

STATE OF FLORIDA  
DIVISION OF ADMINISTRATIVE HEARINGS

GLOBAL HOOKAH DISTRIBUTORS,  
INC.,

Petitioner,

vs.

Case No. 16-3105RU

DEPARTMENT OF BUSINESS AND  
PROFESSIONAL REGULATION,  
DIVISION OF ALCOHOLIC BEVERAGES  
AND TOBACCO,

Respondent.

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FINAL ORDER

Pursuant to notice to all parties, a final hearing was conducted in this case on August 18, 2016, via video teleconference with sites in Tallahassee and Lauderdale Lakes, Florida, before Administrative Law Judge R. Bruce McKibben of the Division of Administrative Hearings ("DOAH"). The parties were represented as set forth below.

APPEARANCES

For Petitioner: Gerald J. Donnini, II, Esquire  
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For Respondent: Elizabeth A. Teegen, Esquire  
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STATEMENT OF THE ISSUE

The issue in this case is whether Respondent, Department of Business and Professional Regulation, Division of Alcoholic Beverages and Tobacco (the "Department"), is operating under an unadopted rule in its application of sections 210.276 and 210.30, Florida Statutes, which impose a surcharge and an excise tax, respectively, on tobacco products other than cigarettes or cigars, commonly known as other tobacco products ("OTP"), by utilization of "best available information" in lieu of actual documents submitted by the taxpayer when performing audits to establish a tax assessment.

Unless otherwise stated herein, all references to Florida Statutes shall be to the 2016 codification.

PRELIMINARY STATEMENT

On June 6, 2016, Petitioner, Global Hookah Distributors, Inc. ("Global Hookah"), timely filed a Petition to Determine Invalidity of Agency Statements. Petitioner has standing to initiate this proceeding, and DOAH has jurisdiction over the parties and subject matter in this consolidated proceeding.

The instant case was consolidated with DOAH Case No. 15-6901 for the purposes of conducting a final hearing. A separate

and distinct Recommended Order in that case is being issued contemporaneously with this Final Order.

Global Hookah alleges in its Petition that the Department is creating OTP tax assessments by applying unlawful and unpromulgated policies in which the Department seeks to artificially estimate the wholesale sales price of a tobacco product. Specifically, the Department used something it deemed the "best available information" to make the assessment.

At the final hearing, Global Hookah called one witness: Brennan Appel, owner of Global Hookah. Global Hookah's Exhibits 4 through 22, 31 through 34, 37, 38, 40 through 42, and 53 through 55 were admitted into evidence. The Department called one witness: Julio Cesar Torres, senior tax audit administrator. The Department's Exhibits 1 through 6 were admitted into evidence.

The parties advised that a transcript of the final hearing would be ordered. The parties were, by rule, allowed 10 days from the filing of the transcript at DOAH to submit proposed final orders but asked for and were granted 15 days. The Transcript was filed at DOAH on September 13, 2016, and each party timely submitted a proposed final order.

#### FINDINGS OF FACT

1. Global Hookah was formed as a Florida corporation on June 9, 2005, with its principal place of business in Melbourne,

Florida. After graduation from college, Global Hookah's owner and 100 percent shareholder, Brennan Appel, decided to move his company to North Carolina. Global Hookah was re-formed as a North Carolina corporation on June 14, 2007. Appel then moved all of his inventory and business equipment to a 10,000-square-foot warehouse in Charlotte, North Carolina. Each corporate annual report filed since 2007 reflects the Charlotte, North Carolina, address. All annual meetings and corporate tax returns indicate North Carolina as the situs for the corporation. Mr. Appel, sole shareholder of Global Hookah, has resided in North Carolina continuously since 2007. At all times pertinent hereto, Global Hookah was conducting its business from North Carolina. When the North Carolina corporation was formed, Mr. Appel mistakenly failed to convert the Florida Global Hookah corporation into a foreign for-profit corporation. That oversight was corrected on May 31, 2016, by way of a filing with the Florida Division of Corporations.

