxes on sales of food for the periods included in the assessment. On August 28, 2001, the president of the Corporation pled guilty to two felony counts of attempting to evade or defeat North Carolina [State and local] taxes for the period January 1, 1998 through June 30, 2000, and was ordered to pay \$9,142.02 in restitution to the Department and a fine of \$2,000.00 to the courts. The fraud charges were based on transactions where the Taxpayer collected sales tax from patrons, but reported and remitted substantially less than the amounts collected.

Subsequent to the trial, the examining auditors completed an audit report that resulted in a civil assessment of additional tax, penalty, and interest. The assessment included the transactions addressed in the criminal fraud trial as well as transactions where the Taxpayer failed to collect and remit tax on sales of alcoholic beverages. The Department will allow credit for any tax paid to the courts against the tax assessed in the civil assessment as the payments are received by the courts.

The Taxpayer objected to the application of the fraud penalty (50%), provided in G.S. 105-236(6), in the civil assessment. The Taxpayer's attorney argued that jeopardy attached in the criminal trial and that the imposition of the 50% fraud penalty is unconstitutional as it amounts to double jeopardy. He also objected to the increase in the amount of tax underpaid from \$9,142.02 as presented in the criminal trial to \$10,402.77 as reflected in the civil assessment, on the basis of res judicata.

In the matter of the fraud penalty included in the civil assessment, the Taxpayer objects on the basis that a criminal penalty was imposed by the courts and the 50% fraud penalty included in the civil assessment constitutes double jeopardy. The Taxpayer's attorney cites Department of Revenue v. Kurth Ranch, 511 U.S. 767 (1994), and Lynn v. West, 134 F.3d 582 (1998), in support of his client's objections, cases where the courts held that a drug tax imposed by a State (Montana and North Carolina, respectively) after a criminal conviction for the underlying drug offense amounted to double jeopardy. The Department counters by citing State v. Davis, State v. Wilson, and Helvering v. Mitchell, cases where the assessment of civil penalties were not found to be an affront to the Double Jeopardy Clause after the courts had previously imposed criminal penalties.

The issue considered in these referenced cases is whether the civil penalties imposed by the states are remedial or punitive in their actual purpose. The courts have consistently held that civil penalties are not punishment and not a violation of the double jeopardy clause when the penalties are viewed as remedial, that is the penalties serve primarily to compensate the state for its expense due to the unlawful actions of the taxpayer. The Taxpayer and the Department reference U.S. v. Halper, 490 U.S. 435 (1989), where the courts held that "The Government is entitled to rough remedial justice, that is, it may demand compensation according to somewhat imprecise formulas, such as reasonable liquidated damages or a fixed sum plus double damages, without being deemed to have imposed a second punishment for the purpose of double jeopardy analysis." The courts also wrote that, if an offender's sanction is

“overwhelmingly disproportionate to the damages he caused, the penalty constitutes punishment for the purposes of the Double Jeopardy Clause.”

The Taxpayer contends that the cost in collecting the tax has been amply paid by virtue of the \$2,000.00 criminal fine imposed in the criminal prosecution and that jeopardy has attached. I disagree. Balanced against the number of man hours amassed by the State's auditors, Criminal Investigation Division, and Attorney General's Office in prosecuting the Taxpayer and generating a civil assessment, the \$5,201.39 civil penalty as recompense does not seem “overwhelmingly disproportionate.” I find, therefore, that the imposition of the fraud penalty imposed in the Department's civil assessment does not constitute a violation of the Double Jeopardy Clause.

The Taxpayer has also objected to the assessment on the basis that the amount of additional tax found to be due was decided in the criminal trial and that the assessment should be amended on the basis of the doctrine of res judicata. The Latin phrase “res judicata” means “the thing has been adjudicated.” The Taxpayer argues that there was a final judgement entered on tax liability, privity of claim (unpaid sales tax), and privity of parties (the president of the Taxpayer and the Department) and that the amount pled to, found due, and ordered paid was the same amount alleged by the Department.

The imposition of tax on transactions involving the retail sales of alcoholic beverages was not adjudicated in the criminal trial. The retail sale of alcoholic beverages by a restaurant is a taxable event and failure to collect and remit sales tax thereon constitutes negligence on the part of the Taxpayer. The State did not prosecute the Taxpayer in criminal court for these transactions nor were they addressed. Clearly the doctrine of res judicata attaches to the transactions where the Taxpayer pled guilty, but does not apply to those transactions and the applicable tax due thereon that were not addressed in the criminal courts, notwithstanding that the periods in which these transactions occurred may have overlapped.

Wherefore the assessment is sustained in its entirety, and is declared to be final and immediately due and collectible.

This 17th day of October, 2002.

Signature _____

Eugene J. Cella
Assistant Secretary of Administrative Tax Hearings