OPINION NO. 1102

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

PETWORTH PHARMACY INC.	)	
	)	
vs.	)	Docket No. 2179-72
	)	
DISTRICT OF COLUMBIA	)	

Sylman I. Euzent
Attorney forPetitioner

Melvin J. Washington
Attorney for Respondent

OPINION

This case comes to the Tax Division on a civil petition by the taxpayer Petworth Pharmacy Inc. seeking a refund of $26,846.61 paid on deficiency assessment, fraud penalties and interest to the District of Columbia. This civil tax proceeding is complicated by a number of related criminal actions that have occurred in the District of Columbia and in Maryland, as well as tax claims now being heard in the U.S. Tax Court wherein the Commissioner of Internal Revenue is seeking deficiencies and penalties from Petworth Pharmacy Inc. and Richard Rosenberg on related subject matter.

The Court has heard substantial testimony over a period of several days, has studied voluminous exhibits and accounts of the petitioner-taxpayer as well as accounting reports developed by the District of Columbia Tax Department, and has read a number of District of Columbia and U.S. tax opinions.

In substance, the evidence reveals that petitioner Petworth Pharmacy Inc. purchased large quantities of a narcotic-based cough syrup

with the trade name of Robitussin AC from wholesale drug distributors during the years 1967, 1968, and 1969. The wholesale or inventory price of these purchases was more than $241,000 in aggregate. An infinitesimal amount (159 ounces with a wholesale value of less than $250) was sold in the normal channels of the retail drug trade. Most, if not all of the remainder, found its way to Baltimore and into the illicit market for such codeine-based syrups where it was sold at substantial mark-ups without prescription to those wanting temporary euphoria.

The question facing this Court is whether the large volume of such sales of Robitussin AC were reported in Petworth Pharmacy's annual franchise tax reports to the District of Columbia. The petitioner-taxpayer protests that (with the exception of $25,300 of sales allegedly omitted from its 1969 tax return) all sales were included in its tax reports. It alleges that, although no sales of Robitussin AC are identifiable as such in its sales tax reports, all such sales were cash sales and were in the regular course of business rung up on its cash registers and thus included as "miscellaneous" products on its daily cash receipts which were included on its tax reports to the District of Columbia Government. If so, the deficiency assessment was incorrect and should be refunded. The respondent District of Columbia, on the other hand, insists that none of the sales of Robitussin AC (except the 159 ounces sold in prescriptions) were reported in petitioner's tax returns and that the failure to report these sales was intentional. Hence, respondent demands unpaid franchise taxes for all three years, plus fraud penalties and interest.

The entire fulcrum of this case is the determination of whether the petitioner-taxpayer did or did not report its very substantial sales of Robitussin AC. If this question is answered in the affirmative, because the D.C. franchise tax is a tax on net profits rather than gross sales, a subsidiary question arises as to the price at which such Robitussin AC was sold. If there were unreported sales, the Court must also decide whether the failure of Petworth to report them was inadvertent or willful in order to determine whether a 50% fraud penalty assessed by the District of Columbia was justified.

In reaching the question of whether or not Petworth Pharmacy Inc. failed to report its sales of Robitussin AC, the Court first determined the legal question of the burden of proof in this civil tax proceeding. Rule 11(d) of the Superior Court Tax Division rules provides that "The burden of proof shall be upon the petitioner, except as otherwise provided by statute." This rule is based upon the U.S. Tax Court's similar Rule 32 and upon the legal principle which gives a presumption of correctness to the taxing authorities' assessment of taxes due. Welch v. Helvering, 290 U.S. 111 (1933).

In this case Petworth Pharmacy assumed the burden of proof and provided the Court with evidence to try to show (1) that all but $25,300 of its sales were included in its cash sales receipts upon which it paid franchise taxes for 1967, 1968 and 1969, (2) that the District of Columbia's original assessments were excessive and arbitrary, and (3) that the District of Columbia's proof varied substantially from the original allegations upon which the assessments were made.

Petworth's direct case consisted of testimony and exhibits attempting to show that Petworth reported all of its cash sales and that, therefore, all of its taxes were paid. There was no mention of Robitussin AC in this testimony and no categorical reference to sales of Robitussin AC in its cash receipts. But by presenting such cash register tabulations, the Court felt that Petworth's evidence taken in the most favorable light overcame the presumption that the District of Columbia's assessment was correct. Furthermore, Petworth established that there was a variance of significant proportion between the District of Columbia's proof and its deficiency assessments. In fact, at the conclusion of the hearings the D.C. Government conceded that $10,619.60 of the deficiency assessment should be refunded to Petworth (and has since made that refund).