2. Global Hookah does not currently have a physical place of business in Florida; its only connection to the State is the sale and delivery (by unaffiliated carriers) of the products it sells. When the company was still operating out of its Florida offices, Mr. Appel's mother, Jennifer Appel, worked as an employee and was an officer of the Florida corporation. After the move to North Carolina, Mrs. Appel became a part-time

employee, performing quality assurance checks in the North Carolina warehouse. She was paid for her services by way of a direct deposit into her checking account in Florida. Mrs. Appel continues to reside permanently in Florida, traveling to North Carolina when working for Global Hookah. Mrs. Appel is not an officer of the North Carolina corporation.

3. When Global Hookah was located in Melbourne, Florida, the Department's Orlando office conducted its semiannual tax audits. The Department's office in Margate, Florida, conducts audits of out-of-state licensees, and the audit at issue was therefore conducted by the Margate office.

4. Global Hookah sells about 3,500 different tobacco-related products to customers in many jurisdictions, including Florida. Its customers are primarily businesses, such as hookah lounges, night clubs, bars, restaurants, and cigar stores, but also other tobacco distributors. Some products are also sold by Global Hookah directly to consumers. The products are sent to customers via U.S. Mail, or third-party carriers.

5. The Department is the government agency responsible for, *inter alia*, monitoring and collecting taxes on the sale of tobacco and OTP in Florida. As part of its duties, the Department audits on a regular basis (from every six months to every two years) each entity which distributes tobacco and OTP in Florida.

6. In July 2013, the Department notified Global Hookah that an audit would be performed on that company for the period January 1, 2013 through June 30, 2013. The primary purpose of the audit was to determine the wholesale sales price of the OTP sold by Global Hookah in Florida during the audit period, determine the amount of products which had been sold, and assess a tax on the total. How that audit actually transpired is a matter of dispute between the parties. The parties agree that an auditor from the Department, Deborah Spady, contacted Mr. Appel and requested certain records so that she could conduct the audit. Beyond that, the parties completely disagree as to what transpired.

7. The Department's position, based almost entirely on unsubstantiated hearsay testimony from Mr. Torres, is as follows: Ms. Spady asked for certain company records to be sent to her via U.S. Mail, but Global Hookah refused to comply with the request. Ms. Spady then scheduled a visit to the Global Hookah offices in North Carolina to obtain the records she needed. She was provided numerous boxes of documents to review, but was not allowed to use the company's copier to make copies. She called her supervisor, Mr. Torres, who told her to purchase a hand-held scanner and to scan all the documents so they could be printed on her return to Florida. Ms. Spady purchased a scanner and returned to Global Hookah. At that point, she was

told that she could not scan the documents. Discussions between the Department and attorneys for Global Hookah ensued, resulting in Ms. Spady being allowed to scan the documents. She allegedly scanned an amazingly large number of documents in just a day and a half at the Global Hookah offices. Ms. Spady brought the scanned documents back to Florida so they could be printed and an audit could be performed for the audit period. At that point, Ms. Spady commenced the audit.

8. According to Mr. Appel, the audit happened like this: Mr. Appel was informed by Mr. Torres that Ms. Spady would be conducting an audit for the aforementioned time period. Mr. Torres said that Ms. Spady preferred to come to North Carolina to do the audit. Upon her arrival at the Global Hookah offices in North Carolina, Mr. Appel gave Ms. Spady a CD containing all the requested documents, i.e., purchase invoices showing the cost of the tobacco and OTP, sales documents showing the products were sold in Florida, and the monthly returns filed by the taxpayer pursuant to Florida requirements. The monthly returns are a self-reporting summarization of products shipped to and sold in Florida by a distributor (minus some allowed exemptions). Compilation of those records on a CD was Mr. Appel's normal procedure for the semiannual audits conducted by the Department. Ms. Spady reviewed the CD on her computer when she went to lunch. When she returned to Global Hookah's

office after lunch, she reported that some of the files on the CD would not open properly. Mr. Appel converted the documents on the CD into another format and verified that Ms. Spady could open the files. Ms. Spady said she was satisfied with the results and left the Global Hookah offices. Mr. Appel never saw Ms. Spady again.

