

STATE OF NORTH CAROLINA

**BEFORE THE
SECRETARY OF REVENUE**

COUNTY OF WAKE

IN THE MATTER OF:

The Proposed Assessment of Sales and Use)
Tax for the period August 1, 1996 through)
August 31, 2002 by the Secretary of)
Revenue of North Carolina)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2004-68

This matter was heard before the Assistant Secretary of Revenue for Administrative Tax Hearings, Eugene J. Cella, in the City of Raleigh, on May 25, 2004, upon application for hearing by the Taxpayer wherein it protested the proposed assessment of tax, penalty and interest for the period August 1, 1996 through August 31, 2002. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and M. D. Stephenson, Administration Officer. Also, Mr. J. M. Bryan of the Department’s Criminal Investigations Division appeared. The Taxpayer was represented by _____, Attorney at Law, and _____, Certified Public Accountant.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment to the Taxpayer on January 6, 2004 assessing tax, penalty and interest in the amount of \$297,079.26. The Taxpayer’s representative objected to the proposed assessment and timely requested a hearing.

ISSUES

The issues to be decided in this matter are:

1. Is the method the Department used to determine the Taxpayer’s liability, utilizing his gross business bank account deposits less exempt receipts, for the assessment period correct?
2. Are any adjustments to the assessment in order based on the percentage of exempt receipts as that figure bears to gross receipts deposited?
3. Is the fraud penalty correctly assessed?

EVIDENCE

The following items were introduced into evidence by the Sales and Use Tax Division:

1. Copy of Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings (Assistant Secretary), designated Exhibit E-1.
2. Copy of sales and use tax audit report dated November 30, 2003, designated Exhibit E-2.
3. Copy of File Number XXXXXXXX, in the General Court of Justice, Superior Court Division, certified by Judge Craig Croom on December 15, 2003, in the matter of the State of North Carolina versus [Taxpayer], designated Exhibit E-3.
4. Copy of a press release dated December 16, 2003 issued by the Department, designated Exhibit E-4.
5. Copy of Notice of Sales & Use Tax Assessment dated January 6, 2004, designated Exhibit E-5.
6. Copy of letter dated February 2, 2004 from the Taxpayer's attorney to the Sales and Use Tax Division ("Division"), designated Exhibit E-6.
7. Copy of Sales and Use Tax Technical Bulletin Section 9, designated Exhibit E-7.
8. Copy of letter dated February 17, 2004 from the Assistant Secretary to the Taxpayer, designated Exhibit E-8.
9. Copy of letter dated February 20, 2004 from the Assistant Secretary to the Taxpayer, designated Exhibit E-9.
10. Copy of letter dated February 26, 2004 from the Division to the Taxpayer's attorney, designated Exhibit E-10.
11. Copy of letter dated March 1, 2004 from the Taxpayer's attorney to the Division, designated Exhibit E-11.
12. Copy of letter dated March 10, 2004 from the Division to the Taxpayer's attorney, designated Exhibit E-12.
13. Copy of letter dated April 29, 2004 from the Assistant Secretary to the Taxpayer, designated Exhibit E-13.

14. Copy of letter dated May 5, 2004 from the Division to the Taxpayer's attorney, designated Exhibit E-14.

The following exhibits were submitted by the parties during or after the administrative hearing on January 15, 2004.

15. Brief for Tax Hearing, dated May 25, 2004 from the Sales and Use Tax Division to the Assistant Secretary of Revenue for Administrative Tax Hearings, designated Exhibit E-15.
16. Copy of letter dated June 2, 2004 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-16.
17. Copy of letter dated July 22, 2004 from the Taxpayer's Certified Public Accountant to the Division, designated Exhibit TP-1.
18. Copy of letter dated August 3, 2004 from the Division to the Taxpayer's Certified Public Accountant, designated Exhibit E-17.
19. Copy of Amended Sales and Use Tax Audit Report dated September 10, 2004, designated Exhibit E-18.
20. Copy of letter dated September 10, 2004 from the examining auditor to the Taxpayer's Certified Public Accountant, designated Exhibit E-19.
21. Copy of Memorandum dated September 20, 2004 from the Division to the Assistant Secretary, designated Exhibit E-20.
22. Copy of Notice of Amended Assessment dated September 22, 2004 from the Department to the Taxpayer, designated Exhibit E-21.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary of Revenue for Administrative Tax Hearings makes the following findings of fact:

- (1) The Taxpayer operates a florist business in [city] North Carolina.
- (2) The Taxpayer made taxable retail sales of tangible personal property during the assessment period.
- (3) The Taxpayer did not register for sales and use tax purposes prior to being audited and did not file returns, notwithstanding that he was liable for sales tax due on his taxable retail sales.