Thus petitioner succeeded in meeting its burden of proof by the prima facie showing that the original assessment was incorrect or was excessive. The Court, at the conclusion of petitioner's proof, denied the District of Columbia's motion to direct a verdict for respondent, and the obligation to proceed shifted to the D.C. Government. Helvering v. Taylor, 293 U.S. 507 (1935).

Respondent then proceeded to prove to the Court's satisfaction that Petworth had purchased at wholesale nearly one-quarter million dollars worth of a narcotic-based drug (Robitussin AC) from wholesale distributors, that it had not recorded in the exempt-narcotic records required by law to be maintained by every pharmacy any sales of Robitussin AC, that it declined to sell said product over the counter to police agents posing as

customers, that about one-tenth of one percent of its purchases of this product (159 ounces) was listed in Petworth's prescription books, and that only about $4,500 wholesale value of the product remained in stock when a search was conducted in February 1970.

What happened to the remaining $236,500 worth of Robitussin AC?

The District of Columbia presented testimony from Sgt. Mackinnon of the Narcotic Squad of the D.C. Metropolitan Police Department and Willie Mack Holt to show that large clandestine bulk transfers of the product were made by Jerry Rosenberg and Richard Rosenberg, the principal officers and owners of Petworth Pharmacy, to purchasers who operated illicit "syrup houses" in Baltimore. Tax opinions support respondent's deductive methods at arriving at the amount of such undisclosed sales. See Schwarzkopf v. Commissioner, 246 F. 2d 731 (1957). In view of the undercover methods and illegal aspects of this trade, it is understandable why the District of Columbia was not able to provide invoices showing the total amount of such sales and the specific sale prices. Nevertheless, the Court was convinced by the respondent's proof that there were massive sales of Robitussin AC which Petworth did not ring up on its cash registers and did not report for franchise tax purposes.

In rebuttal, Petworth put Mr. Richard Lahr on the stand, and he was qualified as an expert in accounting procedures. Mr. Lahr explained how it was possible that sales of Robitussin AC could be included in the tax returns of the Petitioner for the years 1967, 1968, and 1969.[1/] Mr. Lahr's

1/ Transcript pp. 484-488.

testimony was at best hypothetical, because the relevant cash register receipts produced by Petworth lacked any identification. Moreover, any presumption that petitioner's cash records were consistently reliable was negated by its subsequent admission that $25,300 of sales in 1969 were unaccountably unreported. (Petitioner concedes that franchise taxes and interest are due on this amount of unreported sales.)

Thus, in light of the "hard" proof by the D.C. Government that there were large bulk sales of Robitussin AC by Petworth, coupled with the vague and unbusinesslike nature of petitioners' records and accounts, Petworth's contention that all its sales of Robitussin AC were included in its unidentified cash receipts was wholly unconvincing. If the petitioner's records had shown any evidence of bulk sales of Robitussin AC, the Court might have given some credence to its claim. But they did not. In the Court's opinion, the failure of petitioner to produce any record of the Robitussin AC transactions, despite legal requirements that such transactions be recorded, warrants an unfavorable inference. Washington Gas Light Co. v. Biancaniello, 87 U.S. App. 164, 183 F. 2d 182 (1950). Given the nature of the traffic, the Court was firmly persuaded by the evidence that all the Robitussin AC purchased at wholesale by Petworth Pharmacy (except the 159 ounces listed in the prescription books and the stock on hand at the time of the execution of the search warrant on February 28, 1970) was sold secretly by Petworth in bulk to Baltimore dealers represented by Willie Mack Holt and Moses Mills, and was not included in its cash register receipts.

Thus, the Court finds that Robitussin AC worth $236,500[2/] was sold by Petworth Pharmacy during the years 1967, 1968, and 1969, without any such sales being reported or taxed.

Having considered the primary issue as to whether Petworth failed to report sales of Robitussin AC and answered it in the affirmative, the Court now examines the issue of the selling price: that is, what profit Petworth realized and did not report. Proof of the prices at which Petworth sold Robitussin AC in 24-bottle cases of 4-ounce bottles and one-gallon bottles came from the oral testimony of Moses Mills and Willie Mack Holt. The testimony indicated purchases of one gallon bottles of the syrup at prices ranging from $45.00 to $65.00. Cases of 24 four-ounce bottles were reportedly purchased by them at about $5.00 less than the one gallon bottles. Because of their involvement and previous criminal records neither was a pristine or totally believable witness. Moreover, their statements differed significantly. Nor were their statements precise as to times or amounts. Nevertheless, their testimony is the best available evidence on sale prices. In the Court's opinion this proof satisfactorily supports the respondent's contention that the mark-up from wholesale purchase price to bulk sale price of Robitussin AC was approximately 100%. It having been