9. The parties basically agree only that an audit was initiated by the Department, it was commenced by Ms. Spady, and that someone else ultimately completed the audit. Just about everything else about the pre-audit process is disputed. It is as if the parties were talking about two completely different audits, which is what Global Hookah suggests happened. There was a subsequent audit performed by the Department where the auditor did scan some documents. There was allegedly some dispute in the latter audit concerning the auditor attempting to scan documents relating to sales in states other than Florida. A letter was supposedly sent to the auditor addressing that issue, but no such evidence was presented at final hearing. The Department says there was a subsequent audit, but Global Hookah "refused to provide records" so it was not completed.

10. At some point in time, another auditor, Robert Lerman, took over the Global Hookah audit from Ms. Spady. None of Ms. Spady's audit notes were preserved and so were not available for review at final hearing to substantiate Mr. Torres' hearsay



testimony concerning how the audit was initiated. Ms. Spady, who no longer works for the Department, was not called as a witness at final hearing.

11. On November 24, 2014 (about four month after Ms. Spady commenced the audit), Mr. Lerman set up an audit file. At the commencement of his work, Mr. Lerman was advised by Mr. Torres that the records obtained from Global Hookah could not be trusted. This was due to the fact that Global Hookah had produced documents entitled "sales order" rather than traditional "invoices," even though the Department had accepted the same kinds of documents from Global Hookah in the past. The Department believed that the sales orders could be altered, while the invoices would be more precise and final. Faced with its unease using the sales orders, the Department contacted Mr. Appel and requested that he submit invoices instead of sales orders for the audit period. Global Hookah contacted its supplier in California, Fantasia Distributors, Inc. ("Fantasia"), to obtain invoices to submit to the Department. The only difference between the sales orders and invoices--besides the title of the documents--was that some charges had been zeroed out, presumably because the amount had been paid when the invoice was issued. Mr. Appel provided the Department with 40 pages of invoice documents marked as "invoiced in full."

12. The Department compared the new Fantasia invoices with the Global Hookah sales orders and determined that some of the information contained therein did not match up appropriately. There were some missing numbers, some invoices were not in logical number sequence, and there appeared to be other discrepancies.

13. At that point, Mr. Torres got more involved in the Global Hookah audit. From the documents supplied by Global Hookah, Torres prepared a spreadsheet identifying 18 separate dates of transactions between Global Hookah and Fantasia during the audit period. He found, however, that there were really only about 15 actual purchases; some of the costs relative to a single purchase were divided and appeared on invoices with different dates. Some of the invoices had five-digit identification numbers that did not seem to match up with the sales orders previously provided. Based upon his review and findings, Mr. Torres deemed the invoices from Fantasia (which had been provided by Global Hookah) to be less than credible. Mr. Torres in fact concluded, unilaterally, that Global Hookah was attempting to hide purchases and to "deceive" the Department. It is noted that the Department made no attempt to contact Fantasia, with whom it was very familiar, to ascertain why the documents did not match up.

14. Once Mr. Torres reached that conclusion, he decided to ascertain the actual purchase amounts by way of "best available information." According to his audit notes, Mr. Lerman was directed by Mr. Torres to determine the "best available information" as follows: He was to make a schedule of all products purchased by Global Hookah from Fantasia. Inasmuch as the Department was familiar with Fantasia and knew that company supplied many distributors in Florida, Mr. Lerman was told to compare the cost of each product Global Hookah had bought from Fantasia with the cost other providers had paid for the same products. An average unit price for the products was thus calculated by the Department.

15. The Department determined that Global Hookah was paying far less for some products than Fantasia was charging some of its other distributor customers. No competent evidence was produced as to why this disparity existed. The Department simply surmised that Global Hookah was apparently misstating the amounts it had paid Fantasia for the products. The Department, based on its comparison of Fantasia's other non-related invoices, determined that Global Hookah was understating those product costs amounts by 454 percent.