- (4) The Taxpayer collected sales tax on his taxable retail sales, but never paid the tax collected to the Department of Revenue. The unpaid taxes collected were assessed against the Taxpayer.
- (5) The Taxpayer maintained and provided inadequate books and records of invoices or receipts issued to customers for the auditors to complete an examination.
- (6) The audit was completed using an indirect method, based on the business's total bank account deposits minus deposits from sources not subject to tax, such as telefloral wire-ins and re-deposits.
- (7) During the hearing, the Taxpayer's representative, for the first time, made the Division aware of a mechanical error in the original audit report and also agreed to provide additional information pertaining to loans, the proceeds of which were deposited into the business bank account of the Taxpayer and should be excluded from net taxable receipts.
- (8) Based on additional information furnished by the Taxpayer after the hearing the audit was amended to remove from taxable retail sales bank deposits from certain loans as well as to correct the mechanical error of including tax collected in net taxable receipts.
- (9) On December 15, 2003 the Taxpayer plead guilty to one count of embezzling State and local sales taxes under a plea agreement covering the period December 1, 2001 through August 31, 2002. The Taxpayer was ordered to pay \$10,827 in restitution which has been credited to the proposed assessment.
- (10) The Notice of Proposed assessment was mailed to the Taxpayer on January 3, 2003.
- (11) The Taxpayer notified the Department that it objected to the assessment and timely requested a hearing.
- (12) A Notice of Amended Assessment was mailed to the Taxpayer on September 22, 2004.
- (13) The corrected tax due, penalty, and accrued interest are reflected in the amended audit report dated September 10, 2004 and amended assessment dated September 22, 2004.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary of Revenue for Administrative Tax Hearings makes the following conclusions of law:

- (1) The original notice of proposed assessment issued to the Taxpayer based on the original audit report contained errors, which were resolved by amending the audit report. The amended assessment also removes the proceeds from loans which were included in net taxable receipts.
- (2) The Taxpayer is a retailer engaged in business in North Carolina making taxable retail sales of tangible personal property subject to State and local sales tax.
- (3) A retailer is a trustee for the State of North Carolina for all sales taxes collected.
- (4) As trustees, retailers must file returns and remit taxes collected from customers to the Department as required by G.S. 105-164.16.
- (5) The Taxpayer did not keep adequate records of retail sales of tangible personal property as required by G.S. 105-164.22.
- (6) The Taxpayer did not maintain separate records of all taxable sales and all sales not taxable as required by G.S. 105-164.24; however, the auditor made a reasonable effort to determine the amount of taxable sales and sales not taxable, based on the records that were available, in performing the audit examination.
- (7) The Taxpayer's actions caused deficiencies and delinquencies in the payment of sales tax it collected that resulted in embezzlement of sales taxes for a period of ten years. Those actions led to a criminal conviction for embezzling State and local sales taxes. While the Revenue Laws might not specifically define "fraud," it is appropriate to construe the term given its usual and ordinary meaning. The Second College Edition of the American Heritage Dictionary defines "fraud" as "1. A deception deliberately practiced in order to secure unfair or unlawful gain...3.a. One who defrauds; cheat." The Taxpayer's embezzlement of State and local sales taxes constitutes a form of "fraud" for purposes of the civil penalty statute, notwithstanding that the Taxpayer was not charged with or convicted of criminal fraud. Therefore, the 50% civil fraud penalty is applicable and is properly imposed within G.S. 105-236(6).
- (8) The Taxpayer is liable for the applicable State and County sales and use tax reflected in the amended audit report as additional tax due.
- (9) The amended assessment is properly proposed within G.S. 105-241.1.

DECISION

The Taxpayer has been in the retail florist business for approximately ten years. Based on the Taxpayer's operation of an identical business in [city], North Carolina, the Taxpayer knew he was liable for collecting and remitting State and local sales taxes on his taxable retail sales. The Taxpayer also knew, or in the exercise or reasonable and ordinary care should have known, that there are consequences for collecting sales tax, not filing returns and paying the tax collected, in the form of civil penalties and interest and the possibility of criminal prosecution.

The Taxpayer was investigated by the Department's Criminal Investigations Division and was tried and convicted of embezzling State and local sales taxes. An error in the audit report by including deposits from loan proceeds and the sales tax collected in the taxable retail sales. The audit has been amended to remove these items. The amended audit also corrects the period of time for which records were examined and the Taxpayer is assessed. It is understood that the Taxpayer's representatives now agree that the amended audit represents a true depiction of the Taxpayer's net taxable retail sales during the audit period within G.S. §§§§ 105-164.3(24), 105-164.21, 105-164.22, and 105-164.24. Therefore, the only remaining issue to be addressed is the fraud penalty.

For a period of several years, the Taxpayer was engaged in the florist business making retail sales he knew were taxable, and he collected the tax due from customers.

However, the Taxpayer did not register and did not file returns with remittance of the tax due until he received notification that he had been selected for audit. The Taxpayer claims to have visited the Department's office in [city], North Carolina, several times in an attempt to register for sales and use tax purposes, but the office was closed. However, the Taxpayer could have contacted that office or the Raleigh office and made an appointment or downloaded the application from the Department's website and registered. Instead, he continued to collect sales tax from customers, convert the funds collected for his own personal use, and did not pay any of the tax he collected to this Department.

In reviewing this matter, I draw no other conclusion than that the Taxpayer sold taxable tangible personal property he knew was taxable, collected the sales tax due, and committed a civil fraudulent act each and every month he did not file a return and remit the taxes due. Knowingly, the Taxpayer converted the sales taxes he collected as a trustee for and on behalf of the State and County for other uses. As a result of the criminal investigation of the Taxpayer for the period December 2001 through August 2002, he was charged with and convicted of embezzlement of State tax and County tax. Considering the Taxpayer committed these acts over such an egregiously long period of time, I find no basis upon which to warrant waiver of the civil fraud penalty included in the assessment.

Based on additional information furnished by the Taxpayer during the process of the tax hearing, the auditors have made appropriate adjustments to the proposed

assessment. Therefore the proposed assessment of tax, penalty and interest as adjusted is deemed correct under the law and the facts and is hereby sustained and declared to be final and immediately due and collectible with interest as allowed by law.

This 20th day of October, 2004.

Eugene J. Cella
Assistant Secretary of Revenue for Administrative
Tax Hearings