---

2/ The figure of $236,500 is what Petworth paid for the Robitussin AC from wholesale distributors of the drug. The price at which Petworth sold the Robitussin AC, and therefore, the gross retail sales, is discussed *infra*.

proved by ample proof at the hearings that petitioner made unreported sales of $236,500 worth of Robitussin AC, the Court finds that respondent's conclusion that these illicit sales resulted in approximately 100% profit[3/] for petitioner is reasonable in the absence of any evidence by petitioner to the contrary. If Petitioner-taxpayer wishes to provide a more accurate record of the prices at which it made its previously unreported bulk sales of Robitussin AC, this proceeding will remain open for two weeks to allow the introduction of such proof.

Having thus established the tentative value of unreported net sales upon which District of Columbia franchise taxes were due and owing from Petworth Pharmacy for the tax years 1967, 1968 and 1969, the Court must decide whether the District of Columbia was correct in assessing the 50% penalty for willful or fraudulent failure to report such sales authorized by Section 47 D.C. Code 1589(b). This issue applies to both the unreported bulk sales of Robitussin AC made during 1967, 1968 and 1969, and the $25,300 of cash sales which the petitioner conceded were not included in its 1969 tax return. Both parties agree that the burden of proving fraud rests upon the shoulders of the taxing authority and the Court proceeds accordingly.

The District of Columbia has proven that Petworth made wholesale purchases of more than $241,000 of Robitussin AC during a three-year period when its gross retail drug sales (not including Robitussin AC) totaled

3/ The gross amount of Petworth's Robitussin AC sales for the three years thus equaled $473,000, or twice its wholesale costs.

$637,000. Undisputed testimony revealed that large shipments of this narcotic-based syrup were transferred at night from Richard Rosenberg's garage to the car of an ex-convict for transport to Baltimore for illegal sale there. No sales receipts were kept, no exempt narcotic records were maintained. Except for records showing prescription sales of 159 ounces of Robitussin AC, the accounts of petitioner do not even mention the named product. Yet the Court has found that gross sales of more than $573,000 of Robitussin AC were made but not reported for tax purposes. To the Court it is inconceivable that Petworth would willfully violate criminal laws requiring the recordation of the sale of such narcotic-based products by pharmacists and yet unintentionally fail to report such illegal transactions for D.C. Tax purposes. To believe that would require a rebirth in innocence. The failure to report these sales was not an honest mistake or an oversight! The totality of the circumstances overwhelmingly persuades the Court that Petworth's failure to report these sales for tax purposes was part of a conscious plan to hide the entire series of transactions from governmental scrutiny.

Therefore, the Court holds that the D.C. Government was correct in assessing a 50% fraud penalty on all of Petworth's unreported sales of Robitussin AC in the years 1967, 1968 and 1969.

Finally, the D.C. Government was legally entitled to assess interest on the previously unpaid franchise taxes.

In accordance with Rule 15(a) of the Tax Division Rules, the Court will withhold entry of its final decision as to the dollar amount of

Petworth Pharmacy's D.C. tax deficiencies for 1967, 1968 and 1969. Within two weeks the petitioner-taxpayer (Petworth Pharmacy) may file with the Deputy Clerk of the Tax Division any documents, records, accounts or receipts which purport to establish more accurately the price at which Robitussin AC was sold in bulk by Petworth Pharmacy during the calendar years 1967, 1968 and 1969.

In the absence of any such rebuttal evidence, the Court will accept the District of Columbia Government's determination of 100% markup on all such bulk sales as correct. If Petworth files new documentary evidence of the sales price of Robitussin AC, the Court expects the D.C. Government to file with said Deputy Clerk, within one week after receipt of Petworth's documentary evidence and computation, a brief response and comment on such proof. Both parties may file with said Deputy Clerk a computation of the tax deficiencies believed by it to be in accordance with these findings and conclusions by the Court. If the computations submitted differ as to the amount to be entered as the final decision, the Court will schedule oral argument thereon and thereafter determine the correct deficiency, penalty, and interest, and enter a final decision.

Both parties are hereby notified that the Court will in such further proceedings adhere strictly to the letter and spirit of Rule 11(c).

Copies served to:
Sylman I. Euzent, Esq.
Attorney for Petitioner.
Melvin J. Washington, Esq.
Assistant Corporation Counsel, D.C.
Finance Officer, D.C.

Orman W. Kitcham
Associate Judge

Dated: March 9, 1973.