16. The Department thereupon applied a factor of 4.54 to all of Global Hookah's purchases and Florida sales for the entire audit period. Although less than 20 percent of Global

Hookah's purchases for that audit period were with Fantasia, the factor was applied to all Florida sales in order to make the tax assessment.<sup>1/</sup> The tax assessment on Global Hookah using the revised cost figures was determined to be \$305,374.76, plus \$152,687.37 of penalties, and \$58,419.43 in interest, for a total tax assessment of \$516,481.53. The Department had taken the purchases reported by Global Hookah on the monthly returns filed during the audit period, multiplied that figure by 4.54 to arrive at an adjusted figure, took the difference between the reported amount and the adjusted figure, and made a tax assessment on that amount.

17. Later, the Department decided to revise its assessment by removing some of the non-Fantasia purchases, resulting in a tax assessment of \$170,292.42 in tax, plus 1 percent interest per month, plus a penalty in the amount of 50 percent of the assessment, for a total tax assessment of \$241,818.77. The basis for this reduction in tax assessment was that the Department determined that the 454 percent mark-up based on the Fantasia invoices should not necessarily be applied to the other 80 percent of Global Hookah's purchases from other suppliers.

18. Contrary to the Department's position regarding the Fantasia purchases, Mr. Appel's unrefuted testimony was that the prices shown on the sales orders were the actual amounts paid by Global Hookah to Fantasia. An affidavit dated April 2, 2016,

from Fantasia's president, Randy Jacob, corroborated Mr. Appel's testimony.<sup>2/</sup> That evidence is contrary to Mr. Torres' contention that Global Hookah was falsifying its purchase price as to products purchased from Fantasia. The Department presented no competent evidence as to the basis for the prices Fantasia charged Global Hookah for products. The Department's position, though based on logical reasoning in the abstract, was still entirely speculative and unpersuasive.<sup>3/</sup>

19. The Department's decision to rely upon "best available information" is a new, unique way of conducting its review of records for an audit. Mr. Torres stated that in 30 years, he had not had to resort to such a process. The Department relied upon the "best available information" policy only in the instant case. There is no evidence that the policy was to be used in any other case or as a regular or appropriate method of dealing with less than acceptable records. It was used in the case at issue because Mr. Torres felt no other means would suffice.

20. Global Hookah also contends that the Department's inclusion of federal excise tax, shipping costs and other items in the taxable base for distributors constitutes an unpromulgated rule. That issue, however, has already been decided in Florida Bee Distributors, Inc. v. Department of Business and Professional Regulation, Case No. 15-6108 (DOAH Mar. 3, 2016) ("Florida Bee"), and will not be addressed in this

Recommended Order. The Final Order in Florida Bee has been stayed and is currently under appeal at the First District Court of Appeal, Case No. 1D16-1064, meaning that the Department is free to rely on the policy pending a decision by the appellate court.

CONCLUSIONS OF LAW

21. The Division of Administrative Hearings has jurisdiction over the parties to and the subject matter of this proceeding pursuant to section 120.56(4), Florida Statutes.

22. Global Hookah alleges the Department is relying upon a statement of general applicability that should have been promulgated as a rule, i.e., an unadopted rule. Section 120.56(4) states in part:

- (a) Any person substantially affected by an agency statement that is an unadopted rule may seek an administrative determination that the statement violates s. 120.54(1)(a). The petition shall include the text of the statement or a description of the statement and shall state facts sufficient to show that the statement constitutes an unadopted rule.

23. Global Hookah has standing to bring this proceeding pursuant to section 120.56(4)(a).

24. The term "rule" is defined in section 120.52(16), which states:

"Rule" means each agency statement of general applicability that implements,

interprets, or prescribes law or policy or describes the procedure or practice requirements of any agency and includes any form which imposes any requirement or solicits any information not specifically required by statute or an existing rule. The term also includes amendment or repeal of a rule.

25. An "unadopted rule" is defined as an agency statement that meets the definition of the term "rule," but that has not been adopted pursuant to the requirements of section 120.54. § 120.52(20), Fla. Stat.

26. Florida case law has expanded on the definition of rule to include "[t]hose statements which are intended by their effect to create rights, or to require compliance, or otherwise have the direct and consistent effect of law." Ag. for Health Care Admin. v. Harvey, 356 So. 2d 323, 325 (Fla. 1st DCA 1977).

