SUPREME COURT OF VERMONT

Travia's Inc. and Robert and Jill Mellion v. State of Vermont, Department of Taxes

194 Vt. 585 (2013) · No. 2012-422 · Decided August 9, 2013

SUMMARY

The Vermont Supreme Court upheld tax assessments against Travia’s Inc. and its owners for meals, alcoholic beverage, corporate income, and personal income taxes. The Court held that the Department of Taxes could look beyond the taxpayers’ unreliable and altered business records and estimate tax liability using external data and industry-based methods. The taxpayers failed to show by clear and convincing evidence that the assessments or methodology were erroneous.

CASE DETAILS

COURT	Supreme Court of Vermont
WRITING FOR THE COURT	Skoglund, J.; Reiber, C.J.; Dooley, J.; Burgess, J.; Toor, Supr. J., specially assigned
JURISDICTION	Vermont
DECIDED	August 9, 2013
DOCKET	2012-422
DISPOSITION	affirmed
PROCEDURAL POSTURE	Taxpayers appealed the Vermont Department of Taxes' assessments of meals, alcoholic beverage, corporate income, and personal income taxes. The Commissioner of Taxes affirmed the assessments, and the Superior Court, Chittenden Unit, Civil Division, affirmed. The taxpayers appealed to the Vermont Supreme Court.
STANDARD OF REVIEW	The Court reviewed the Commissioner's decision under the same standard applicable to the intermediate appeal, independently of the superior court's findings and conclusions. The Commissioner's factual findings would not be set aside unless clearly erroneous, and the taxpayers bore the burden of showing by clear and convincing evidence that the assessments were erroneous. The Court accorded substantial deference to the Department's expertise and methodology.
PRECEDENTIAL VALUE	binding

PARTIES	Travia's Inc., Robert Mellion, Jill Mellion v. State of Vermont, Department of Taxes

TOPICS

tax audits · tax deficiency · administrative law · statutory interpretation · tax

PRACTICE AREAS

state taxation · administrative law · tax audits · tax litigation

QUESTIONS PRESENTED

1. Whether the Commissioner of Taxes had authority to investigate and estimate tax liability from external information when the taxpayers had filed returns but their underlying records were unreliable.
2. Whether the Department's methodology for reconstructing Travia's gross receipts and calculating the resulting tax assessments was arbitrary, invalid, or clearly erroneous.
3. Whether the taxpayers met their burden of demonstrating that the assessments were incorrect.

HOLDINGS

1. When filed returns and the source documents used to prepare them are inaccurate, incomplete, or unreliable, the Commissioner of Taxes may conduct further audits and investigations and estimate tax liability using information outside the taxpayer's records.
2. The Department's reconstruction of gross receipts using vendor records, industry ratios, drink prices and sizes, and food-purchase information was a reasonable and commonly accepted methodology, and the taxpayers did not show by clear and convincing evidence that it was arbitrary or invalid.
3. Taxpayers must maintain reliable records sufficient to permit a reasonable determination of tax liability, and they bear the burden of showing by clear and convincing evidence that an assessment based on an audit reconstruction is erroneous.

KEY QUOTATIONS

> *"When a taxpayer's records are not maintained so as to allow the determination of the correct tax liability, as was the case here, then the Commissioner must conduct an examination beyond the books and records."* (¶ 21)

> *"Taxpayers here have not met their burden of demonstrating the assessments are incorrect, and we uphold the Commissioner's determination."* (¶ 22)

FACTUAL BACKGROUND

Travia's Inc. was an S corporation operating a bar and grill, wholly owned and operated by Robert Mellion, with Jill Mellion maintaining the business books. An audit revealed unusually high cost-of-goods ratios and unreliable records, including discrepancies between running tapes, Z tapes, handwritten envelopes, and weekly summaries, with many records manually altered. After rejecting those records as an adequate basis for determining sales, the Department reconstructed income using vendor records, industry averages, drink prices and sizes, and food-purchase information, resulting in additional meals, alcoholic beverage, and income tax assessments.

PROCEDURAL HISTORY

The Department of Taxes audited Travia's records for multiple tax years and issued revised assessments after determining that the taxpayers' cash-register tapes, envelopes, and summaries were unreliable and contradictory. The Commissioner of Taxes affirmed the assessments. Pursuant to 32 V.S.A. § 9275, the taxpayers appealed to the superior court, which affirmed the Commissioner. The Vermont Supreme Court affirmed.

DISPOSITION

affirmed

CASES CITED

- Tarrant v. Dep't of Taxes, 169 Vt. 189, 195, 733 A.2d 733, 738 (1999)
- Devers-Scott v. Office of Prof'l Regulation, 2007 VT 4, ¶ 4, 181 Vt. 248, 918 A.2d 230
- Morton Bldgs., Inc. v. Dep't of Taxes, 167 Vt. 371, 374, 705 A.2d 1384, 1386 (1997)
- In re DeCato Bros., Inc., 149 Vt. 493, 496, 546 A.2d 1354, 1356 (1988)
- In re Williston Inn Grp., 2008 VT 47, ¶ 11, 183 Vt. 621, 949 A.2d 1073 (mem.)
- Korba v. N.Y. State Tax Commission, 444 N.Y.S.2d 312 (App. Div. 1981), appeal denied, 435 N.E.2d 1099 (N.Y. 1982)
- Christ Cella, Inc. v. State Tax Commission, 477 N.Y.S.2d 858 (App. Div. 1984)
- In re L.G.J. Rest., Inc., 27 B.R. 455, 459 (Bankr. E.D.N.Y. 1983)
- Rock v. Dep't of Taxes, 170 Vt. 1, 11, 742 A.2d 1211, 1219 (1999)
- Cebollero v. Comm'r of Internal Revenue, 967 F.2d 986 (4th Cir. 1992)
- Webb v. Comm'r of Internal Revenue, 25 T.C.M. (CCH) 454 (1966)
- Town of Killington v. Dep't of Taxes, 2003 VT 88, ¶ 5, 176 Vt. 70, 838 A.2d 91
- Hogg v. United States, 428 F.2d 274, 282 (6th Cir. 1970)
- Alexandre v. Comm'r of Revenue Servs., 22 A.3d 518, 527-28 (Conn. 2011)
- Rodriguez v. Tax Appeals Tribunal of State, 918 N.Y.S.2d 625, 627 (App. Div. 2011)
- Crabtree v. Comm'r of Internal Revenue, 78 T.C.M. (CCH) 1232 (1999)
- Chittenden v. Waterbury Ctr. Cmty. Church, Inc., 168 Vt. 478, 491, 726 A.2d 20, 29 (1998)