27. An agency statement is any declaration, expression, or communication. It does not need to be in writing. See Dep't of High. Saf. & Motor Veh. v. Schluter, 705 So. 2d 81, 84 (Fla. 1st DCA 1997). To be a rule, the statement must be an "agency statement," that is, a statement which reflects the agency's position with regard to law or policy. A generally applicable statement purports to affect not just a single person or singular situations, but a category or class of persons and activities. See McCarthy v. Dep't of Ins., 479 So. 2d 135 (Fla. 2d DCA 1985). The statement need not apply universally to every

person or activity within the agency's jurisdiction. It is sufficient that the statement apply uniformly to a class of persons or activities over which an agency may properly exercise authority. See Schluter, 705 So. 2d at 83. In this case, it appears the Department used the "best available information" technique solely due to the facts surrounding this particular audit and does not propose relying on it in the future.

28. Global Hookah has the burden of demonstrating that the agency statement regarding "best available information" meets the definition of a rule, and that the agency has not adopted the statement by rulemaking procedures. S.W. Fla. Water Mgt. Dist. v. Charlotte Cnty., 774 So. 2d 903, 908 (Fla. 2d DCA 2001); see also Ag. for Pers. with Disab. v. C.B., 130 So. 3d 713, 717 (Fla. 1st DCA 2013).

29. The standard of proof is by a preponderance of the evidence. § 120.56(1)(e), Fla. Stat.

30. Global Hookah has not proven by a preponderance of evidence that the "best available information" policy used in the conduct of the January 1 through June 30, 2013, audit was used as or intended to be a statement of general applicability. There is no evidence that the policy would be used on any other audited entities. Nor was the phrase, in and of itself, sufficient to be deemed an unadopted rule.



31. Global Hookah has requested an award of attorneys' fees pursuant to section 120.595. Fees may be awarded under that statute only if "all or part of an agency statement violates s. 120.54(1)(a)." As stated above, the Department did not violate that provision of statute.

ORDER

Based on the foregoing Findings of Fact and Conclusions of Law, it is

ORDERED that the policy statement by the Department of Business and Professional Regulation, Division of Alcoholic Beverages and Tobacco, concerning the use of a "best available information" process is not an unadopted rule whose existence violates section 120.54(1)(a), Florida Statutes.

It is FURTHER ORDERED that no award of attorneys' fees or costs is warranted in this matter.

DONE AND ORDERED this 20th day of October, 2016, in Tallahassee, Leon County, Florida.



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R. BRUCE MCKIBBEN  
Administrative Law Judge  
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Filed with the Clerk of the  
Division of Administrative Hearings  
this 20th day of October, 2016.

ENDNOTES

<sup>1/</sup> Although Global Hookah only makes less than 20 percent of its purchases from Fantasia, and about 60 percent from Sierra Network, the Department did not investigate whether Fantasia was paying less for Sierra Network products than other distributors were paying. The significance of the Department's analysis regarding the Fantasia invoices (only) is questionable.

<sup>2/</sup> The Department objected to admission of the affidavit on the basis of hearsay. While the affidavit is an out of court statement offered for the truth of the matter asserted therein, the affidavit "supplemented and explained" Mr. Appel's testimony and is thus admissible. See § 120.57(1)(c), Fla. Stat. The Department also complained that it did not have sufficient time to depose the affiant, Mr. Jacobs, but that complaint did not appear credible.

<sup>3/</sup> It must be noted that the credibility and impact of Mr. Torres' testimony was significantly reduced by the fact that his attorney continuously offered extensive testimony in the form of leading questions. It was difficult to ascertain Mr. Torres' own knowledge versus his willingness to affirm his counsel's statements.

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NOTICE OF RIGHT TO JUDICIAL REVIEW

A party who is adversely affected by this Final Order is entitled to judicial review pursuant to section 120.68, Florida Statutes. Review proceedings are governed by the Florida Rules of Appellate Procedure. Such proceedings are commenced by filing the original notice of administrative appeal with the agency clerk of the Division of Administrative Hearings within 30 days of rendition of the order to be reviewed, and a copy of the notice, accompanied by any filing fees prescribed by law, with the clerk of the District Court of Appeal in the appellate district where the agency maintains its headquarters or where a party resides or as otherwise provided by law.